



SELECTING AN INVESTMENT CONSULTANT

How to find your perfect match

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An increasing number of small- to mid-size foundations have turned to an investment consultant to help them manage their funds – a trend that accelerated with the credit crisis and historic market volatility of 2008. As the jarring events of that year showed, it can be beneficial for a foundation to have the support of an investment consulting firm. However, finding the best-fit consultant for your foundation can be a daunting task. There are a number of advisory models to choose from and a myriad of issues to be considered. This paper – and the attached *Checklist for Choosing an Investment Consultant* - can help foundation staff and directors in this process.

In this white paper, we will explore the five key roles that investment consultants can play – as well as the critical question: What value can they add in each of these roles?

[Investment Partner](#)

[Fiduciary Advisor](#)

[Educator](#)

[Administrator](#)

[Supporter](#)

Consultant as Investment Partner

The core benefit of hiring a consultant is receiving investment advice based on strong research. An experienced investment consultant can help you navigate the challenging waters of goal setting, cash flow analysis, asset allocation, risk assessment, manager selection, ongoing portfolio review, and performance reporting. A consultant can also help address ad hoc financial and related requests that come up from time to time – and that often need to be resolved promptly.

A collaborative approach separates the good from the great

Experienced consultants should be able to handle the basics of developing capital market projections, investment policy statements, asset allocation frameworks and manager recommendations. What separates the good from the great, in our view, is an ability to work in a collaborative and dynamic manner. While there should be some



consistency in the advice delivered across a consulting firm, the advice must be tailored to the client foundation's individual needs and adjusted dynamically in response to a changing market and client circumstances. Truly, no size fits all. An investment consultant should act as a partner to the investment committee or board of directors, but also be willing to introduce new ideas and challenge convention. They must be responsive to clients' requests, yet also lead and educate.

There's no substitute for good chemistry

Chemistry and trust are twin aspects of a successful advisory-client relationship. Before signing on the dotted line, get to know the individuals who will actually be delivering advice and with whom you will be working on a day-to-day basis. It does no good to hire what you consider to be a great firm only to be assigned a consultant who does not meet your specifications – or fit your working style.

Like Goldilocks, pick just the right size

Look carefully at the size of the consulting firm's "AUM" – assets under management. Just as Goldilocks assessed three chairs in the Bears' house, find a consultant with the right amount of AUM, neither too large nor too small. With too few assets, an investment adviser may not have the people and resources in place to provide high quality service and, further, may not have sufficient profitability to reinvest in their business. By contrast, a firm with huge AUM may be hamstrung from an investment perspective; they may have trouble finding enough top notch investment managers to recommend across their large client base. For example, let's assume that a consultant has \$20 billion in client assets, allocates 10% of that amount or \$2 billion to US small-cap managers, wants to limit investment to 10% of a given manager's asset base, and the average manager under consideration has \$1 billion in AUM. That consultant faces the daunting task of having to identify 20 superior management companies when, in fact, it can be a challenge to identify just a handful of excellent managers in this category.

Find out where the incentives are

It's vitally important to understand the fees you will be charged (sometimes not an easy endeavor) and whether those fee arrangements present conflicts of interest. Many claim that they operate independently when, in truth, they are associated with a larger financial services organization. It is absolutely critical that you understand their incentives and whether they align with yours - not a small task with many firms.

Consultant as Fiduciary Advisor

To meet their fiduciary responsibilities, foundation boards often lean heavily on the advice, expertise and analysis provided by independent investment consultants. An experienced consultant can be extremely valuable in the formulation, documentation, and implementation of a rational and meaningful investment process. Of course, a board cannot merely “rubber stamp” the recommendations received from an investment consultant; the board still must exercise its own judgment in considering the information presented to it in light of the foundation’s goals and needs.

The “prudent investor” standard

Various laws impose a duty of care often described as a “prudent investor” standard. That is, fiduciaries must use prudent judgment in conducting or overseeing investment activities. In general terms, this standard requires a “total portfolio” approach in structuring a foundation’s investments, rather than a focus on individual investments. Modern portfolio theory often serves as a central basis for this analysis.

