

# SESSION SEVEN

Understanding the Roles and Responsibilities of Investment Advisors and Broker-Dealers



**SUSAN MUNSON**  
*Managing Director*  
Academy Securities, Inc.



**MONIQUE SPYKE**  
*Managing Director*  
PFM Asset Management



**HUBIE WHITE, CFA, CTP**  
*Chief Investment Officer*  
City & County of San Francisco

# About This Session

This session will describe the unique roles investment advisors, investment consultants, and broker/dealers play in providing services to public agency investors. Because there is no “one size fits all” solution, understanding the standards of care and business models of providers allows public agency investors to engage a team best suited to meet their needs.

After completing this session, a successful learner will be able to:

- Compare and contrast the roles and responsibilities of investment advisors, investment consultants, and broker/dealers
- Identify levels of fiduciary responsibility and the Municipal Advisor Rule
- Name the factors best considered before engaging service providers

# Public Agency Portfolio Objectives



However managed, investment objectives for public agency portfolios are the same:

**Safety:** Protect principal

**Liquidity:** Maintain sufficient liquidity

**Return:** Optimize returns, recognizing need for safety and liquidity

**Compliance:** Invest funds in accordance with the California Government Code and the Investment Policy

# Licensing Matters

- Brokers
  - Series 7 and 63 required
  - FINRA regulated
  - <https://brokercheck.finra.org>
- Registered Investment Advisors
  - Licensed at the firm level
  - SEC regulated
  - Individual licensing may be required depending on activity and state
  - <https://adviserinfo.sec.gov>
- Municipal Advisors
  - Series 50
  - RIAs are exempt
  - <https://www.msrb.org/municipal-advisors>
- Some individuals are dually registered

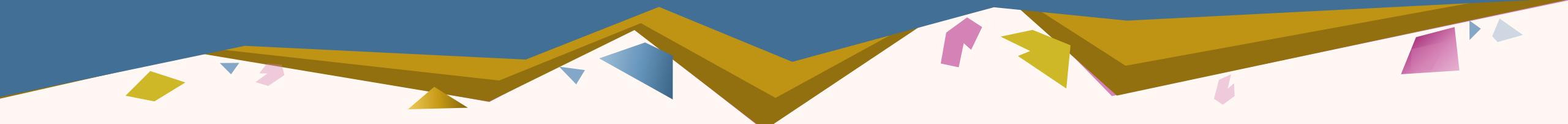
# Municipal Advisor Rule

The Municipal Advisor Rule is designed to regulate advisors who provide advice to state and local governments on financial matters, particularly regarding municipal securities and municipal financial products.

Persons who provide advice to municipalities or their agents regarding municipal securities or municipal financial products are required to comply with the rule.

Municipal Advisors must register with the SEC and MSRB.

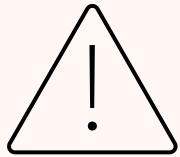
# Municipal Advisor Rule (cont. 2 of 2)



- Are there exemptions to the Municipal Advisor Rule?
  - Registered Investment Advisors
  - Broker-dealers serving as underwriters for specific deals
  - Brokers-dealers who do not provide advice on municipal financial products or issuance of municipal securities

# Overview of Investment Advisors

# Types of Investment Advice



Terms are often used interchangeably

- Non-discretionary
  - Periodic advice
  - Recommendations
    - You approve; advisor executes
- Discretionary
  - Portfolio management within previously established strategy, without prior approval for each transaction
- Other Discretionary
  - LAIF
  - County pools
  - LGIPs
  - Money market funds/mutual funds

# What is an Investment Advisor?

- A firm whose job is to help investors achieve their investment goals
  - Scope of services varies among investors and their unique needs
- Owns no securities
- Owns no inventory
- Does not purchase securities for resale to clients
- Competitively procures securities from broker/dealers
- Access to new issues
- Compensation typically based on assets under management

# Standard of Care



- Under the Investment Advisers Act of 1940, registered investment advisors are held to a **fiduciary duty**
- A fiduciary must put clients' interests ahead of their own interests when giving advice
- This means that an advisor must:
  - Be loyal to its clients and act in good faith on their behalf
  - Have a reasonable, independent basis for recommendations
  - Seek best execution of clients' transactions
  - Be free of conflicts of interest, or disclose any conflicts of interest or potential conflicts of interest and proceed only with the client's informed consent

# What Does an Investment Advisor Do?

Investment Advisors are meant to serve as thought partners to their clients.

Sample Scope of Services:

- Reviews investment policy
- Conducts cash flow analysis
- Develops long-term investment strategy
- Develops short-term investment strategies
- Proactively manages portfolio
- Provides monthly and quarterly reports
- Serves as general resource

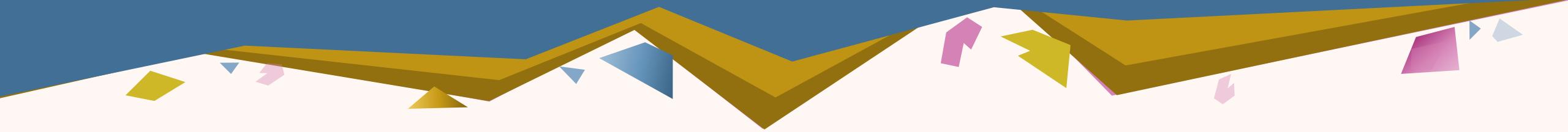
# Typical Portfolio Management Responsibilities



This assumes a  
discretionary  
relationship

- Continually review portfolio holdings for opportunities to add value
  - Strategically lengthen and shorten portfolio's duration
  - Execute sector swaps
  - Employ yield curve placements
- Structure the portfolio to perform well in changing market conditions
- Continually monitor credit-worthiness of securities

