APPROVED
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THE 2022 CSMFO ANNUAL CONFERENCE

DISCOVER CSMFO

EXPLORING OUR FINANCIAL FUTURE

SAN DIEGO FEB 16-18, 2022

Evaluating Proposals for Investment Advisory Services

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What’s On Deck

The Agenda:

First, we’ll go over the basic framework of a Request For Proposals (RFPs),

Then, we’ll dive into some questions you should make sure are included within your next RFP,

We will then discuss what to look for within the supporting documentation normally requested as part of an RFP

The Goal:

To help you streamline your RFP review process and select the registered investment adviser that best meets your needs.

GFOA’s Best Practices

- ***“It is important for governments to take a careful and informed approach in the selection and use of investment advisers”.*** (GFOA Best Practices)
- Determine the level of authority
  - Advisory-only
  - Non-Discretionary
  - Discretionary
- Under any agreement type, the government maintains control of its investment program by establishing the guidelines and policies to which the adviser must adhere.

SOURCE: GFOA.ORG BEST PRACTICES

Relevant Experience and Expertise

- Firm History and Ownership
- Define Firm Experience
  - AUM/ # of clients / years managing proposed approach
- Experience of team you will work with
- Performance track record
- Assets Under Management
- Firm current client list/client references
- Communication approach: Team vs Portfolio Manager vs Relationship Manager
- Turnover of staff
- Are resources focused on purchasing the securities in your investment policy?
- Full disclosure of any regulatory or censure of Firm or investment professionals

Investment adviser’s Disclosure Documents
Trust…… but Verify

- Form ADV Part 1
- Form ADV Part 2a
- Form ADV Part 2b
- Employee Biographies

Getting to Know your Investment Adviser

Your RFP should contain several specific sections, each with a goal in mind….

- **Introduction** - The Investment Adviser (“RIA”) submitting the RFP should include a well-written introductory letter that focuses on the firm’s strengths – *here’s where they should put their best foot forward.*
- **Executive Summary** – The investment adviser should provide you with a brief history of the firm and their experience managing the type of account you are looking for – *understanding the firm’s history gives you a better picture of who they are and where their focus lies.*
- **Qualifications** – The investment adviser should get specific here with regard to managing the type of account / strategy that you are looking to employ – including the amount of experience and background of key investment adviser professionals. *There is no substitute for solid experience!*
- **References** – Ask the investment advisers to provide at least three references.
    - Take this opportunity to reach out to each reference provided, and make sure to ask specific questions:
        - Customer service
            - Reporting
            - Other services
        - Professionalism
            - Who are the direct contacts?

Getting into the Weeds - let's Talk Investment Management

Now that the investment adviser has introduced itself to you, it's time to get into the weeds a bit. In short: it's time to talk about how they will manage the assets you give them.

Make sure your RFP includes questions that address the following:

- The investment adviser's overall investment philosophy
- How investment decisions are made – from macroeconomic evaluations to individual issuer research
  - Is the process disciplined and repeatable?
- The various tools used by the investment adviser to execute and allocate trades for their clients
  - Make sure to make the investment adviser describe in detail how it selects broker / dealers with which to trade, as well as their ongoing evaluations of their performance!
- The electronic and manual controls surrounding compliance with clients' investment guidelines and regulatory restrictions

Bottom Line: ***An investment adviser should be able to explain how they do what they do in a concise way that is easy to understand.***

Being an Investment adviser is also about getting it right…

Getting your investment adviser to go into detail regarding its overall investment methodology is just one part of the puzzle. You also need to be comfortable with their consistent ability to simply do things correctly. So….

- Disciplined repeatable investment process
- Make sure that your RFP contains a section on Trade Settlement and Operations
  - Make the investment adviser go into detail regarding trade settlement and account reconciliation processes
- Your RFP should also contain some questions surrounding Client Services & Reporting
  - Will you have a seasoned representative assigned to your account as a point person?
  - How often will you receive client statements?
  - Will you have access to view your account history and statements through an on-line portal?
  - How does the investment adviser communicate with clients (i.e., frequency, etc.)

Bottom Line: ***operational and customer service processes are key to a healthy client / investment adviser relationship.***

But wait – there’s More!