Process, rather than result, is the touchstone of meeting fiduciary duties

As a sound fiduciary, a board needs to adopt an overall investment plan based on the foundation’s goals, expenditure and other needs, and risk tolerance. Often articulated in an Investment Policy Statement (IPS), the plan may seek to achieve a desired investment return, consistent with an acceptable level of risk. This normally involves adequate diversification among several asset classes and investment styles, taking into account expected risks, returns, and the relationship among the various components of the portfolio. Implementation of the plan may then be delegated to outside investment managers, subject to the board’s exercise of appropriate care and diligence in selecting, monitoring and, when necessary, replacing these managers. It is critical to emphasize that the board’s decisions in this regard are evaluated in terms of process, not results. If the board diligently follows a carefully designed process, documented appropriately, and seeks expert advice where necessary, the board will normally have fully discharged its fiduciary duties.

Consultants should supplement the board’s expertise

Engaging professional investment consultants may be required, not merely helpful, if a board does not have sufficient time or investment expertise to handle the vital task of developing an Investment Policy Statement. Consultants also advise the board regarding the managers, funds and other investments they believe are best suited to implement the plan. Critically, consultants then provide ongoing monitoring and reporting, including performance and risk information evaluated in light of appropriate

benchmarks. This essential input allows the board to make decisions consistent with the prudent investor standard and to document and support the basis for those decisions.

Consultant as Educator

Many small- to mid-size foundations do not have a Chief Investment Officer and have very few investment experts on the board or staff. As a result, foundation leaders are often left to make complicated and critical decisions without feeling qualified to do so. A good investment consultant can and should make up this knowledge gap.

Foundations should engage an investment consulting firm that actively educates its foundation clients. Useful subject areas include investment terminology, the role alternative investments can play in the portfolio, and mission related investing, to name a few. In addition to structured education programs, an investment consultant plays the role of educator along the way. The consultant is responsible for setting performance expectations, helping the board understand risks, providing clear choices to the decision makers (finance or investment committee), and assisting the foundation in understanding the consequences of its spending policy.

Consultant as Administrator

The Commonwealth Fund's [2009 Annual Report](#) identified endowment management as the most critical factor affecting portfolio performance. That said, administrative support is an often overlooked yet critical issue for foundations, many of which work with a limited operating budget and staff. In some cases, foundation employees work on only a part-time basis. Those employed by small- to mid-size foundations have a wide range of responsibilities, and their priorities are typically (and appropriately) focused on the foundation's operations, programs and grant making activities. Staff may not have the time, confidence or expertise to handle finance and operations on their own. Without outside assistance, investment results can suffer, not only from inappropriate design of portfolio strategy, but also from poor execution and monitoring.

The level of service can vary dramatically

The amount of service support provided by an outside consultant is determined by the relationship established between the advisor and client. Investment advisors who have full discretion in managing funds are, by extension, providing a high degree of administration. Those operating on a non-discretionary basis can provide either a little or a lot of administrative assistance to the foundation. Some investment consultants simply are not staffed or trained to provide administrative support or they view their role as delivering investment advice but nothing more. Yet others in the field view



administration as one of their core competencies and integral to the service they provide. The latter are willing to assist foundation staff in preparing trading instructions, reconciling accounts, investigating operational issues, reviewing investment agreements of all sorts, preparing account applications and interfacing with the foundation's custodian and other professional relationships such as attorneys and auditors. These investment consultants want to ensure that their advice is implemented correctly and promptly. And, they want to minimize the chance that administrative snafus detract from the relationship.