# Developing a Strategy



- Conduct statistical study of agency's historical portfolio balances
- Determine liquidity needs and balance available for longer-term investments
- Develop a strategy that considers the performance objectives of the portfolio:
  - Interest earnings and/or
  - Growth of portfolio value
- Determine tolerance for market value fluctuations
- Discuss industry-standard performance benchmarks

# Overview of Broker/Dealers

# B/D Roles in the Capital Markets

- Facilitate issuance of debt and equity to raise money for banks, corporations, public entities, and special purpose vehicles
- Active in the secondary markets to provide liquidity and orderly market flow
- Primary dealers: Banks and brokerage firms (currently 24) authorized as trading counterparties of the New York Fed
- Regional or Secondary dealers: all other authorized by regulators

# What is the Role of a Broker?

- Acts as Agent: Buys securities from sellers to resell to buyers; does not maintain firm inventory
- Compensation: Earns the difference between the buy price and the sell price, commonly referred to as commission

# What is the Role of a Dealer?

- Underwrites securities
- Commits capital to “take a position” in the market
- Owns securities; buys for, and sells from, “house” inventory; acts as principal, may also act as agent
- Compensation: The difference between the buy price and the sell price, aka “spread,” or fees paid by the issuer when underwriting new issues; can also earn a “commission”
- Many firms operate as both; aka, broker-dealers

# Standard of Care – Buyer Beware

- FINRA Rule 2111
  - Recommendations made on a reasonable basis
  - [www.finra.org/rules-guidance/rulebooks/finra-rules/2111](http://www.finra.org/rules-guidance/rulebooks/finra-rules/2111)
- Institutional Exemption
  - Institutional Accounts Affirm
    - Capable of Evaluating Investments
    - Will Exercise Independent Judgement
- Best Practice - Delivery versus Payment
  - Third Party Custodian Recommended
  - Custodian Banks Held to Fiduciary Standard

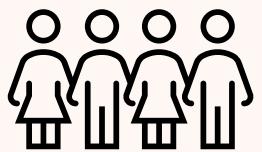
# Services Often Provided by Broker/Dealers

- Firm research, trading desk access, and market commentaries
- Market color and context when assessing investment options
- Access to street inventories to expand the universe of available options

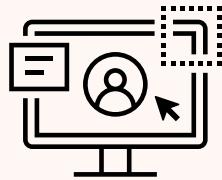
# Discussion

# How do you decide?

**Assess your existing resources.**



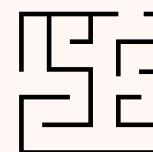
What kind of finance staff do you have?



What market tools and access do you have?



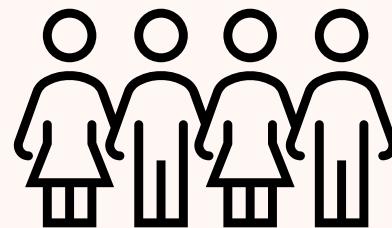
How much time and capacity can you spend on portfolio decisions?



What is the size and complexity of your portfolio?

# Staff

- What kind of finance staff do you have?



CONSIDER INVESTMENT ADVISOR

Understaffed

Less Expertise

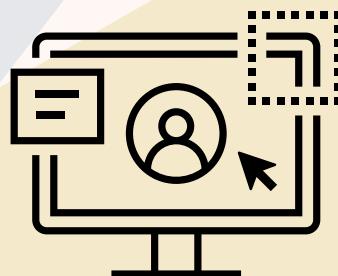
Staffed

More Expertise

CONSIDER BROKER/DEALER

# Tools and Resources

- What market tools and access do you have, or can you reasonably acquire?



Consider the cost of systems and services

CONSIDER INVESTMENT ADVISOR

Google

Excel

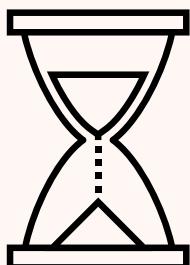
Independent  
Market Access

Investment  
Accounting System

CONSIDER BROKER/DEALER

# Time and Capacity

- How much time and capacity can you spend on portfolio decisions?



Consider how many hours per week you are able to spend

## CONSIDER INVESTMENT ADVISOR

Wearing 12 hats

Unable to add staff

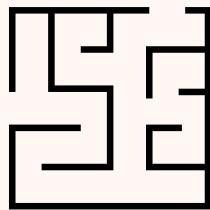
Dedicated investment officer

Ample time to assess options

## CONSIDER BROKER/DEALER

# Size and Complexity

- What is the size and complexity of your portfolio?



Investment options  
and trading volume  
impacts portfolio  
management costs

## CONSIDER INVESTMENT ADVISOR

More compliance and  
reporting requirements

Diversified among sectors

Less compliance and  
reporting requirements

Limited among sectors

## CONSIDER BROKER/DEALER

# What To Look For in an Investment Advisor

- Reputation
- Experience managing funds for local governments
- Investment philosophy/approach
- Years of experience of the firm and its investment professionals
- Amount of assets under management for public agencies
- Flexibility to meet your specific needs
- Performance

# What To Look For When Selecting Broker/Dealers

- Financial Statement Review
- Capital Adequacy Standards
- History of SEC Complaints or Violations (<http://brokercheck.finra.org>)
- State Registration
- Representative's Qualifications
- Reputation/References
- Familiarity with investment code
- Involvement in state and local government associations
- Ability and willingness to bid and offer securities across asset classes
- Ability and willingness to become familiar with your investment policy

# Takeaways

- Customize a program that works for you
- Seek out service providers that meet your specific needs
- **No one size fits all!**

# QUESTIONS?



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