

ROLES AND RESPONSIBILITIES OF INVESTMENT ADVISORS AND BROKER/DEALERS

Fundamentals of Public Funds Investing
January 23 – 24, 2019

Presented by:

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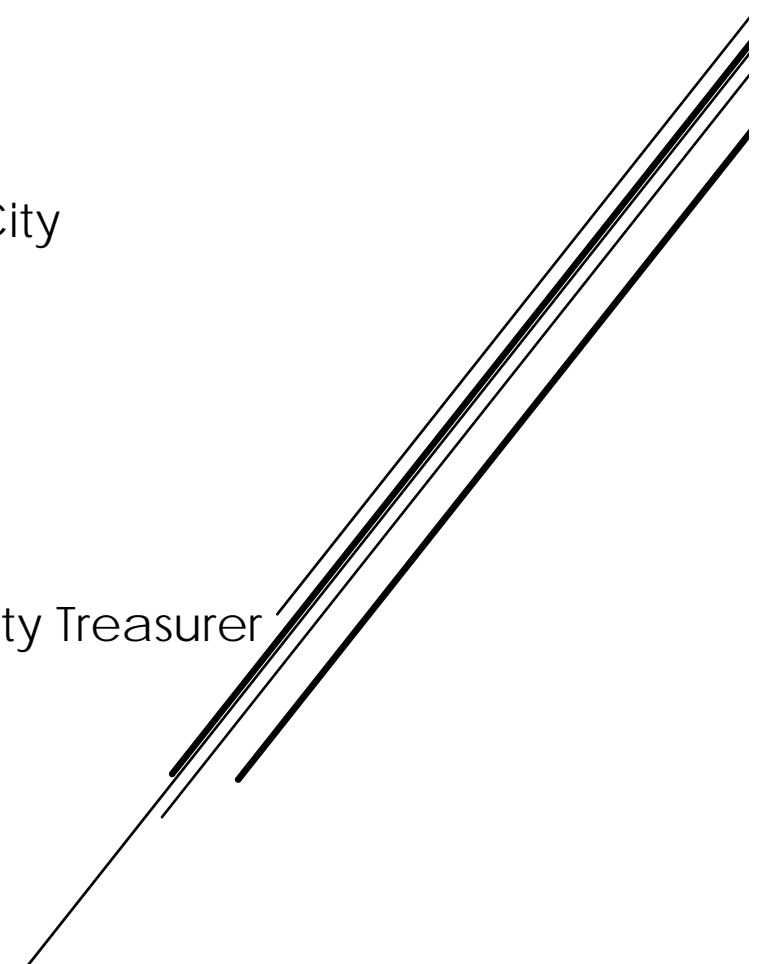
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OVERVIEW

- ▶ Investment Advisor Services
- ▶ Broker/Dealer Services
- ▶ Which is right for your organization?
- ▶ Regulatory Oversight/Municipal Advisor Rule
- ▶ Additional Resources
- ▶ Q & A

INVESTMENT ADVISOR SERVICES

Fiduciary versus Suitability

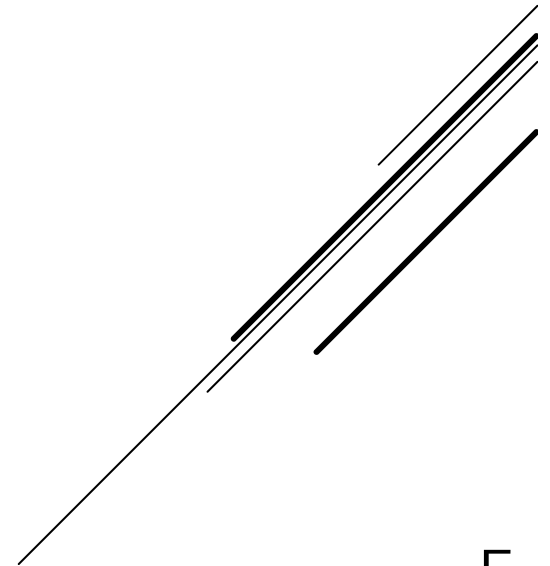
- ▶ **Fiduciary:** The Fiduciary Standard was created in 1940 as part of the Investment Advisors Act. This standard, regulated by the SEC or state securities regulators, maintains that investment advisors are bound to a standard that requires them to put their client's interests above their own. The following rules fall under the Fiduciary Standard:
 - ▶ An advisor must place his or her interest below that of the client.
 - ▶ An advisor is prohibited from buying securities for his or her account prior to buying them for a client.
 - ▶ An advisor must do his or her best to make sure investment advice is made using accurate and complete information. The analysis must be as thorough as possible.
 - ▶ An advisor must avoid conflicts of interest. As a fiduciary, an advisor must disclose any conflicts of interest or potential conflicts of interest.

