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Investment Committees: More than the sum of their parts

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Why do some committees generate better investment outcomes than others; is it because they are just better investors, or are there group dynamics at work that can systematically rob a committee of its ability to make consistently strong decisions? Committees that lack diversity, fall prey to groupthink, or fail to adequately share knowledge are likely to make less-than-optimal decisions. Investment committees steward millions or billions of dollars in assets, and their ability to function effectively as a team can have a tremendous and long-lasting impact on the performance of those assets. For this reason, it is worth applying intention and focus to committee structure and decision-making. This paper outlines the fundamentals of building and maintaining a successful investment committee.

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Why investment committees?

> "None of us is as smart as all of us."
>
> *- Ken Blanchard*

Common wisdom holds that decisions made by a group of people are better than individual decisions, particularly when it comes to the complexities of investing and asset management. In a group, multiple opinions and perspectives, as well as a potentially broad base of knowledge and varied experiences, can be brought to bear on any given issue. Thus investment committees serve as a common structure for the decision-making responsibility involved in overseeing assets. But research shows that it takes more than a collection of people to make wise decisions. How can you go from being a group of individuals to becoming a strong and effective committee?

Whether or not a group's decision-making skill proves superior to that of an individual has to do with both who is in the group and how the group functions as a team. Why do some committees generate better investment outcomes than others; is it because they are just better investors, or are there group dynamics at work that can systematically rob a committee of its ability to make consistently strong decisions? Committees that lack diversity, fall prey to groupthink, or fail to adequately share knowledge are likely to make less-than-optimal decisions. On the other hand, a carefully constructed committee with team members who have diverse backgrounds but common values, a firm and effective leader, and clear processes has the greatest potential to optimize decision-making. People are not all naturally strong at teamwork (many experts suggest most people are notoriously poor at it without training); there are skills involved that need to be learned and it requires careful discipline to reap the benefits of teamwork.

While a great deal of care and thought go into the investment standards committees use, the appointment of committee members can be based on politics, convenience, expediency, and/or other secondary concerns rather than in a deliberate consideration of differentiated and relevant skill sets and personalities. When the process for member selection is suboptimal, so too can be committee decision-making. Similarly, the processes by which committees work together, evaluate information, and structure decision-making affects their success as a group. Investment committees steward millions or billions of dollars in assets, and their ability to function effectively as a team can have a tremendous and long-lasting impact on the performance of those assets. For this reason, it is worth applying intention and focus to committee structure and decision-making.

> "Groups as decision-making bodies have been afforded a special status in society from at least the times of the early Greek civilization that developed democratic voting structures. This special status remains intact in most societies and cultures today. Legislatures decide which bills to pass into law; juries decide the guilt or innocence of defendants and the amount of damages awarded to plaintiffs; school boards decide how to structure the curricula used to teach our children; sales teams decide how to market new products; corporate boards decide which investments are warranted and which person should serve as CEO."
>
> *- Tindale, Kameda, & Hinsz, 2007*

"People tend to think that teams are the democratic — and the efficient — way to get things done. I have no question that when you have a team, the possibility exists that it will generate magic, producing something extraordinary, a collective creation of previously unimagined beauty or quality. but don't count on it. Research consistently shows that teams underperform, despite all the extra resources they have. That's because problems with coordination and motivation typically chip away at the benefits of collaboration."

~ Hackman, Harvard Business Review, 2009

In this paper, we will explore how a committee can make the best use of its collective knowledge and diversity of experience and discuss the potential pitfalls and biases of group behavior that can affect investment outcomes. While much of the information to follow applies to any working group or committee, this paper is focused specifically on improving the effectiveness of investment committees. The terms "committee" and "investment committee" are used interchangeably throughout.

BUILDING A COHESIVE TEAM

It's easy to assume that if everyone in a group simply did their part individually, contributing as necessary and not overstepping bounds, that a team would function smoothly and efficiently. However, a team is not just the sum of its parts. Group dynamics, synergy, potential conflicts, demographics — all of these can either contribute or detract from a team's effectiveness.

"It's easy to get good players. Getting them to play together, that's the hard part."

-Casey Stengel

J. Richard Hackman, the Edgar Pierce Professor of Social and Organizational Psychology at Harvard University and a leading expert on teams, suggests that "the best way to get individuals to behave well in a group is to do a good job of setting up and supporting the group itself." (*Hackman, 2002*) Choosing team members, establishing roles, and determining the team's structure all significantly affect the team's performance.

"Larger teams are more vulnerable to poor communication, fragmentation, and free riding (due to a lack of accountability)…Team leaders must be vigilant about adding members only when necessary. The aim should be to include the minimum number — and no more"

- Haas & Mortensen, 2016

Committee size

In a group that is too small, the team may find that it has inadequate resources or that members feel overly exposed and uncomfortable expressing disagreement. But in a group that is too large, the team runs into difficulties with coordination, social loafing (see page 13), and communication conflicts.

