



# Hiring a Consultant vs. Investment Advisor/Manager

## IPPFA Regional Seminar

**Presented By: Jason Palmer**

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## PFM Asset Management, LLC

### ◆ National Leadership

- \$122.8 billion in total assets under management and advisement (as of 12/31/17)
- Multi-Asset Class and Fixed Income portfolios
- Ranked in the top 7% of the nation's largest investment managers by Pensions & Investments\*

### ◆ Public Sector Experience

- Serving public sector for over 37 years
- 95% of clients are from public sector



### Midwest Multi-Asset Class Specialist

#### Background:

- ✓ Corporate Pension Fund Management
- ✓ Public Pension Fund Investment Consultant
- ✓ University of Chicago MBA



## Agenda

- I. IL Pension Code Definitions
- II. Discussion of Investment Models
- III. Industry Trends
- IV. Issuing RFP for Investment Services
- V. Evaluating a Consultant or Investment Advisor/Manager



# IL Pension Code Definitions



## IL Pension Code – Investment Adviser

(40 ILCS 5/1-101.4)

Sec. 1-101.4. Investment adviser. A person is an "investment adviser", "investment advisor", or "investment manager" with respect to a pension fund or retirement system established under this Code if the person:

- (1) is a fiduciary appointed by the board of trustees of the pension fund or retirement system in accordance with Section 1-109.1;
- (2) has the **power to manage, acquire, or dispose** of any asset of the retirement system or pension fund;
- (3) has **acknowledged in writing that he or she is fiduciary** with respect to the pension fund or retirement system; and
- (4) is at least one of the following: (i) registered as an investment adviser under the federal Investment Advisers Act of 1940 (15 U.S.C. 80b-1, et seq.); (ii) registered as an investment adviser under the Illinois Securities Law of 1953; (iii) a bank, as defined in the Investment Advisers Act of 1940; or (iv) an insurance company authorized to transact business in this State. (Source: P.A. 90-507, eff. 8-22-97.)



## IL Pension Code – Investment Consultant

(40 ILCS 5/1-101.5)

Sec. 1-101.5. Consultant. "Consultant" means any person or entity retained or employed by the board of a retirement system, pension fund, or investment board to **make recommendations** in developing an investment strategy, **assist with finding** appropriate investment advisers, or monitor the board's investments.

"Consultant" does not include non-investment related professionals or professionals offering services that are not directly related to the investment of assets, such as legal counsel, actuary, proxy-voting services, services used to track compliance with legal standards, and investment fund of funds where the board has no direct contractual relationship with the investment advisers or partnerships. "Investment adviser" has the meaning ascribed to it in Section 1-101.4.

(Source: P.A. 96-6, eff. 4-3-09.)



# Discussion of Investment Models



## Traditional Consulting (Non-Discretionary)

- ◆ Traditional consultants offer consultation and recommendations to institutional clients
- ◆ Traditional investment consultants support needs in the following areas:

Investment policy development	Capital market research
Asset allocation analysis	Risk management
Manager research & searches	Liquidity management
Cash flow analysis	Reporting capabilities





## Investment Advisor/Manager (Discretionary)

- ◆ Offers implementation of investment advice to institutional clients
  - Organizations hire a trusted advisor with discretion to manage assets
  - Committees retain oversight without needing to be involved with the day-to-day decision process – allowing time to focus on other strategic initiatives
- ◆ In addition to the benefits of the traditional consulting model, an advisor can also offer:

Holistic portfolio management	Timely implementation
Modified governance process	Enhanced fiduciary oversight
Fewer administrative responsibilities	Potential to offer lower investment management (mutual fund) fees

- ◆ Often referred to as Outsourced Chief Investment Officer (OCIO), Discretionary Managers, Manager of Managers

