

Session Two: Understanding the Roles and Responsibilities of Investment Advisors and Broker/Dealers

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ROLES AND RESPONSIBILITIES OF ADVISORS AND BROKER/DEALERS

- Services
- Roles
- Responsibilities
- Regulatory oversight
- Expectations
- Selection Criteria
- Costs

INVESTMENT ADVISORY OVERVIEW

Investment Advisory services are becoming the norm for public fund investors.

- Fiduciary Capacity
- Transparency of Fees
- Provides more comprehensive services including:
 - ✓ Investment Policy
 - ✓ Strategic Development
 - ✓ Cash Flow Analysis
 - ✓ Board Presentations
 - ✓ Reporting
- Efficient use of time and internal resources

Comparison of Advisory Fiduciary versus Broker Suitability

Registered Investment Advisors have a regulatory duty to act as a fiduciary in their dealings with their clients. A fiduciary must act in the clients' best interest at all times and disclose any potential conflicts of interest. The historical provider of fixed income services to public entities have been through fixed income brokers. Brokers fall under different regulatory requirements and are held to a "suitability standard". The suitability standard only requires that the broker offers securities that are suitable for a client while a Registered Investment Advisor is held to the higher standard of fiduciary.

TYPES OF INVESTMENT ADVISORY SERVICES

Discretionary:

- Investment program is outsourced to a manager
- Strategy is developed and manager implements
- The portfolio is managed by investment policy
- May have securities transacted and allocated across various accounts.
- Engagement managers are assigned to the account
- Market input is limited by the public fund
- Minimal time requirement of internal staff
- May include policy updates
- Includes competitive pricing on all transactions with broker dealers

TYPES OF INVESTMENT ADVISORY SERVICES

Non-Discretionary:

- Investment program is developed in collaborative manner with the public fund finance team
- Strategy is developed and executed by the advisor
- All transactions require approval by the client prior to execution
- May be a more customized approach and more extension of staff
- Portfolio advisors work directly with the client
- Includes competitive pricing on all transactions with broker dealers for the individual client; not batched trades

DIFFERENCES IN RESPONSIBILITIES



Set Asset Allocation Targets
Investment Policy Statement
Implement/Rebalancing
Security Selection

ADVISOR
Recommends
Recommends
Recommends
Recommends

CLIENT
Approves
Approves
Approves
Approves



Set Asset Allocation Targets
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Implements

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Approves
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Monitors
Monitors

ASPECTS OF EACH APPROACH

NON-DISCRETIONARY

DISCRETIONARY

Implementation of Recommendations

More Time Intensive

Seamless

Client Control

More

Less

Accountability of Performance

Mixed

Clearer

Formal Oversight of Assets

Daily

Daily

Client Time Required

More

Less

Client Back Office Responsibilities

More

Less

OVERSIGHT INVESTMENT ADVISORY SERVICES

Consulting:

- Services to assist internal investment team with oversight and input to the portfolio strategy
- Provide third party reporting and recommendations
- Monitor compliance and procedures
- May assist on transactions as needed
- Reconciliation of the portfolio
- Sometimes hired by General Manager or Treasurer to oversee and support staff

REGULATORY OVERSIGHT OF INVESTMENT ADVISORS

Securities Exchange Commission:

Under the Investment Advisors Act of 1940

- Investment Advisors are Fiduciaries – they have a fundamental obligation to act in the best interest of client
- Investment Advisors have Compliance Programs
- Code of Conduct and Procedures
- Code of Ethics and most are part of the CFA Institute which holds to a higher standard

SELECTION CRITERIA – GFOA Best Practice

- The adviser's understanding of the government's investment program, objectives and constraints
- The adviser's background, including experience, resources and qualification of the firm in general and individuals assigned to the governments account.
- The adviser's experience in working with public fund operating and bond proceeds.
- The adviser's recommended approach to the management of the portfolio and collaborative work with your team
- Personalities with the intent to build a long term relationship
- Experience in discretionary versus non-discretionary
- Fees

MUNICIPAL ADVISOR RULE AFFECTING BOND PROCEED INVESTMENTS

- Bond proceed investments were impacted by the new regulations overseeing bond issues
- Public funds can not receive advice from broker dealers on bond proceeds.
- Must have an RFP for specific securities or services or the broker must be registered with the SEC as municipal advisor
- Registered Investment Advisors are exempt from registering as an Municipal Advisor since they already report to the SEC
- The intent is to prevent conflicts of interest on funds that are tied to a bond issue which is a registered investment

COSTS AND FEE STRUCTURE

TRANSPARENT – No Transaction Costs

- Fixed Fee based on Scope of Service and Asset Size
- Basis Point Fee based on Assets Under Management
- Discretionary typically is 7-10 basis points
- Non-Discretionary is 4-6 basis points
- Consulting is negotiated based on scope of service

Comparison of Advisory Fees versus Broker Dealer Fees

Advisors improve transparency in the transaction process. Brokers are compensated by marking up or down the price of each security that they trade with their clients. These markups vary between accounts and are not disclosed. Registered Investment Advisors must disclose all of their fees and are prohibited from marking up securities. Advisors fees are transparent, and their fees can be offset by the reduction in markups experienced through the broker delivery model. The amount of offset can be substantial depending on the historical activity with a broker and the type of security transacted.