> "Team design was four times as powerful as leader coaching in affecting a team's level of self-management, and almost 40 times as powerful in affecting team performance."
>
> *- Hackman, 2004*

Adding new members to a team generally increases productivity; however, research shows diminishing returns the more members you add. Thus, the increase in productivity is slightly less for each additional team member, until it is negligible. For instance, the productivity increase from adding a seventh member is significantly less than when the team added its fourth member. Additionally, each team member added also introduces increased *losses* in productivity caused by coordination problems, inefficiencies, and reduced motivation and engagement across the team.

Most research supports the idea that beyond a group size of four to seven members, larger groups become unwieldy and the disadvantages substantively outweigh any added value. Is there an optimal size for an investment committee? Four to six members is a good guideline, but investment committees are often structured with political considerations and may require the presence of key individuals. All things considered, the best rule of thumb is to keep the investment committee as small as possible given the circumstances and requirements of the organization.

Additionally, consider the advantage of having an odd number of members to eliminate voting ties. If your committee has an even number of members, the group should assess in advance what they will do in the case of tied votes.

Diversity

The composition of a group can be analyzed in a variety of different ways. Social category diversity — including differences in gender, age, and ethnicity — is only one measure of diversity. There is also informational diversity (differences in education, skills, and knowledge) and value diversity (differences in values, commitment, priorities). In a Vanguard survey of investment committees, when asked to rank the diversity elements that positively contributed to the effectiveness of the committee, the top two by a significant margin were *diversity in professional experience* and *diversity in committee experience*. (*Vanguard, 2014*)

> "…[T]o the extent that groups are more diverse in their perspectives and approaches to problem solving, they would outperform groups with less diversity. However, to exchange information, groups must have both the ability and the willingness to engage in constructive, task-focused conflict to integrate their divergent perspectives."
>
> *- Mannix & Neale, 2005*

It has been demonstrated that diversity can improve a team's creative and problem-solving ability by bringing different perspectives, experiences, skills, and styles to the table. However, diversity in background and values can challenge a team's cohesion, and groups should be aware that extra effort may be required to ensure that they share a common purpose and are aligned regardless of individual differences.

How issues are approached can maximize diversity advantages and minimize obstacles. For instance, negative effects can be neutralized by supporting a cooperative organizational culture and emphasizing the group's values as opposed to individual values. Staying focused on the committee's common goals promotes unity and prevents members from concentrating on social differences. On the other hand, taking advantage of diversity requires making a concerted effort to encourage and foster an atmosphere of information sharing and embracing some degree of conflict. Research shows that groups have a strong tendency to focus on shared information rather than inviting individual expertise from members, and that team members who hold minority or unique opinions may pay a social or psychological cost for speaking up. *(Mannix & Neale, 2005)*

Team member selection

In selecting team members, you should consider the skills and knowledge that individuals bring, but it's also important to look at personality and behavior as well. Investment committee members should have a foundational knowledge of investing, including an understanding of principles such as diversification and correlation. Including at least one or two members with a more sophisticated grasp of investment trends and best practices is helpful.

> "In truth, putting together a team involves some ruthless decisions about membership; not everyone who wants to be on the team should be included, and some individuals should be forced off."
>
> *-J. Richard Hackman*

The selection process should identify people who have some intellectual curiosity, who are courageous and willing to examine new information, who are open to potentially controversial ideas, and who are thorough and attentive. Seek out members who are also able to listen, who won't dominate a discussion, and who are not overly attached to their opinions. Harvard's J. Richard Hackman also recommends having one member who is a "deviant," someone who will prevent the team from becoming complacent by taking a step back and challenging assumptions. Their job is not to derail the team, but to help open the team up to new ideas and perspectives. (*Coutu, 2009*)

Continuity is important for investment committees, and high turnover can impede integration and communication. Wide divergences in tenure can also increase conflicts as newer members may not have the same context and information of members who have been on the team longer. These issues can be mitigated by providing thorough education and onboarding for newer committee members, cluing them in to past decisions and reasoning, as well as making sure they are fully trained on the committee's processes and procedures.

Finally, conflicts of interest must be eliminated. If there is an economic benefit to any members for making particular investment decisions, it raises ethical issues. It's possible in certain instances to abstain from voting on some decisions, but the fewer conflicts of interest, the better.

Shared goals, strong structure

"The foundation of every great team is a direction that energizes, orients, and engages its members." (*Haas & Mortensen, 2016*) In order to serve its function, a team must understand their purpose and share the ultimate objective. Equally important is a strong structure that fosters an atmosphere of information sharing and open communication, along with clear decision-making processes and organizational efficiencies. That structure should include a clear and effective leadership.