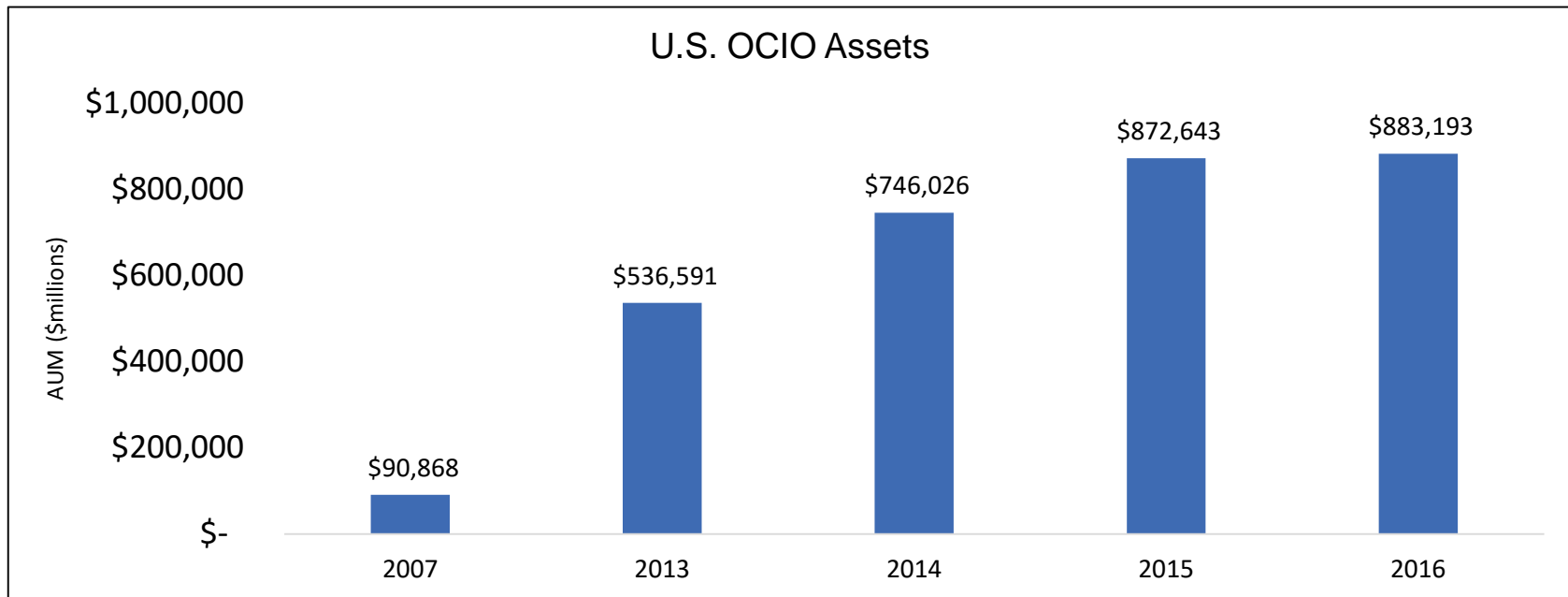


# Industry Trends



## Growth in OCIO Assets

- Worldwide investment outsourced assets grew 16% year-over-year to top \$1.5 trillion as of 1Q 2015\*
- OCIOs expect continued industry expansion
- Evolved from traditional consulting



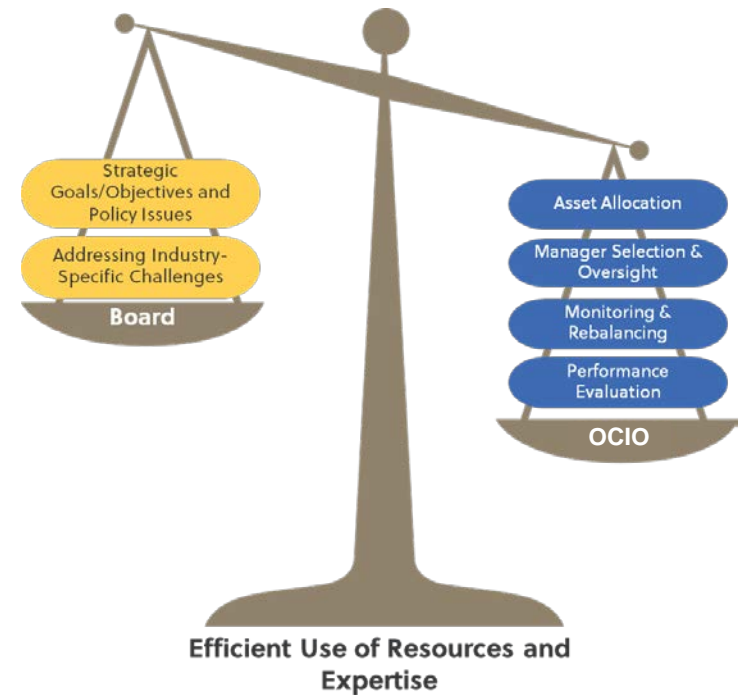
2017 Outsourced Chief Investment Officer Buyer's Guide

\* The Cerulli Report – Investment Consultants 2015: Trends Reshaping the Investment Consulting Landscape



