

## Challenging Economy Demands Effective Investment Committees

By  
**Sharon  
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*Hospital investment committees have more work to do in an uncertain economy as they face the triple whammy of tighter operating margins, increasing capital requirements and three years of falling stock prices. Financial experts advise these committees to step up to the task by arming themselves with expert members; meeting more often; and making a careful plan that details what the hospital needs money for, and which investments will raise that money in the most responsible, reliable manner.*

Just a few years ago, recalls Chicago investment consultant Bob DiMeo, hospital investment committees could “have a turkey sandwich and a soda pop, note that the Standard & Poor’s [indices] are up 20 percent again, and say, ‘Aren’t we great?’”

Ah, sweet memories. Today’s investment committee meetings are far more somber, and if DiMeo is present, the trustees spend at least part of their time talking about how much risk they’re willing to take with each asset class, including stock, bond or real estate purchases.

“We have serious discussions with our investment committees about defining risk,” says DiMeo, managing director of Chicago-based DiMeo, Schneider & Associates. “It’s absolutely critical because every strategy has a risk to it.” During the bullish 1990s, he notes, “Some hospitals maybe didn’t spend quite enough time on risk.”

Many of them paid dearly when the equity bubble burst, notably the well-regarded, billion-dollar Cleveland Clinic Foundation. After raking in more than \$900 million in the late 1990s by investing heavily in about two dozen high-risk technology stocks, the foundation watched its fortune dwindle from \$1.2 billion to \$650 million by July 2002. A 21-member finance committee—led by a billionaire trustee with plenty of confidence that the stock market would rebound—at one time steered up to 95 percent of its pension funds and long-term investment capital into equities, according to news reports.

Looking back, of course, those involved can say the group invested too heavily in stocks and placed too many financial eggs in the technology basket. *Great Boards* was unable to reach clinic officials for comment, but the foundation’s new chief financial officer, Michael O’Boyle, told *The New York Times*, “We’re attempting to be more conservative in the handling of our investments.”

### Balancing the books

Yet “conservative” isn’t necessarily the right route for every hospital investment committee. Rather, say financial advisers, “balanced” is an optimal state

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The Stamford Hospital*

for an investment portfolio. And “optimal” doesn’t happen without a thoughtful investment policy, notes financial consultant James Kingsbury, who also serves as a trustee for Continuum Health Partners and Columbia Memorial Hospital, both in New York.

“The most important role of the investment committee,” Kingsbury says, “is setting investment policy and then making sure the investment allocation is such that it’s conversant with that policy.”

To that end, agrees Richard Jones, treasurer and senior vice president for finance at The Stamford Hospital in Connecticut, his institution’s finance and audit committee, which doubles as the investment committee, works with a financial consultant who oversees the performance of both investments and the investment managers the hospital has hired. The committee meets quarterly with the consultant to:

- Get an update on the performance of investments.
- Review the performance of investment managers.
- Establish or revise criteria

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for the managers' performance, including setting benchmarks.

Managers might be expected to outperform the Standard and Poor's 500, for example, or to outperform the rate of inflation by some fixed percentage.

Using those objectives, the committee can decide how to allocate the hospital's assets to reach that performance benchmark.

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Bob DiMeo*

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### **Prudent planning**

Trustees at The Stamford Hospital, whom Jones labels "prudent," weigh the risk of each investment, steering the health system's funds into large-cap value companies like General Electric and Proctor & Gamble as well as small-cap stocks. And they're careful not to over-invest in technology or in any single industrial sector, Jones says.

In fact, he says Cleveland Clinic's problems, which arose after that foundation had enjoyed enormous profits from its technology investments and decided to keep most of its funds in the sector that was making it so much money, "could never happen" at Stamford. "The boards I've been involved with spend a lot of time looking at as-

set allocations," he says. "If all of a sudden there's a hot place to go because of technology, where we could make 50 to 70 percent, we still wouldn't be over-weighted in that area. When that went cold, it went cold fast."

Resisting the temptation to pile money into what's-hot-today stocks, Jones says, is tempered by a serious investment plan, coupled with good investment managers and a good outside consultant.