Shared goals

Establishing a committee charter to set out the committee's fundamental structure and objectives lays the foundation for a strong committee. One of the reasons why a committee charter is so important is because it elucidates roles and responsibilities. Understanding exactly what the committee's authority, duties, and liabilities are is crucial to a functioning committee. Is the committee authorized to make investment decisions, or are they only making recommendations to a board? Does the committee make both asset allocation and manager selection decisions, or only asset allocation decisions? The committee needs to be clear on how far their authority extends and what their responsibilities are, as well as any bodies they need to either consult or report to.

Committee members should also be clear on their fiduciary duties and the liability that accompanies their membership. Providing foundational fiduciary education for committee members can ensure that all team members have a fundamental understanding of the group's responsibilities as fiduciaries. Outside advisors may be a good source for fiduiary education; for instance, Arnerich Massena offers a proprietary fiduciary education curriculum, ***Blueprints*™**, available to all Arnerich Massena client committee members.

Leadership

Nearly all experts agree that in order for a group leader to be the most effective, they should focus on the process of the group rather than the outcome. It is the team's job to arrive at the outcome, not the leader's. But the leader, or the individual who fulfills the role of leadership, is a critical facilitator, who needs a measure of personal courage, skill in identifying priorities, and emotional maturity, as well as the ability to challenge group norms and disrupt established routines. (*Hackman, 2004*)

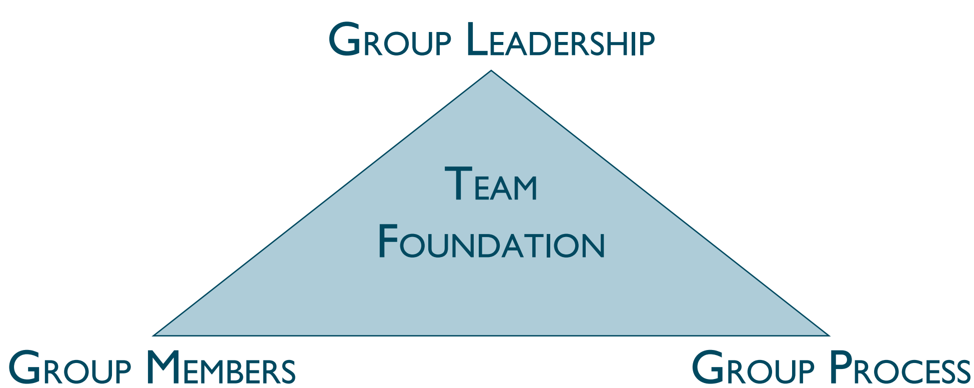
No single leadership style is optimal; different teams may require different approaches and often, the same outcome could be generated by several different styles. Research has shown that a purely autocratic style of leadership tends to have poor results, but a purely democratic leader effects similarly poor results. One of the most important skills an investment committee chair can have is the flexibility to adapt fluidly in changing situations.

The committee chair's role is to support and guide the team throughout the process, creating the conditions for information sharing and decision making. Some of the specific responsibilities of a leader to help facilitate smooth teamwork include:

- Establishing clear goals for the team and emphasizing a common purpose
- Promoting a cohesive and unified group identity
- Determining the specific roles and responsibilities of team members
- Prioritizing tasks and scheduling time allotments
- Keeping the group focused and on track during meetings
- Making sure all team members are sharing their information and input
- Maintaining adherence to the agreed-upon decision-making process
- Managing healthy conflict

Structure and process

If you think of a team as having a triangular foundation or base, the group members and leadership are two sides of that foundation, and the third side is the team's structure and process. Without clear organizational principles and a decision-making process, even a great team of people can flounder to achieve their objectives. How will the team set the agenda,



stay on track, ensure that all relevant information is brought to the table, and ultimately make decisions that reflect the highest thinking of the team? Establishing clarity in structure and process can ensure that the committee is able to focus on the issues that require thought, discussion, and insight, rather than taking the time to negotiate decisions and processes that should be straightforward.

Begin by establishing ground rules that set the stage for success. It may seem self-evident, but specifically identifying the behaviors you want, such as being punctual and not interrupting, can help foster a healthy group dynamic. If your committee has turnover, be sure to keep these ground rules where they can be easily referenced and revisit them as a team periodically.

How you conduct meetings can have a profound effect on your team's long-term outcomes. While there are a variety of different potential structures and plans that can be successful, below are some fundamentals that can provide guidance:

- *Robert's Rules of Order* are a useful starting place for many committees in organizing their meeting structure.

