CPIM

CENTER FOR PUBLIC INVESTMENT MANAGEMENT

A PROGRAM BROUGHT TO YOU BY:

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INVESTMENTS 225

Managing Investment Professionals

2014 CPIM Academy

Managing Investment Professionals

- Who are the typical service providers?
- Why use?
- How to evaluate – what to consider?
- How to engage for services?
- What are your responsibilities?

FINANCE OFFICER ULTIMATELY ACCOUNTABLE

Legality & Constraints

Legality

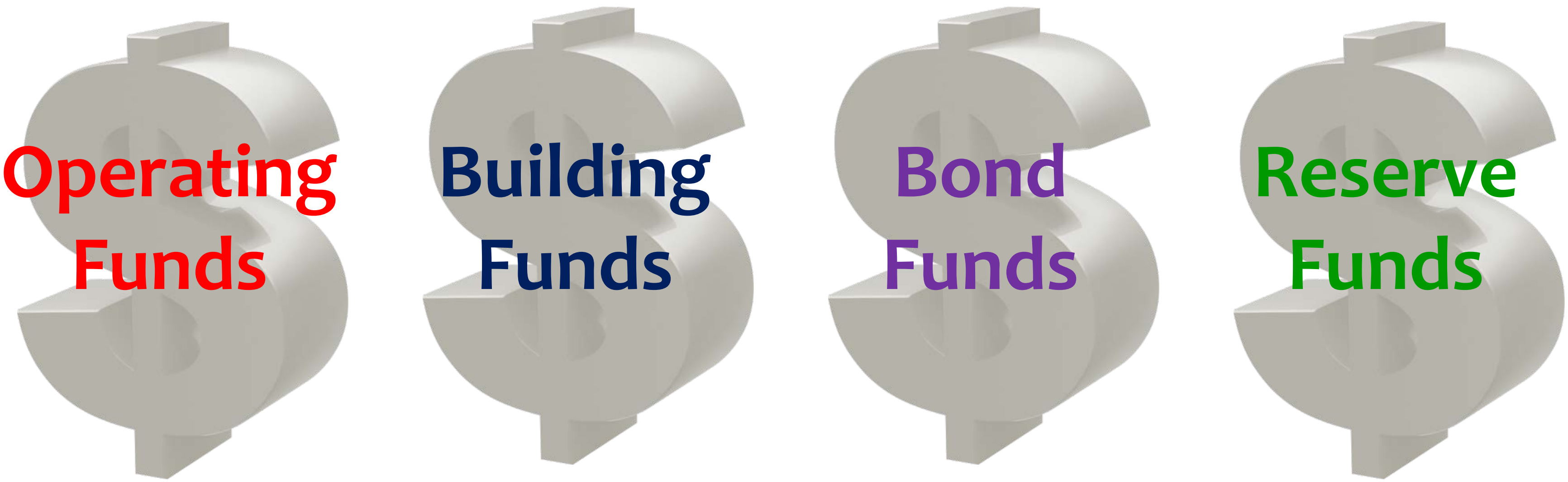
- With or without a manager, limited to permissible investments per Ohio Revised Code 135

Constraints

- Safety – low default or credit risk
- Liquidity – able to turn asset into cash quickly, without great loss of principal
- Yield – always the last consideration

What Funds Do You Want to Include?

- You may select a manager for a *general* or *specific* purpose.



Decide What You Want to Achieve With a Manager

- Investment policy creation or change
- Maturity allocation strategy
- Increased yield
- Cash flow analysis
- Portfolio reporting
- Education and training

Internal vs. External Managers

Internal Managers

- Usually are the:
  - Treasurer
  - Finance Officer
  - Other Staff of the Entity

External Managers

- Usually are the:
  - Investment Advisors
  - Broker/Dealers
  - Mutual Funds

External Managers – Advisor

- Provides investment advice
- Fiduciary responsibility
- May or may not have direct control (discretionary vs. non-discretionary)
- Executes purchases/sales
- Manages or provides advice on overall portfolio
- May coordinate safekeeping (3rd party custodian)

Definition of "Fiduciary" - fi·du·cia·ry - noun

- In law, a person in a position of authority whom the law obligates to act solely on behalf of the person he or she represents and in good faith.

Source: Merriam-Webster

External Managers – Broker/Dealer

- Provides investment advice
- No fiduciary responsibility
- Does not have direct control
- Acts as a broker when executing orders on behalf of clients
- Acts as a dealer when trading from its own account
- May provide safekeeping

External Managers – Mutual Funds

- Money market funds and bond funds
- Options are limited
- Dangers of choosing certain funds – unknowingly violate code
- Cannot own a security in a fund that you could not otherwise own directly

Discretionary vs. Non-Discretionary Authority

Discretionary vs. Non-Discretionary Authority

Discretionary

- Granting complete authority to execute investment transactions subject to general constraints set by the entity's investment policy or by contract with the advisor

Non-Discretionary

- Manager must obtain approval prior to executing investment transactions.