INVESTMENT ADVISOR SERVICES

- ▶ **Suitability:** Although the two terms may sound similar, there is a difference between suitability and fiduciary. Suitability means only making recommendations that are consistent with the best interest of the underlying customer. Here's what else you need to know:
 - ▶ Instead of having to place his or her interest below that of the client, the suitability standard only requires that the advisor has to reasonably believe that any recommendations made are suitable for the client, in terms of the client's financial needs, objectives and unique circumstances.
 - ▶ Suitability means making sure transaction costs are not excessive or that a recommendation is not unsuitable for a client.
 - ▶ The need to disclose potential conflicts of interest is not as strict a requirement as it is with a fiduciary.
 - ▶ An investment for a client only has to be suitable; it doesn't necessarily have to be consistent with the individual investor's objectives and profile.

INVESTMENT ADVISOR SERVICES

- ▶ TYPES OF INVESTMENT ADVISORY SERVICES:
 - ▶ Consulting
 - ▶ Non-Discretionary
 - ▶ Discretionary



INVESTMENT ADVISOR SERVICES

▶ Consulting

- ▶ Monitor investment compliance and procedures
- ▶ Portfolio reporting
- ▶ Portfolio reconciliation
- ▶ Client training, education, and market analysis
- ▶ Cash-flow modeling and analysis
- ▶ Broad to specific strategy recommendations
- ▶ Transactional assistance

INVESTMENT ADVISOR SERVICES

- ▶ Non-Discretionary advisory services may include:
 - ▶ All transactions require approval of the client prior to execution
 - ▶ Includes competitive pricing on all transactions with broker dealers for the individual client
 - ▶ Portfolio advisor works directly with the client
 - ▶ Investment program is developed by both the client and advisor
 - ▶ May work as an “extension” of your staff (i.e.: customized portfolio approach)
 - ▶ Strategy may be developed and executed by the advisor

INVESTMENT ADVISOR SERVICES

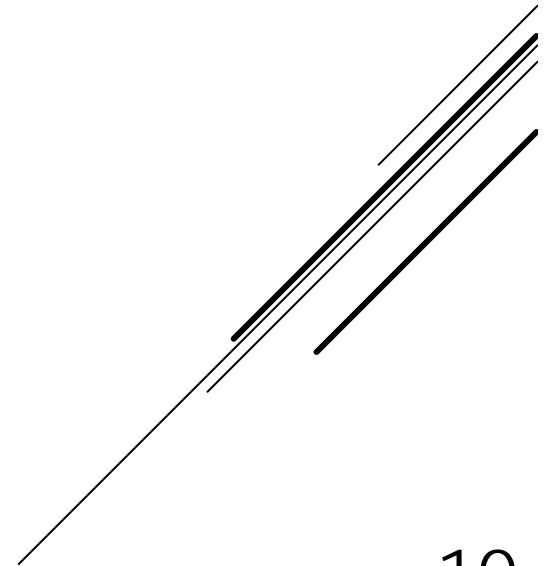
- ▶ Discretionary Investment Advisory Services
 - ▶ Investment program is outsourced to a manager
 - ▶ Strategy is developed and manager implemented
 - ▶ The portfolio is managed by the investment policy
 - ▶ May have securities transacted and allocated across various accounts
 - ▶ Engagement managers are assigned to the account
 - ▶ Market input by the public agency is limited
 - ▶ Less time requirement by the clients internal staff
 - ▶ May include policy updates
 - ▶ Includes competitive pricing on all transactions with broker dealers

INVESTMENT ADVISOR SERVICES

- ▶ Why choose an investment advisor?
 - ▶ Fiduciary capacity
 - ▶ Transparency of fees of the Advisor:
 - ▶ 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 upon scope of services
 - ▶ Complete asset management option
 - ▶ Tailored versus indexed