- Set a clear, detailed agenda for each meeting. This will help keep meetings on task and on track.
- Divide work up thoughtfully. In delegating tasks, share both the labor-intensive chores and the more interesting, creative tasks. Giving team members some autonomy in managing their work can result in greater satisfaction and effectiveness.
- Understand different ways of discussing and evaluating topics, and make sure the group knows which one is at play at any given time. For instance, *brainstorming* is usually unstructured, open inquiry in which members toss out ideas and the group withholds judgment and criticism until all options have been identified. *Dialectical inquiry* is similar to a debate, in which team members take opposing sides and argue the advantages and disadvantages of their proposed solutions. In the *nominal group technique*, group members rank or rate alternatives.

How the group comes to decisions is also critical. Some investment committee charters are explicit in outlining how decisions must be made, such as by vote, in which case the committee must abide by the process set forth in the charter. If no process is identified, the committee should clarify in advance how each decision will be made:

- **Autocratic:** The group provides input but the leader of the team makes the final decision.
- **Democratic:** One person, one vote; majority wins. A democratic vote can be expedient, but it may be helpful to use secret ballots for major decisions, thus eliminating the potential for one member to unduly influence other members' votes and to prevent groupthink.
- **Consensus:** The group discusses the issue until they are able to arrive at a consensus.
- **Decision-leader:** The decision leader gathers input from stakeholders and makes a decision based on the input.

"A number of years ago, I was on a committee that was voting on whether to bring a person into the organization. After hearing the balance of the evidence on the candidate, I was in favor of bringing him in. The committee chair then started going around the conference table, asking for a verbal 'yea' or 'nay' on whether we approved of the candidate.

"It so happened that the man sitting next to me was a physicist who had won the Nobel Prize and is probably the smartest person I have ever met. He was to vote right before me, and offered a nay when the chair called on him. So here I was, set to say yea, but faced with the world's smartest man saying nay only seconds before. Feeling seriously conflicted, I said nay and slumped in my chair.

"Diversity is one of the key ingredients in group decision making. But by going around the room as he did, the chair invited social conformity and reduced independence. To get the best possible results from the committee, the chair must ask for independent votes.... The chair should not ask for opinions sequentially, and should not reveal his preference until after the process is over, if at all."

-Mauboussin, 2009

Group dynamics

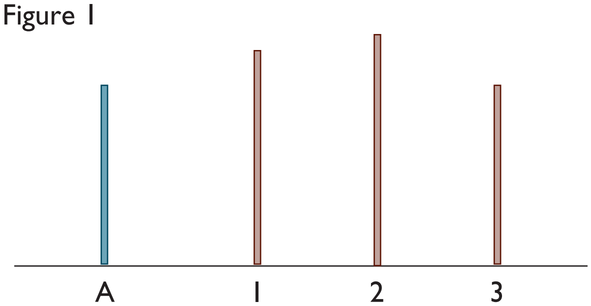
Teams are subject to a variety of well-researched and documented pitfalls that can undermine their efforts and effectiveness. Just as behavioral economics has identified certain irrational behaviors, or heuristics, that individuals fall prey to when making decisions, groups are subject to irrational behaviors as well, some of which can even be amplified in group contexts. For investment committees, it's wise to be aware of these dynamics in order to identify and prevent them whenever possible.

Groupthink

Any group is susceptible to groupthink, which can manifest itself with a variety of effects, all of which impact the group's ability to function effectively. "Groupthink occurs when members of a cohesive group are more interested in avoiding conflict and maintaining unanimity than in realistically appraising the various courses of action.... When groupthink occurs, the desire for group unanimity overrides the motivation to realistically discuss and appraise different alternatives." (*Mottola & Utkus, 2009*) Groupthink and the tendency toward conformity can override critical thinking in profound ways — see below for an astounding example. Unfortunately, the tendency toward groupthink grows as a group's cohesiveness increases, so a delicate balance must be struck. See the following page for recommendations on countering groupthink.

Tendency to conform

Figure 1



A famous experiment conducted in 1956 by social psychologist Solomon Asch demonstrates the power of the tendency toward social conformity. Subjects were placed into groups of seven to nine people in which the other members were, unbeknownst to the subject, assistants to the experimenters; these confederates were assigned specific roles.

In the experiment, the groups were shown a picture (similar to Figure 1 above) and were asked, "Which line — 1, 2, or 3 — is the same length as line A?" In unscripted trials, all subjects chose the correct line: line 3. But in some trials, the confederates were directed to give convincingly wrong answers, and in these trials, 75 percent of the subjects agreed with the confederates and said that line 1, obviously an incorrect answer, was equal to line A in at least one trial. They were convinced to give the wrong answer in the face of obvious evidence to the contrary due to the social pressure to conform.