Now that you have an understanding of the investment adviser’s investment methodology and the key operational & client services processes, there are other core subjects to address:

- Performance Measurement
- Tone at the Top / Corporate Culture
- Compliance / Risk Management
- Technological Controls / Cybersecurity
- Business Continuity
- Fees

Performance Measurement

Make sure that the investment adviser provides you with the appropriate amount of detail pertaining to how your account's performance over time will be weighed & measured…

- Are the investment adviser's composites GIPS-verified?
  - What is an Investment composite?
  - Prepared **<u>and</u>** verified
  - Total return versus interest income/yield
- Is the performance benchmark index(ices) appropriate for the type of strategy in which you are looking to participate?
- Ask some detailed questions on how securities are valued, and performance is calculated.

Bottom Line: ***you want to walk away feeling comfortable with the investment adviser's ability to provide you with performance figures that are accurate.***

Tone at the Top/Corporate Culture

- Being a sound fiduciary for clients begins with the firm's Tone from the Top:
- Ask a few questions regarding the firm's overall culture of compliance (how is ethical behavior driven by the management team?)
- Request and review a copy of the firm's Code of Ethics
- Ask for a sample of an employee training deck

Bottom Line: ***If an investment adviser is going to manage your assets, you need to develop a level of comfort with who they are ethically.***

Compliance & Risk Management

Compliance and Risk Management are two other key topics that you want to make sure that you cover in an RFP…

- Make sure to ask some detailed questions regarding compliance oversight on:
  - Employee personal securities trading
  - Gifts & Entertainment
  - Political Contributions
  - Outside Business Activities & Conflicts of Interest
  - Training
  - Annual Compliance Reports (completed in accordance with Rule 206(4)-7 of the Investment Advisers Act of 1940)
- Pertaining to risk management, make sure to inquire about the investment adviser's processes for regularly rating inherent and residual risks

Technological Controls & cybersecurity

Let's face it: Cybersecurity has been #1 on the SEC's list of annual exam priorities for at least the last seven years, and justifiably so. So….

- Make sure you request that the investment adviser provide a detailed summary of its technological controls, including
  - Physical access
  - Logical access
  - Change Controls
  - Remote Access / Use of Mobile Devices
  - Regular Cybersecurity training
- Also ensure that the investment adviser describes its defenses against any form of cyber attack.

Business Continuity

- COVID-19 highlighted the ongoing importance for a solid Business Continuity Plan ("BCP"). So, make sure that you…
  - Ask detailed questions surrounding the firm's response to COVID-19
  - Employee training
  - Annual BCP testing

Ask for and review a copy of the firm's Business Continuity Plan!

Fees: *Transparency*

While fees should not be the primary reason to select an Investment Adviser, it is definitely an important factor. So….

Make sure that the investment adviser discloses ALL fees to you.

- Tiered fee based on assets under management
- Flat fee
- Transaction based fees:
  - As bid/offer spread
  - Or selling concession
- No sales arrangements/fee sharing
- Performance based fees
  - could incentivize the manager to take on more risk
- Subsidizing fees from proprietary products or brokered CDs
- Custody fees
  - Third Party and should not be provided by the investment adviser
  - Delivery versus payment directly to Custodian

Supporting Documentation

It’s important to ensure that the responses provided within the investment adviser’s RFP responses are backed up by corresponding supporting documentation.

Trust……but VERIFY

Time spent performing reconciliations between written responses and supporting documentation help clarify each investment adviser’s answers and can drive value-added follow-up questions.

What Supporting Documentation Should I request?

- Let's go through the list, and we'll touch on some important points to look for in each. We'll start with an investment adviser's disclosure documents….

Performance Documentation

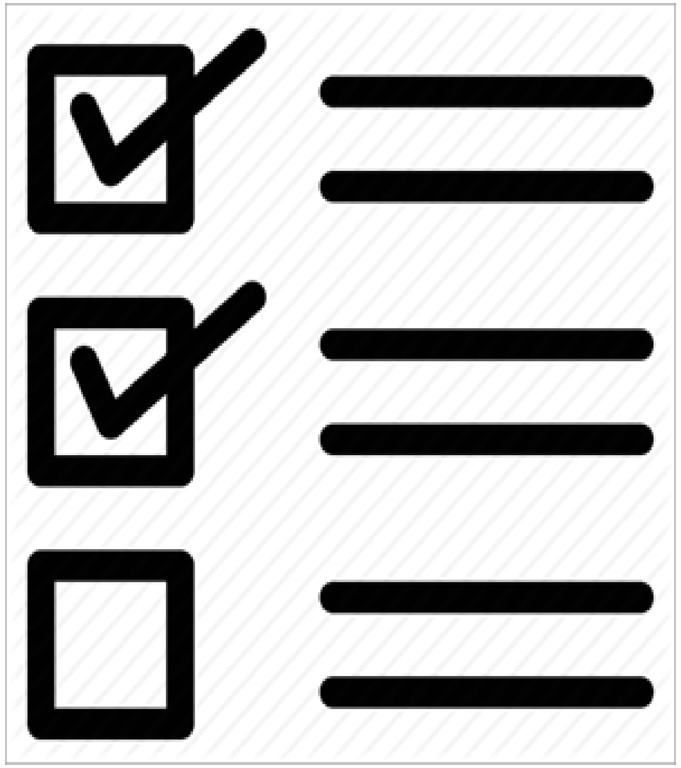
- Form ADV, Parts 1 and 2
- Strategy Profile Sheet
- GIPS Composite Reports and Verification Letter