INVESTMENT ADVISOR SERVICES

- ▶ Why choose an investment advisor?
 - ▶ Ala carte services may include
 - ▶ Investment policy
 - ▶ Strategy development
 - ▶ Cash flow analysis
 - ▶ Board presentations
 - ▶ Reporting



INVESTMENT ADVISOR SERVICES

- ▶ GFOA Best Practices – Selection of Investment Advisor
 - ▶ The Investment Advisor's understanding of the agency's investment program, objectives, and constraints
 - ▶ The Investment Advisor's background, including experience, resources and qualification of the firm in general and individuals assigned to the governments account
 - ▶ The Investment Advisor's experience in working with public fund operating and bond proceeds
 - ▶ The Investment Advisor's recommended approach to the management of the portfolio and collaborative work with your team
 - ▶ The Investment Advisor's personalities with the intent to build a long term relationship with the client
 - ▶ The Investment Advisor's experience in discretionary versus non-discretionary management
 - ▶ The Investment Advisor's fee structure

INVESTMENT ADVISOR SERVICES - RESPONSIBILITIES

| Non-Discretionary | | ADVISOR | CLIENT |
|-------------------|------------------------------|------------|----------|
| | Set asset allocation targets | Recommends | Approves |
| | Investment Policy Statement | Recommends | Approves |
| | Implement/Rebalancing | Recommends | Approves |
| | Security Selection | Recommends | Approves |

| Discretionary | | ADVISOR | CLIENT |
|---------------|------------------------------|------------|----------|
| | Set Asset Allocation Targets | Recommends | Approves |
| | Investment Policy Statement | Recommends | Approves |
| | Implement/Rebalancing | Implements | Approves |
| | Security Selection | Implements | Approves |

INVESTMENT ADVISOR SERVICES

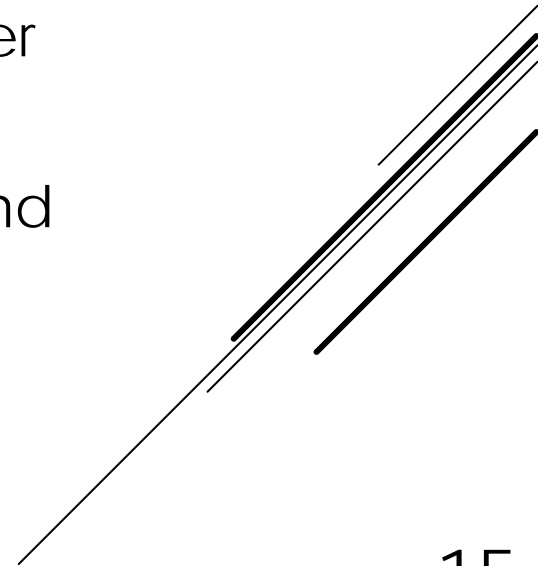
| Aspects of Each Approach | Non-Discretionary | Discretionary |
|-------------------------------------|------------------------------|---------------------|
| Implementation of Recommendations | Time sensitive and intensive | Executed by advisor |
| Client Control | More | Less |
| Accountability of Performance | Mixed | Clear |
| Formal Oversight of Assets | Daily | Daily |
| Client Time Required | More | Less |
| Client Back Office Responsibilities | More | Less |

WHAT IS A BROKER/DEALER?

- ▶ Broker-dealer: A person or firm in the business of buying and selling securities for its own account or on behalf of its customers.
- ▶ As dealers: Act on behalf of the brokerage firm, initiating transactions for the firm's own account or inventory.
- ▶ As brokers: Handle transactions, buying and selling securities on behalf of their clients.