-Wood, 2006

Groupthink

Irving Janis, who coined the term groupthink in 1971, identified eight main symptoms:

- **Pressure:** The group may apply pressure, either subtlely or overtly, to dissenting members. Members who continually express doubt about decisions may find themselves isolated or otherwise excluded.
- **Self-censorship:** Members purposely refrain from expressing an opinion that differs from the majority.
- **Unanimity:** The group begins to believe that the majority view is correct by virtue of being unanimous among respected members. Team members rely on consensual validation rather than critical thinking.
- **Invulnerability:** The group overestimates its ability to form correct decisions. This can lead to a group taking extraordinary risks based on an illusion of invulnerability.
- **Rationale:** Victims of groupthink will ignore or dismiss information that runs counter to their decisions. They will construct rationalizations to negate even factual information that doesn't support their decisions.
- **Morality:** Groupthink victims tend to believe that their decisions are moral because they are supported by the group. Loyalty to the group becomes the highest form of morality. A team may reject legitimate questions of ethics or morality in their decisions.
- **Stereotypes:** Groups that fall prey to groupthink tend to hold stereotyped views of competing groups, demonizing "enemy groups" and potentially causing inter-group conflict.
- **Mindguards:** Members may actually proactively work to prevent the leader and other members from learning about information that is adverse to the group decision.

Specific techniques can help a committee avoid groupthink and/or counteract its effects:

- Committee chairs might refrain from expressing an opinion when an issue is initially approached by the group. This allows members to discuss the issue without being affected by the leader.
- Groups should understand the benefits of healthy conflict and become comfortable with it. Group leaders should explicitly encourage healthy debate.
- Conflict and disagreement should focus on ideas; it should never turn into personal criticisms, insults, or attacks.
- Committees may decide to include opposing opinions in meetings by inviting outside experts or even appointing a devil's advocate.
- The chair can form subcommittees to discuss important issues, so each group can deliberate under a different leader.

Information sharing, availability, and confirmation bias

Groups function best when they make full use of the complete collective knowledge available to the members. However, research shows that this is often not the case; related to the phenomenon of groupthink, groups have a tendency to focus exclusively on shared information that is already available to all the members, rather than soliciting the unique information that only one or a few group members may be able to bring to the table. This lack of information sharing is compounded by the availability bias, which suggests that people tend to make decisions based on whatever information is at hand, whether or not it's the most applicable or relevant.

> "Confirmation bias is a tendency for a group to acquire information that confirms the group's views and to disregard information that conflicts with the group's views."
>
> *-Mottola & Utkus, 2009*

Further narrowing the information pool from which a team may draw, group members also tend to engage in confirmation bias, where the group will only seek out information that confirms their already-existing views and supports their perspectives. Similarly to groupthink victims, group members have a propensity toward things that connect them to a group and an aversion to bringing up information that separates and differentiates them.

Lack of information sharing, availability bias, and confirmation bias detract from a committee's decision-making ability. The groupthink solutions can be applied in this case as well. Another possible solution to information sharing is "bridging," or creating social connections between members. These ties can foster trust and make it easier for members to take the necessary social risks involved in sharing their particular knowledge. *(Mannix & Neale, 2005)*

Representation and overconfidence

Representation occurs when a small or single sample is mistaken as being representative of a larger category. Because of this heuristic, the individual experiences of group members may play an outsized role in the group's judgments. Committees should be aware of this tendency and seek to incorporate outside information and a variety of perspectives.

> "Good decisions come from experience, and experience comes from bad decisions."
>
> *- Author unknown*

Individuals are prone to overconfidence in their own ability to make decisions. Committees, which have the affirmation of an entire group, tend to be even more so. Teams need to exercise caution, ensuring that they are thorough in exploring their options and incorporating outside information. Furthermore, investment committees often lack the feedback that would let them know when they have made a poor decision. Between time constraints and turnover, few investment committees take the time to review and evaluate past decisions. A committee affected by overconfidence may be dismissive of new information to the detriment of the discussion, believing that they already have all the knowledge and information needed to make a decision.

Social loafing: the Ringelmann effect

The Ringelmann effect "describes the inverse relationship between the size of a team and the magnitude of each group member's contribution." *(Wood, 2006)* As the group gets larger, each individual member feels less obligation to contribute the same amount of effort. In larger groups, individual efforts may be recognized less, providing less incentive to participate fully. It also becomes easy to blend into the group and expect the collective team to take up the slack.

Social loafing may be counteracted by taking measures such as the following:

- Have a method for identifying individual members' contributions and hold everyone accountable for their participation.
- Reduce the Ringelmann effect by creating interesting and challenging tasks.
- Demonstrate trust in individual members, ensuring that members have a sense of personal responsibility.
- Decrease social loafing by valuing and publicly acknowledging members' contributions.