Client Service and Operations

- Request samples of the different reports you'll receive as a new client
- Also obtain a walk-through of any electronic dashboard reporting made available to clients
- Other client communications
  - Economic updates, research reports, sample educational presentations

Design the RFP Process

- **Identify Components of your RFP**
  - **Firms Qualifications**
  - **Adviser Experience**
  - **References**
  - **Interviews**
- **Objectives: Who, What, How, and Why?**
- **Centric Driven RFP**
  - **Start with a broader screening assessment**
  - **Narrow down to client's needs**

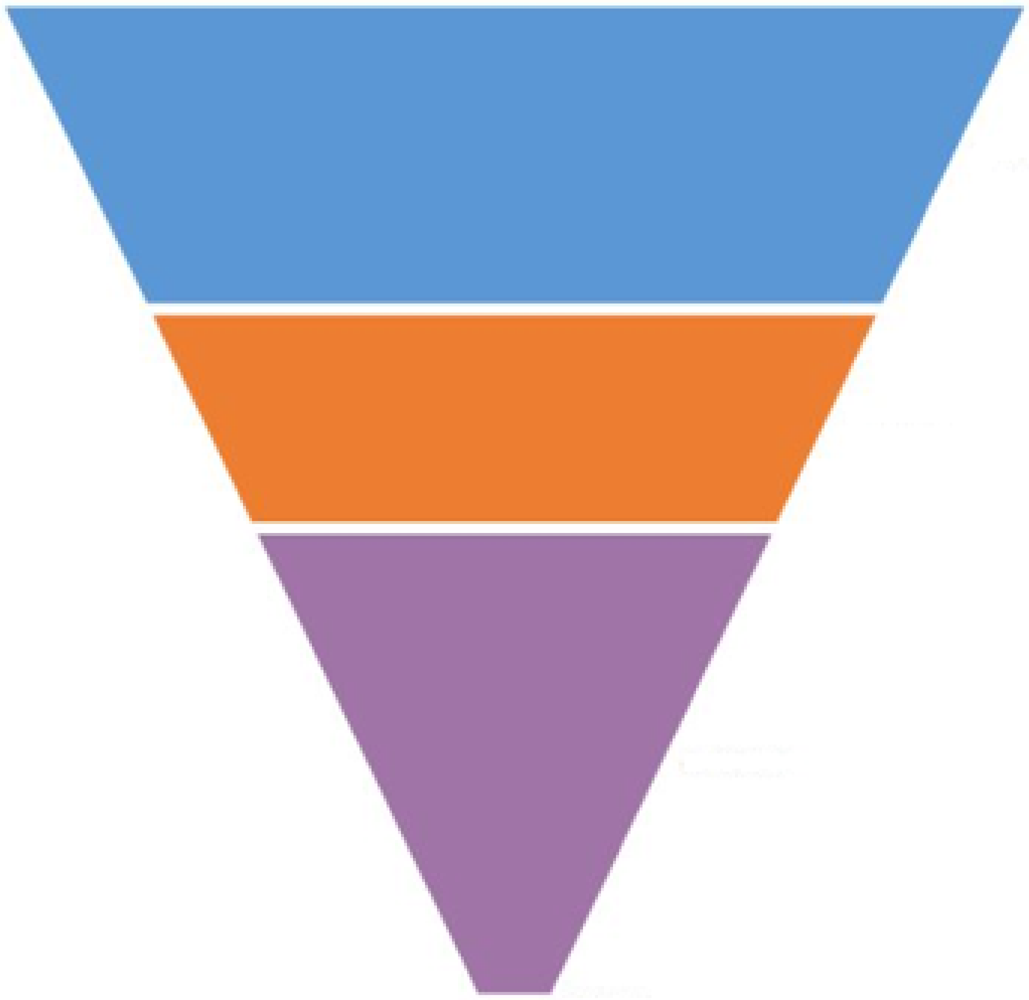


Centric Driven RFP

Broader Screening

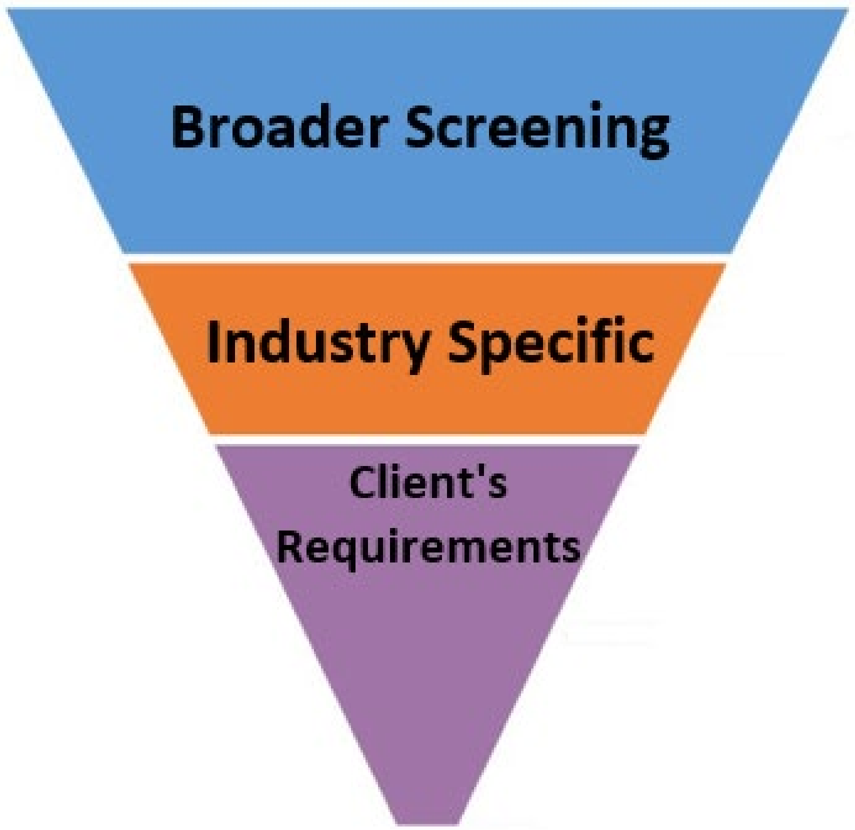