BROKER/DEALER SERVICES

- ▶ Provide market and economic information, economic forecasting
- ▶ Provide lists of currently available/suitable investments
- ▶ Provide information on specific investments such as rating, price, yield, maturity date, other analytics (OAS, Risk, ESG, etc.)
- ▶ Execute purchase or sale of a security and provide a trade ticket/confirmation



BROKER/DEALER REGULATION

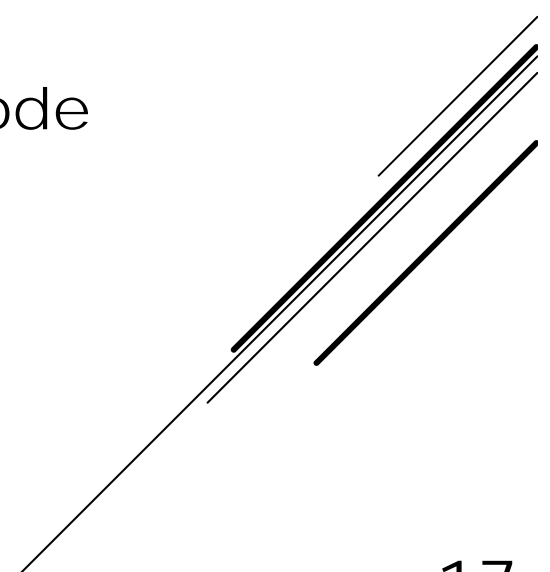
- ▶ Securities laws require brokers/dealers to “know their client” and sell only suitable investments to them. However, they do not maintain the full fiduciary duty of the management of the portfolio.
- ▶ Registered with and regulated by the SEC (Securities and Exchange Act of 1934).
- ▶ Individuals, as employees of the broker/dealer, must be registered with federal/state regulators and be licensed with the Financial Industry Regulatory Authority (FINRA)



BROKER/DEALER SELECTION

Most public agencies work with multiple brokers/dealers. Selection may be based on a number of factors including:

- ▶ Years of experience with public fund investing
- ▶ Experience working with local (within the state) Public Agencies
- ▶ Knowledge of the state's Government Code regarding investments

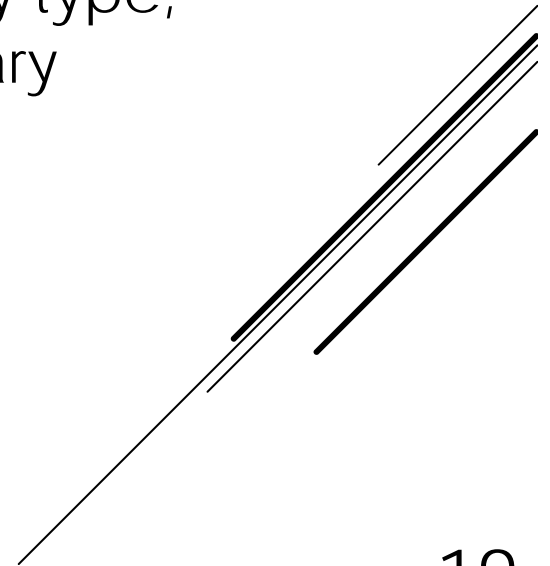


BROKER/DEALER SELECTION

- ▶ Adequate capitalization of the firm
- ▶ Recommendations of other agencies
- ▶ Added services they may provide such as research reports, benchmarking, and portfolio analysis
- ▶ RFQ or RFI process or Broker Questionnaire information
- ▶ Always perform background checks: Confirm registration on FINRA site (www.finra.org), contact all references provided

BROKER/DEALER COSTS

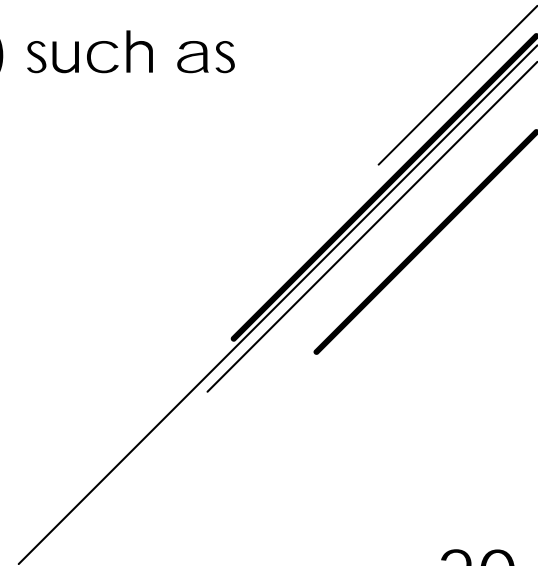
- ▶ Broker compensation is received through the price “spread” on each security sold
- ▶ Not apparent in the price at which the security is offered to you
- ▶ Depends on a variety of factors: Security type, maturity date, structure, new or secondary issue, credit quality, duration