Group polarization

Groups tend to make more extreme decisions than individuals. When a committee is leaning toward a decision in one direction or another, the collective momentum of the group can shift the decision to either a riskier or more cautious decision than most members would have chosen individually. Through confirmation bias, information sharing, and groupthink, the team reaffirms the direction of the decision, pushing the group consensus further and further in that direction and away from a more centered or balanced decision. "Group polarization has been demonstrated repeatedly in psychological laboratories, but it has also been linked to decisions made in economic, political, and legal arenas. This research has obvious implications for investment committees that are routinely charged with determining the risk characteristics for a given investment portfolio." *(Mottola & Utkus 2009)*

Being aware of this tendency can help to prevent it. Encouraging a diversity of ideas and dissenting opinions can also counter polarization.

Slow decision-making

Investment committees are faced with a challenging task. They are making consequential fiduciary decisions that may affect many people, and are charged with examining and assessing all of the relevant information and using their knowledge and skill to make long-ranging decisions. As if this wasn't difficult enough, the speed with which they make those decisions can be nearly as important as the decisions themselves. When it comes to investing, the market does not move at committee speed; it doesn't wait for group consensus. Perhaps one of the greatest challenges of serving on an investment committee is to manage the team's decision-making process and implementation efficiently so that portfolio changes occur in a timely manner.

Committee correlation to portfolio results

Over the past 27 years, we have worked with numerous investment committees and committee members, spanning non-profit foundations and endowments, corporations, and public entities. and including committee members who are compelled by their titles as well as those who volunteer to improve their communities, alma maters, workplaces, and other important causes. We have had the opportunity to observe firsthand many of the factors we discuss in this paper and how group dynamics can both positively and negatively affect long-term portfolio outcomes.

In our experience, we have recognized that some committees generate better investment results than others relative to their investment objectives. In addition to building the right team and having a strong structure, we have identified several additional qualities that exemplify successful investment committees and contribute to a committee's potential to improve the long-term performance of the portfolio for which it bears responsibility.

Ability to look forward

> "There is no data on the future."
>
> *- Laurel Cutler*

The best investors are often those who are able to take a contrarian viewpoint rather than going with the tides of the market and chasing returns. Rather than focusing on past performance, it's critical to be able to look ahead. Overconfidence and confirmation bias can lead committees to be more comfortable embracing an investment strategy that has generated substantial returns in the past, rather than seeing opportunities in advance, particularly when they may not currently be in favor. A committee that has the ability to look forward and recognize the hallmarks of future opportunities will be able to take advantage of those opportunities. Committees should evaluate past performance, but use it as an informational guide rather than as an indicator of future potential.

Openness to new ideas and information

Strong committees are open-minded, willing to embrace new information and engage in open dialogue. These committees are able to use a wider variety of tools and take greater advantage of opportunities than committees that reject ideas that may be new and unfamiliar. This is more difficult than it appears, as teams face a number of headwinds, from confirmation bias to availability bias to groupthink. It requires a proactive approach, in which the team actively seeks out and engages with new information.

Self awareness

One of the things that makes a team most effective is understanding its own strengths and limitations. Committees have differing levels of expertise and different time commitments, and those that recognize when it's important to rely on outside knowledge and experience have a significant advantage. Just as committees should know how best to make use of the strengths and knowledge of their team members, they should also be able to delegate thoughtfully when appropriate. Some investment committees opt to give their investment advisor differing levels of discretion for the explicit purpose of delegating select investment decisions while retaining oversight over big-picture decisions in which their input is crucial. This can improve the efficiency and effectiveness of the process, and make a difference in long-term outcomes. See the next section for information about the difference between traditional investment advisory services and a discretionary model of services.

TRADITIONAL VERSUS DISCRETIONARY ADVISORY SERVICES

A traditional investment advisory approach focuses on making recommendations to support the committee in making investment and portfolio management decisions. In a discretionary model, also sometimes referred to as an outsourced CIO (OCIO) model, decisions on investment product selection, tactical tilts, and rebalancing — within the boundaries of the investment policy — may be delegated to the investment advisor.

More and more, organizations are choosing a partial or fully discretionary approach to investment advisory services. Some of the reasons an organization might choose discretion include:

- **Increasingly complex markets:** Committees face a growing complexity in capital markets, and a discretionary arrangement can deliver the strategic portfolio management needed.
- **Resource constraints:** Many committees face the challenge of having limited internal resources. Having a discretionary arrangement allows a committee to focus on the organization's mission, long-term planning, and strategic objectives. A discretionary arrangement relieves the committee of the burden of ongoing portfolio management to focus on what's really important.
- **Risk management and fiduciary oversight:** With a discretionary arrangement, the advisor bears full fiduciary responsibility for managing the investment portfolio. Many organizations feel that a discretionary approach offers better risk management for the organization.
- **Timely decision-making:** A discretionary model is more nimble, making it possible for the advisor to make and implement investment decisions in a more timely manner to address changing market conditions