## Why Many Have Outsourced: Balancing Time and Expertise

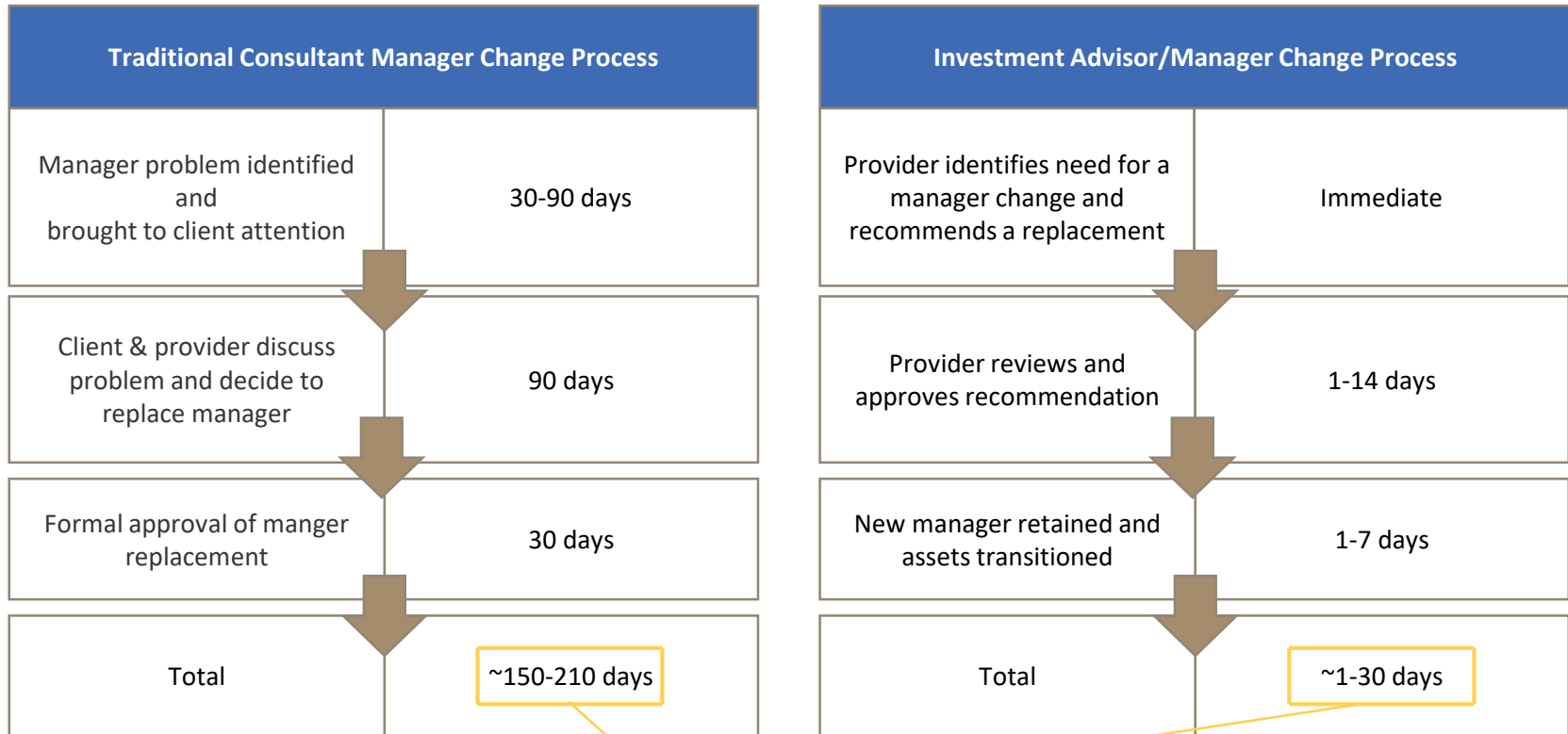
- **Many Committees and staff may not have . . .**
  - Time
  - Expertise
  - Organizational Structure
- **As a result, institutions struggle with . . .**
  - Consensus Building
  - Performance
  - Risk Management
  - Time Allocation