CONCLUSION

- **No** “one size fits all” answer as each organization has different needs, structures personnel and comfort levels
- **Evaluating** your current structure with the information provided should illuminate which approach is the best fit for your organization
- **Main** organizational considerations determining suitability:
 - Time
 - Resources
 - Committee structure/composition/dynamics
 - Portfolio Size and Complexity
 - Staff resources and knowledge



A Broker/Dealer (B/D) Performs Dual Roles

- 1) As a broker, the B/D will focus on the needs of clients of the firm.....
initiating transactions on behalf of clients' accounts
- 2) As a broker, the B/D puts buyers and sellers together
- 3) As a dealer, the B/D will act on behalf of the brokerage firm.....
initialing transactions that involve the firm's account
- 4) As a dealer, the B/D underwrites and inventories securities

The B/D and your Broker (Advisor)

A broker/dealer is a firm that oversees the activities of the investment professional (your broker) that handles your account.

A broker/dealer is charged with oversight from the SEC and FINRA to ensure their clients' (your) best interests are being served with suitable and appropriate recommendations.

A broker/dealer is registered with and regulated by the SEC (Securities and Exchange Act of 1934).

Broker (Advisor) & Public Entity Decision-Making

This is an ongoing joint effort.....and is based on,

Preservation of principal

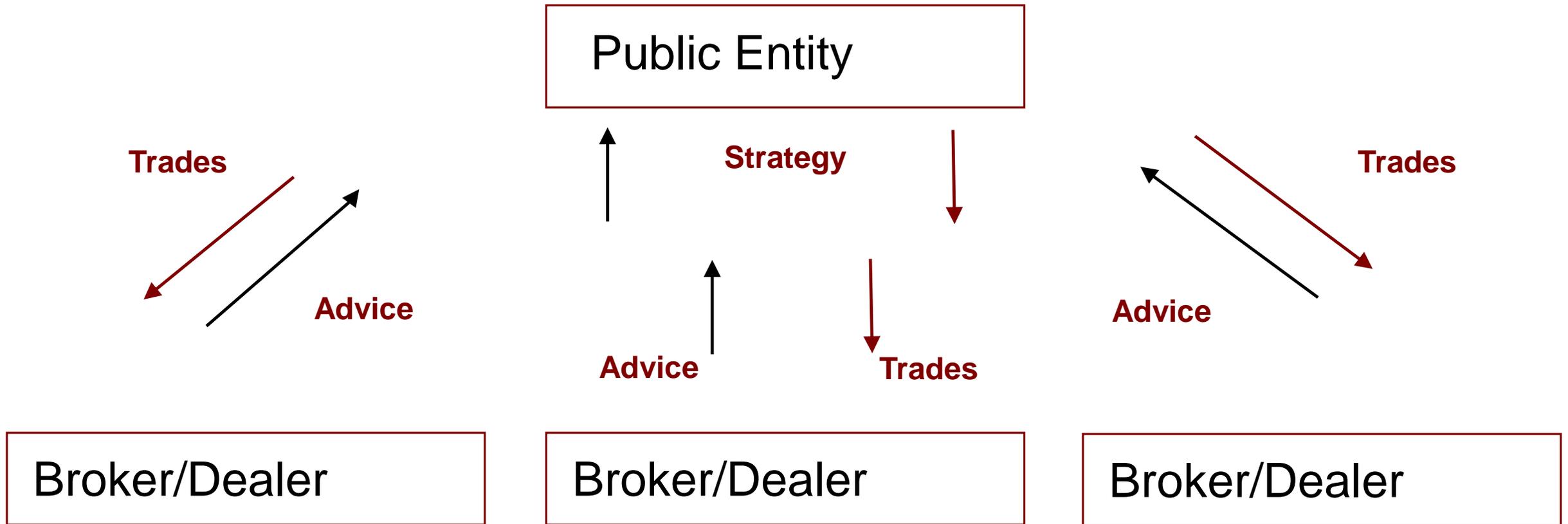
Your Investment Policy, the basis for portfolio selection