> "The growing complexity of issues facing the investment committees of institutions and their foundations is leading more institutions to shift some of the authority for investment decisions to outside advisors to help cope with 'fiduciary fatigue.'"
>
> *- Bahlmann, Camanella, Heck, 2013*

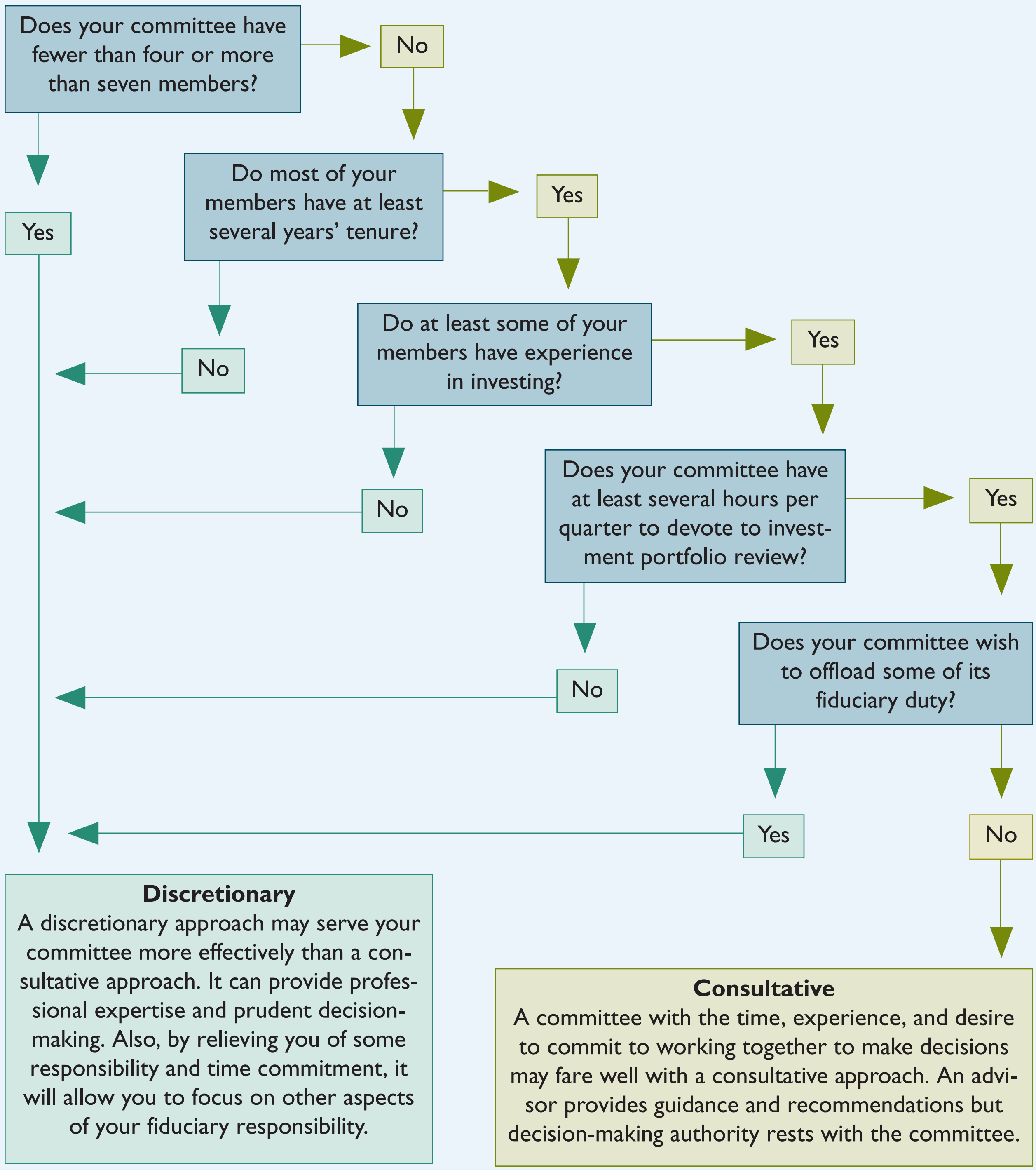
TRADITIONAL VERSUS DISCRETIONARY SERVICES

Traditional Investment Advisory Services Includes comprehensive investment guidance and proactive, timely recommendations.	Client	Advisor		Client	Advisor	**Discretionary Portfolio Management** Includes investment product selection, tactical tilts, and rebalancing within the boundaries of the client's investment policy.
	✓		Set investment policy	✓		
	✓		Set ranges for tactical allocations	✓		
		✓	Asset allocation and spending studies		✓	
		✓	Manager due diligence		✓	
	✓		Select and approve managers		✓	
	✓		Approve tactical tilting		✓	
	✓		Approve rebalancing transactions		✓	
		✓	Performance reporting		✓	
	✓		Execute trades		✓	