***Working with an OCIO allows your investment committee to focus on governance, oversight, and strategic matters.***



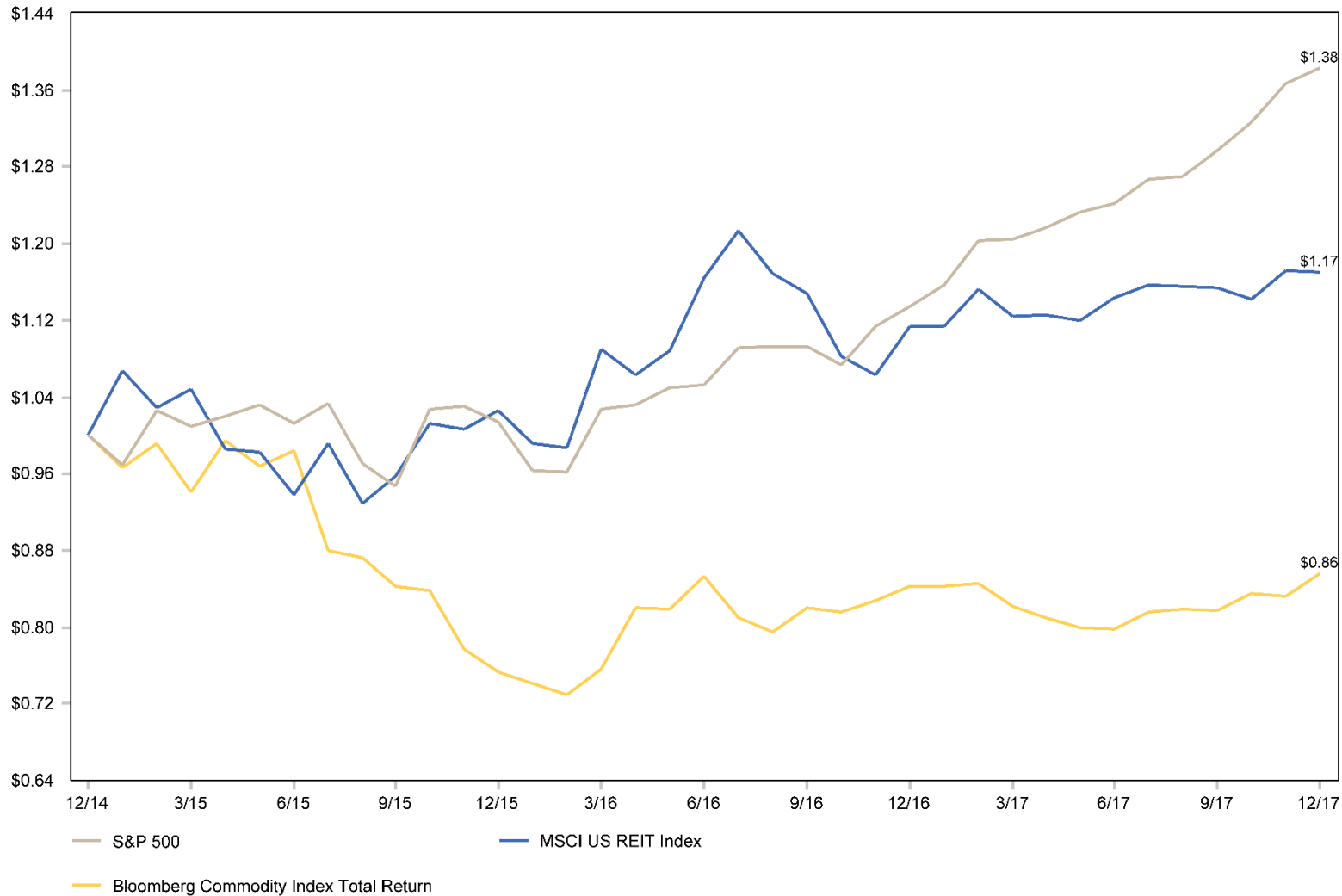
## Comparison of the Investment Decision Process



Delays may result in lost opportunities and create drags on performance



### 3 Year Investment Growth of \$1 – US Stocks, REITs, Commodities



**S&P 500 Index  
\$1.38**

**MSCI REITs Index  
\$1.17**

**Bloomberg  
Commodities  
Index Total  
Return  
\$0.86**



## Summary of the Investment Advisory Models

Service / Responsibility	Manager / Advisor (Discretionary)	Consultant (Non-Discretionary)
Provides Asset Allocation Advice	Similar	
Provides Investment Policy Help	Similar	
Quarterly Performance Reporting	Similar	
Portfolio Changes	Acts on Your Behalf within IPS guidelines	Acts with Board Approval
Portfolio Implementation	Implements on Fund's Behalf	Consultant or Board may be responsible
Responsible for Fund Performance	Manager / Advisor	Board
Board Involvement	Low/Moderate	High
Manager Contracts	Should not be necessary	Likely if investing in separate accounts