Advantages & Disadvantages

	Advantages	Disadvantages
Discretionary Authority	• Quicker response time to market opportunities • Free up staff time for other duties • Easier to monitor investment advisor performance	• Less control over the decision making process • Have to monitor compliance with ORC for outside manager purchases
Non-Discretionary Authority	• More control of decision making process • Higher level of input to the process	• Not able to react to good market opportunities as quickly • Staff time is used handling investments • Manager performance is more difficult to evaluate because of local government input

Passive vs. Active Management

Passive vs. Active Management

- Trading – can sell, but be aware
- ORC 135.14(F): No treasurer or governing board shall make an investment under this section, unless the treasurer or governing board, at the time of making the investment, reasonably expects that the investment can be held until its maturity.

Fees

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Fees

- Common to all external service providers
- They do not provide their services for “free”
- ***Advisors*** typically earn a fee for providing services
  - You will see the fee charged under a separate bill
- ***Brokers*** typically earn a commission for selling a security
  - You don’t see it because it is included in the price of the trade
  - Importance of seeking multiple quotes for a security

How Are Investment Advisors Paid?

Flat Fee

- Fixed dollar charge for managing investments
- Example: $10,000/year, $5,000/quarter, or any other agreed upon price

Fee Based

- Fee based on assets under management - average invested balance multiplied by percentage rate
- Example: 0.25% (25 bps) fee is calculated as $10,000,000 x .0025 = $25,000 per year

Costs of Using External Managers

- Assess "net-of-fees" – take the total yield or return that the manager earns and subtract the fees they charge; remaining earnings will be the "net earnings"
- "Net-of-fees" can be used for bank products also
- Different products have different fee structures

Choosing the wrong manager:
If the manager is not effectively managing the investments…
You can do this for FREE!

Custodian

Custodian

- Has the legal responsibility for someone else's assets
- Custodian is independent and holds the assets for the benefit of the governmental entity only
- Custody account should protect the entity's assets in case of failure of any service provider
- Responsible for:
  - Safekeeping of the assets
  - Accurate record keeping
  - Accounting of assets
  - Timely delivery of securities/interest payments
  - Reporting to the client

"Delivery vs. Payment" (DVP)

- Securities and funds are exchanged simultaneously to settle security transactions
- May be delivered directly to custodial account so assets are protected

DTCC

Securing Today. Shaping Tomorrow.℠

Benefits of Using External Managers

Benefits of Using External Managers

- Professional manager – that is their business.
- Greater access to investment markets/information
- Broker network – potentially more sources to receive best price execution of trades
- Enhanced credit research available for unsecured investments (i.e., commercial paper)
- Can complement internal resources or personnel
- Could increase internal control and "separation of duties"

Why Entities May or May Not Use an Advisor

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Why Entities May Use an Advisor or Consultant

- Develop investment policy
- Active investment strategies
- Yield curve, sector analysis, spread analysis
- Portfolio consolidation or realignment
- Access to additional research and resources (ex. Bloomberg)
- Reduce staff workload

Why Entities May Not Use Managers

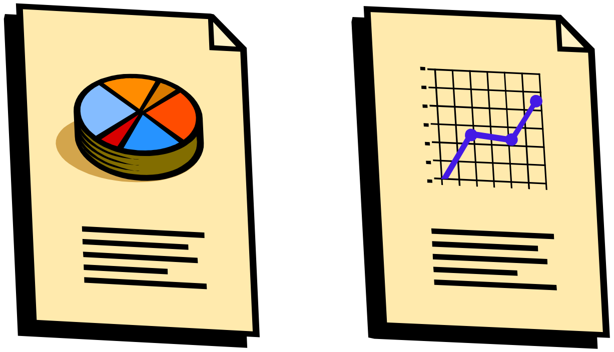
- Size of Entity – may consider themselves too large or too small
- Level of Sophistication – Experienced, well-trained staff in place
- Enjoyment – this is a fun part of the job
- Cost – What is value added “net of fees”
- Staff still needed to monitor investment program
- Finance Officer is still ultimately responsible

Selecting Investment Managers

Image courtesy of Vichaya Kiatying-Angsulee/FreeDigitalPhotos.net

Provide to Prospective Advisors

- Current Investment Policy – advisors or brokers must sign off
- Current Portfolio Listing
- Cash Flow Projections for Coming Year(s)



How to Evaluate – Information You Should Seek

- May use an RFP process (ask about)
- Organization of the firm
- Ownership of the firm
- SEC or regulatory censure/litigation
- Personnel qualifications (CFA, CPA, etc.)
- Size and type of assets managed
- Investment management style and philosophy
- Reporting practices
- Historical performance
- Fees
- References (preferably public sector)
- Personal interview for final candidates

How to Engage for Services

Investment Agreement – Formal Contract

- Term of contract
- Description of services to be performed
- Assurance of compliance with all laws, statutes and policies (sign off on IPS)
- Reporting requirements
  - Portfolio holdings
  - Maturity indicators – both maturity bands and average
  - Average portfolio yield
  - Detailed transaction summary
- Fees clearly stated

Questions

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