When would it be appropriate to choose a discretionary model over traditional advisory services? This depends on the committee and its availability, expertise, and preferences, but there are some situations in which we recommend that a committee consider whether it might benefit from a discretionary approach. These include:

- When there is consistently high turnover of committee members, making continuity difficult
- If there is a large number of committee members, making coordination and timely decision-making challenging
- When the committee is faced with limits on availability that result in severe time constraints
- If there is little investment sophistication among all committee members
- If the committee feels more comfortable turning over some of the fiduciary responsibility of investment decisions
- If the committee wants to focus its efforts on bigger-picture issues and oversight rather than day-to-day investment decisions

SHOULD YOUR COMMITTEE CONSIDER CONSULTATIVE OR DISCRETIONARY PORTFOLIO MANAGEMENT SERVICES?



A consultative approach to advisory services may be appropriate when committees have the time and resources to dedicate to making portfolio management decisions. We recommend that this approach be adopted if a committee has the following:

- A minimum of several hours per quarter to devote to investment portfolio management
- No less than four and no more than seven committee members
- Committee members who understand investment fundamentals, and some members with more sophisticated knowledge
- Tenure of at least several years for most committee members and a program of education for new committee members

Conclusion

An effective investment committee can make a significant difference to the long-term outcome of a portfolio. Our goal is to help committees become as effective as possible through education, information, and guidance. Arnerich Massena investment advisors are available to discuss your committee approach and assess your options. We can also provide fiduciary and investment education to committee members.

We look forward to continuing the discussion. On the following page, you'll find a brief review of some of the key techniques your committee can implement to immediately help make the best use of your team's time and expertise.

Review: Techniques to improve committee effectiveness

- Keep your committee size as small as possible (no fewer than four members, however).
- Eliminate conflicts of interest to the degree possible.
- A committee charter should outline the roles and responsibilities of committee members and describe the methods selected for voting and decision-making.
- An investment policy statement should clearly outline the policy for investment decisions.
- Include informational diversity (diversity of skills and knowledge) in your team, which can give your committee a wide variety of experience from which to draw in making decisions.
- Longer tenure for committee members will improve continuity. Developing an education program for newer members that provides context and history can help members be more successful in integrating themselves and their ideas into the committee decision-making process.
- Create an organizational culture with a unified group identity and collective goals. Emphasize the team's shared vision and objectives to bridge social diversity and improve the sharing of information.
- Establish a set of ground rules committee members should follow.
- An effective committee chair understands his or her role and responsibilities and is flexible in his or her approach.
- Promote objective voting and prevent undue influence from swaying voters by using a secret ballot form of voting for important decisions.
- Encourage healthy debate, assigning a devil's advocate or inviting outside experts when appropriate to provide different viewpoints. Healthy conflict should be managed, not eliminated.
- Identify individual members' contributions to the team, so that committee members feel a sense of personal responsibility and accountability to the team.
- Explicitly request that members share information and express opinions during discussions.
- If possible, create and implement a process for reviewing and evaluating past decisions.
- Periodically invite members to review team processes and make suggestions for improvement.
- Be aware of group behavioral pitfalls, and take proactive measures to avoid them.

ABOUT ARNERICH MASSENA

Founded in 1991, Arnerich Massena is a Portland-based independent investment advisory firm servicing private clients, endowments, foundations, charitable organizations, trusts and estates, and corporate pension and profit sharing plans. Our mission is to secure the future for our clients, colleagues, and communities by investing with vision, passion, and purpose. We are distinguished by exceptional client service, unbiased research, and a long history of providing creative, high-quality investment advice.

The firm provides traditional portfolio management and investing for clients, and is also widely known for successfully investing in high-impact areas like water resources, sustainable agriculture, fishing, healthcare, and clean energy technology. Arnerich Massena strives to be a business that exemplifies both corporate citizenship and professional service, and has received awards for its innovations in corporate philanthropy. More information is available at www.arnerichmassena.com.

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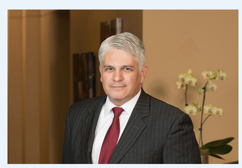

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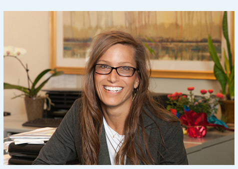

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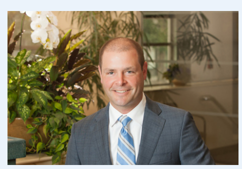

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