Cash flow and budget considerations

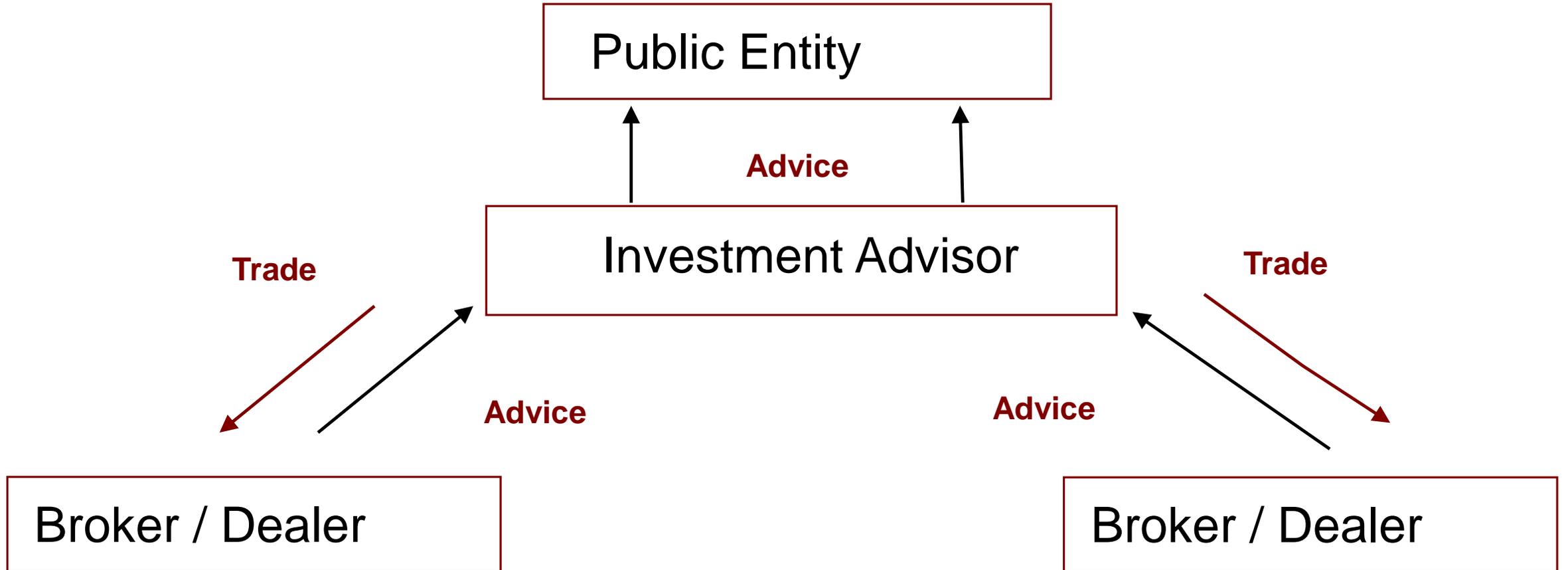
Risk Tolerance and Management

Strategy

B/D Advisor to Public Entity Diagram



Investment Advisor to Public Entity Diagram



What to look for in your Broker (Advisor)

Experience in public funds investing

Competitive Pricing

Independent Thinking

Market and Product Knowledge

Strategic & Tactical Ideas

Willingness to educate you

What to look for in your Broker/Dealer

Analytical Tools and Strategy

- Asset Allocation

- Convexity

- Duration

Credit Analysis

- Sector Ratings (Market Weight, Overweight, Underweight)

- Ratings

Economic Research

Fixed Income Research

- Agency Markets: Bullets, Callables

- Interest Rate Analysis

- Yield Curve Analysis

Trade Execution and Clearance

B/D or Investment Advisor? Relevant Factors

Active or Passive Management

Staffing and Systems in place for internal management

Value-added return for the additional cost of fee-based management

You are responsible regardless of whether internal or external management of your portfolio

B/D Food For Thought

Delegation of Authority...the buck stops with you

Educational Resource...Understand your investments and markets; passing that knowledge on to future treasurers and/or FDs

Cost Considerations...Buy/Hold; minimal overall trades; Buy New Issues; issuer pays a concession; Secondary issues: pay as you go; Vs. ongoing annual fee

Portfolio Analytics...Brokers can provide significant portfolio analytics for those that want it

Competitive environment...brokers vie for better pricing and ideas for you

You and Your Broker

“Part of the reason I hold you in such high esteem is because of your involvement in the many programs available to Treasury staff. I have a list of broker/dealers who would like our business, but they don’t participate in the many programs/agencies/boards like you do. I can’t even match a name to a face. I feel you take a personal interest in assisting us perform our jobs better, and I greatly thank you for that investment of your time/energy. You never tried to sell me your services. Instead, you educated me in best practices and proper procedures, and helped me understand the subtleties of working in a Treasury position.” –Treasurer retiring in March 2017

Disclosure

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