BROKER/DEALER COSTS

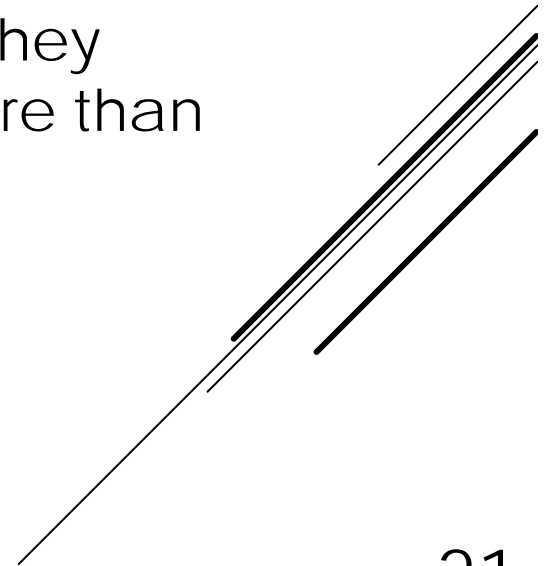
Some possible ways to discover if the spread is reasonable can be:

- ▶ Research the recent trades of fixed income securities on the TRACE system (FINRA website)
- ▶ Request pricing from more than one broker
- ▶ Check pricing on Bloomberg (if available) such as BVAL function



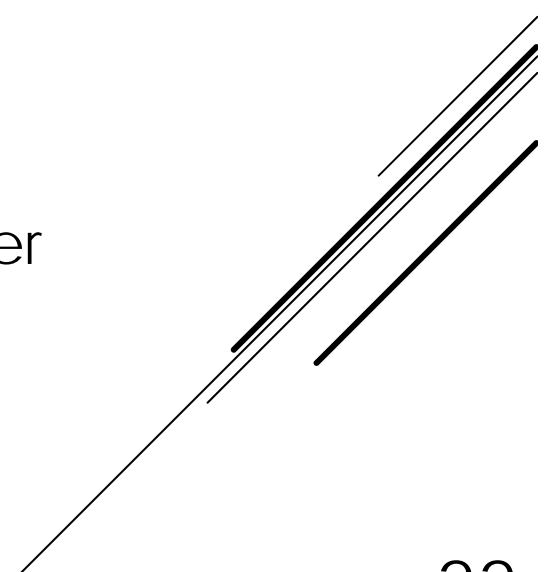
BROKER/DEALER COSTS

- ▶ Market variations and timing affect the pricing of a security, so a direct comparison is difficult.
- ▶ Work with a trusted broker who consistently offers you a fair price.
- ▶ It is realistic to expect that the broker earn a reasonable commission for the services they provide, but you do not want to pay more than is necessary.



BROKER VS. ADVISOR WHICH IS BEST FOR YOUR ORGANIZATION?

- ▶ Active or Passive Management
- ▶ Portfolio Size/Complexity
- ▶ Staff Resources and Knowledge
- ▶ Budget/Cost
- ▶ Availability of Resources
- ▶ Oversight/Management Required for Either



MUNICIPAL ADVISOR RULE

- ▶ Relates to investment of bond proceeds
- ▶ Public funds can not receive advice from broker dealers on bond proceeds (unless they are registered as a municipal advisor)
- ▶ RFP should be issued for specific securities or services (e.g.: Guaranteed Investment Contracts)
- ▶ 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

<https://www.sec.gov/info/municipal/mun-advisors-faqs.shtml>

ADDITIONAL RESOURCES

General Information /Best Practices

- ▶ <https://www.treasurer.ca.gov/cdiac/invest/primer.pdf>
- ▶ <http://www.gfoa.org/selection-and-review-investment-advisors>
- ▶ <http://www.gfoa.org/government-relationships-securities-dealers>
- ▶ **FINRA** - <http://www.nasd.com/>
- ▶ **MSRB Rulemaking Board** - <http://www.msrb.org/>
- ▶ **Sample broker/dealer documents** - david.carr@smgov.net
- ▶ **Sample investment advisor agreements** - don.collins@wedbush.com