Industry Specific

Client's Requirements



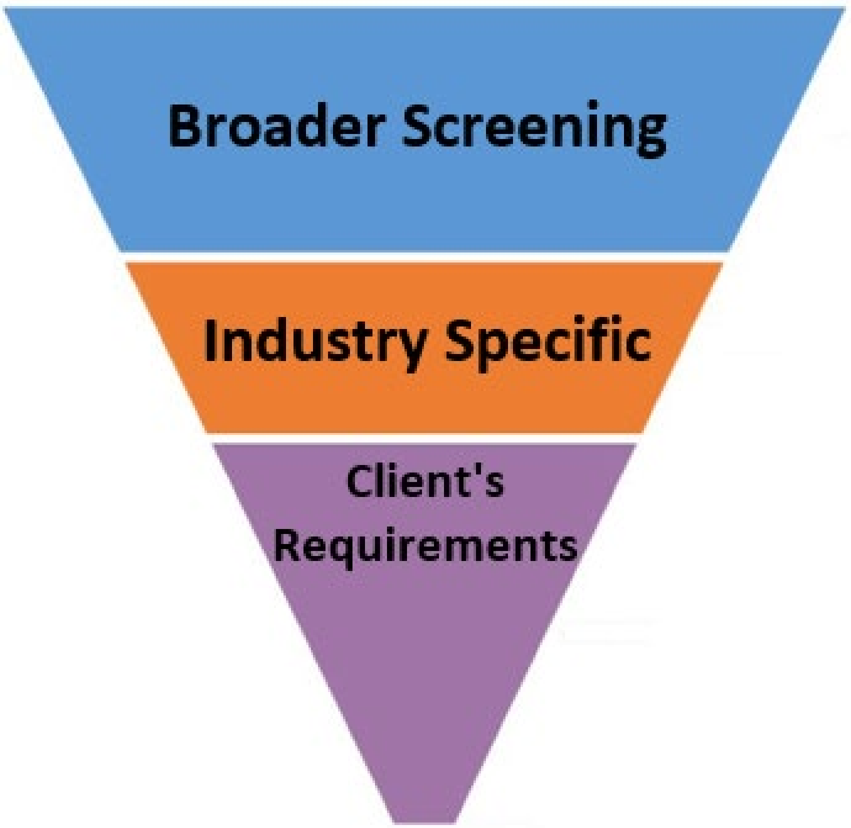
Centric Driven RFP

- Evaluation Criteria
  - Broader Screening Level
    - Firm Background
    - Firm Qualification & Experience
    - Resources
    - Personnel’s Knowledge
    - References
    - Fees



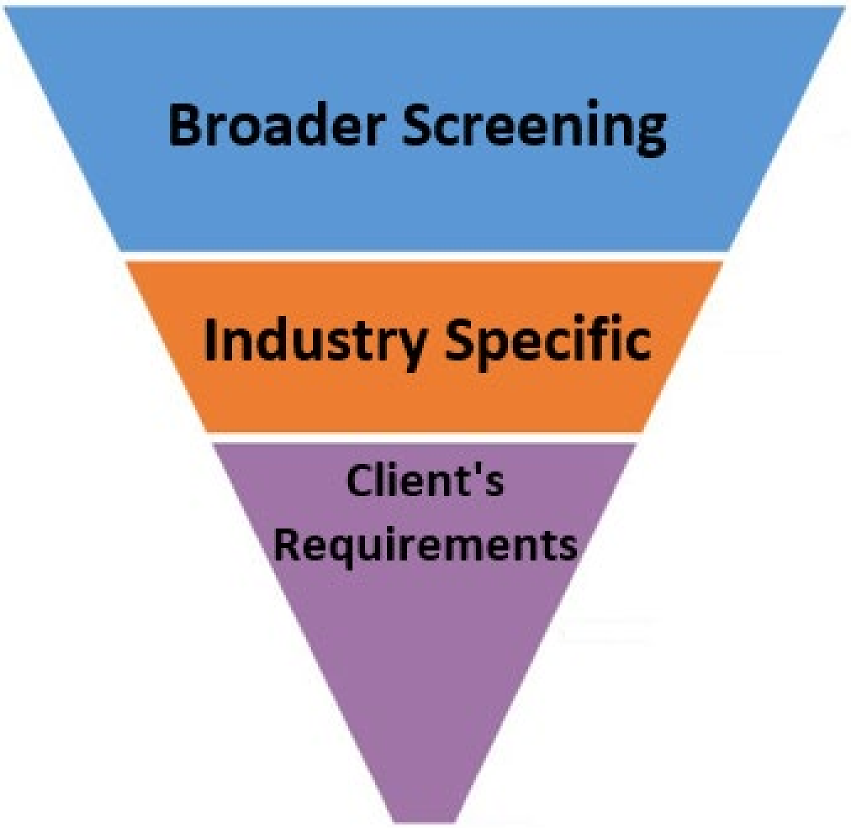
Centric Driven RFP

- Evaluation Criteria
  - Industry Specific Level
    - SEC License Status
    - Conflict of Interest
    - SEC Regulatory events
    - Legal or Disciplinary Actions
    - Investment Philosophy
    - Assets Under Management



Centric Driven RFP

- Evaluation Criteria
  - Client’s needs Level
    - Investment Goals & Objectives
    - Level of discretion
    - Service Level



Set your agency's requirements

- Clearly define your agency's priorities in the RFP.
  - Maximizing portfolio performance
    - Investment goals
    - Evaluate and benchmark past performance
  - Level of service
    - Team extension
  - Agency's interest
    - Promote community economic development
    - Support active military and veteran's businesses
    - Supports Agency's values

Due Diligence

- Ask the Right Questions
  - Area of interest
  - Interview Process

- Ask for Documentations
  - Form ADV Part 1 & Schedules
  - Form ADV Part 2A & Part 2B
  - Firm’s Code of Ethics
  - Resource
    - U.S. Securities and Exchange Commission’s website: https://adviserinfo.sec.gov/