## What's the Best Fit for Our Board?

### ◆ Consulting Approach

- Board that is willing to reject a consultant's recommendation
- Members stay current on global investment marketplace or have a sophisticated investment background
- Active board that wants to be involved in manager selection
- Board prefers evaluating investment managers

### ◆ Investment Advisor/Manager Approach

- Board that tends to adopt most of their provider's recommendation
- Finds it difficult to stay abreast of global investment marketplace conditions
- Recognizes the limitations of their expertise and time
- Prefers to have a trusted advisor make portfolio decision on the fund's behalf
- Prefers to have investment changes implemented quickly

***Governance is the most critical decision***





# Issuing an RFP for Investment Services



# Request for Proposal Considerations

## Consulting Approach

- Understand investment manager database resources
- Ask how frequently investment recommendations or portfolio changes are made
- Ask if the consultant will execute those portfolio changes
- Does the organization help clients secure better pricing for mutual funds, ETFs, etc.?
- Any fees for manager searches?
- Watch List process
- Required every 5 years per IL Pension Code
- Portfolio recommendations last 2 years and why
- Required to RFP every 5 years





# Request for Proposal Considerations

## Investment Advisor/Manager Approach

- ◆ Understand depth of investment manager database and team resources to evaluate prospective managers
- ◆ Does the provider meet with the fund managers selected for client portfolios?
- ◆ Inquire about decision-making body and how markets are researched and put to use for client portfolios
- ◆ Are the business developers also the compliance team, risk managers, traders and investment committee?
- ◆ Does the provider select individual stocks or mutual funds or both for equities
- ◆ What fixed income resources are available?
- ◆ How are portfolio changes are communicated to clients?
- ◆ Any portfolio customization?
- ◆ Does the organization help clients secure better pricing for mutual funds, ETFs, etc.?
- ◆ Portfolio changes for last 2 years and why
- ◆ No requirement to RFP but every 3-5 years is best practice



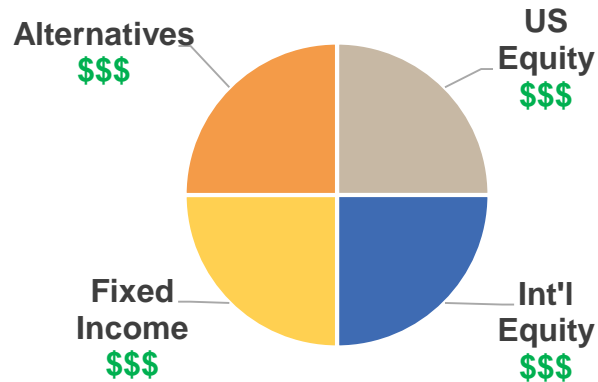


# Evaluating a Consultant or Investment Advisor/Manager



## Fees – Big Picture View

Investment Services + Underlying Investment Manager Fees = Total Fees



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- ◆ Strive to understand these key factors when evaluating consultants or advisors/managers
- ◆ Custodial Fees are important too



## Fees – Key Considerations

### ◆ Consulting Approach

- Typically a flat fee which will be based on total assets under advisement
- May also be some type of commission depending on the relationship structure
- Often billed directly to the client
- May include custody fees

### ◆ Investment Advisor/Manager Approach

- Typically expressed as a % and based on total assets under management
- May be higher given greater level of fiduciary responsibility, but not always
- Fee may be withdrawn directly from portfolio on a periodic basis
- May include custody fees



## Investment Performance – Key Considerations

- ◆ Will a Consultant or Investment Advisor/Manager perform better over time?
  
- ◆ Pay attention to benchmarks
  
- ◆ Has the provider actually added value over time?
  
- ◆ Global Investment Performance Standards (“GIPS”) - Created by the CFA Institute
  - Set of industry-wide principles that guide investment firms on how to calculate and present their investment results to prospective clients
  - Helps to avoid “cherry-picking” well-performing accounts
  - Establishes performance presentation standards and states how to create composites
  - [www.gipsstandards.org](http://www.gipsstandards.org) and [www.cfainstitute.org](http://www.cfainstitute.org)
  - PFM white paper available



## Summary

- ◆ Work with your board to decide whether a consultant or investment advisor is best for you
- ◆ The decision is really a matter of preference
- ◆ It's ok to be straightforward about the type of provider you want in an RFP
- ◆ Have a consultant or advisor/manager visit your board to learn more
- ◆ Either approach can help you achieve your long term goals





**Thank You!**

**Questions?**

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