"I've never seen anyone win by trying to be a market timer or by focusing on one sector," he says. "It's a recipe for disaster."

Jones notes that prudent boards typically invest no more than 5 percent to 10 percent of their assets in one sector or two-thirds in stocks.

### **Shell-shocked**

While it's a good idea to regularly balance the portfolio, DiMeo says the backlash of the poor market showing of the past few years has scared some hospital investors into shying away from stocks altogether.

"A risk right now is to curl up and get ultra-conservative," DiMeo says, "to step out of stocks in a really large way."

But that's not wise investing in the long run, he says. "It may feel good today, but you may not be able to accomplish the nonprofit's goals because you're not giving yourself a fighting chance to do so."

Key to keeping the stock market in perspective, he advises clients, is knowing exactly what the hospital needs to accomplish with its money, and then spelling out the probability of achieving those goals with a balanced mixture of investments.

That tact is rallying trustees on many

investment committees to devote more time to their volunteer duties at the hospital.

### **A time-consuming job**

Kingsbury complains that some investment committees rely too heavily on the hospital's chief financial officer to make decisions and keep tabs on investment performance. "My experience is that across the board, investment committees don't really meet that much," he says.

But a few years of down markets is changing that. "In bad markets, we have more to worry about than in good markets," he says. Besides, Kingsbury notes, members of investment committees are being watched more closely since the disclosure of financial misdeeds at Enron.

"In some cases, there's a lot of money that these trustees are responsible for," says Kingsbury. "If something happens [in the markets] or if you invest it in real estate that doesn't go

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## **The Players**

**Money manager or investment manager:** A transaction-oriented, outside firm that advises trustees about the assets to buy or sell.

**Custodian:** Holds the hospital's invested assets.

**Investment or financial consultant:** Helps the board and investment committee oversee performance. Works with money managers and the custodian to reconcile all of the information.

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well, the onus on the investment committee is much heavier than on everyone else. In bad times, you have to be constantly monitoring and worrying about these types of investments.”

### 3 Steps

He suggests that committees meet two or three times a year, and recommends three steps for them to follow:

1. Constantly update the investment policy.
2. Ensure that asset allocation jibes with the investment policy.
3. Diligently monitor the performance of the investment managers, including their staffs.

He says committees should meet with investment managers several times a year to learn which staff members have left the firm and to revise perfor-

mance benchmarks. And he says money managers welcome the opportunity to meet with hospital committees more often.

A committee that works with an outside investment consultant should meet with that consultant quarterly, Jones adds.

And Jones says investment committees should weigh in when it’s time to recruit new members. “It’s important to make sure committees are populated with knowledgeable people,” he says. “It’s OK to have some non-financial people on the investment committee to ask layman’s questions, but you also need some people who can ask real hard questions, too.”

Trustees can’t control the performance of stocks and bonds, of course. But there are plenty of things within the control of a careful investment committee. “Follow a prudent process,”

Bob DiMeo says. “I believe you’re held more accountable for the process than for the results.”

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## Best Practices Checklist for Board Investment Committees

- Set objectives and adhere to them. Each committee should adopt a standard set of practices and benchmarks for its investment managers.
- Automatically review under-performing money managers. Conducting a review doesn’t necessarily result in firing the manager, but trustees should know why benchmarks are not being met.
- Review performance criteria annually to make sure benchmarks are appropriate for the managers. Have the discipline to rebalance the investment portfolio if large-cap stocks do well, for example, and unexpectedly account for a greater

proportion of investment funds than was planned.

### Best Board Practices Checklist

- Hire a custodian to hold the hospital’s assets rather than leaving that job to the investment manager. There’s less chance of impropriety when the responsibilities are segregated.
- Review financial objectives quarterly. Compare results with goals.

- Tap new trustees who have investment experience. Get substantial financial expertise onto the board.
- Meet with the consultant quarterly and with the investment managers one to three times a year.
- Think strategically rather than tactically. Avoid changing allocations in reaction to a market spike or dip.
- Consider hiring an independent investment consultant in addition to money managers. Consultants oversee the performance of investments and of the managers.