Not all reporting is equal

Reporting is a related issue. Investment reviews provided by consultants vary in frequency, length and scope. Prospective clients should ask to see what they will receive on a periodic basis, how consultants evaluate managers and their own performance, and how they factor in fees and other expenses. They should also evaluate an investment firm's willingness to deliver, with clarity, interim ad hoc reports as well as to adjust formats to meet an investment committee's particular needs and preferences. Some consultants provide extensive capital markets commentary and statistics along with asset allocation and performance. Some board members appreciate this market background while other groups find such information to be unnecessary or cumbersome, actually making the report less useful to them. Working with a consultant who operates as an extension of the foundation's office cannot be overvalued.

Consultant as Supporter: Philanthropy and Social Commitment

An increasing number of foundations have begun the process of using their investment assets, in addition to their grantmaking, to pursue a philanthropic purpose. The most common strategies have been shareholder advocacy and proxy voting. There are many additional forms of Mission Related Investing (MRI), including negative screening (excluding certain securities from their equity portfolios), positive screening (identifying and including market leaders on various social issues), community investment (lending within low-income communities), and other alternative options (social venture capital and green real estate). Opportunities in MRI encompass a range of programmatic areas including environmental sustainability, climate change, sustainable agriculture, healthcare, community development, human rights (i.e. labor practices), and social entrepreneurship.

Finding a consulting firm who believes that foundations can invest assets to achieve both financial and social returns is the first step. Many investment consulting firms say they offer Mission Related Investing (MRI). However, a look under the hood reveals

often that they have recently entered this field, have little expertise, and have very few clients who actually require this knowledge.

In theory, it may seem a simple task to align the foundation's assets with the mission of the organization. However, that requires a wide range of resources, tools and expertise, including 1) professionals skilled at working specifically with foundation boards and understanding the complexities and obligations therein; 2) research analysts who have knowledge and access to money managers who invest using social strategies; and 3) a consulting firm that believes you should not and do not have to give up market level returns in order to invest responsibly.

Conclusion

A foundation considering the pros and cons of hiring an investment consultant should look for one that will function as a *partner, advisor, administrator, educator, and supporter*. The process for selecting a consultant typically begins with circulating a Request for Proposal (RFP) to a select a group of firms (e.g., four to six) that come recommended by other foundation clients or are known to members of the Board, followed by presentations from two or three finalists.

Attached is a checklist that we at Federal Street Advisors believe can be useful to foundations in this selection process.

For additional readings and dialogue about this topic, we encourage you to [e-mail](#) or call Jennifer Christian Murtie, Director of Foundation Services at 617-350-8999.



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Checklist for Foundations Choosing an Investment Consultant

Finding the right investment consultant can be a daunting task for foundation board members and staff. This checklist offers some of the questions that you might want to consider when evaluating prospective consultants.

Firm Profile

- What is their AUM (Assets Under Management)?
- What is the range of their clients by size?
- Who are some of their comparable clients?
- Are they experienced working with foundations?
- What is their industry reputation?
- What is their approach to manager selection and asset allocation?
- How do their fees compare to their competitors?
- Do they have the resources to maintain and reinvest in their own business?
- What is the depth of their research and administrative staff?
- What is their experience with MRI – Mission Related Investing?

What Investment Services Do We Need?

- Goal setting
- Cash flow analysis
- Asset allocation
- Risk assessment
- Manager selection
- Ongoing portfolio review
- Performance reporting
- Administrative support

What Fiduciary Advisory Services Do We Need?

- Development of the Investment Policy Statement (IPS)
- Selection and review of investment managers
- Performance reporting
- Risk monitoring in light of appropriate benchmarks

What Administrative Services Do We Need?

- Preparing trading instructions
- Reconciling accounts
- Investigating operational issues
- Reviewing investment agreements
- Preparing account applications
- Interfacing with the foundation's custodian
- Interfacing with the foundation's attorneys and auditors

What Reporting Do We Want and Need?

- Performance reporting format and frequency
- Timeliness of quarterly reporting
- Manager evaluation: what level of depth, detail and frequency?
- Willingness to prepare ad hoc reports as needed
- Capital markets commentary and statistics
- Willingness to tailor reporting format, depth and frequency to our needs

What Will the Working Relationship Be?

- Who will be our primary consultant; what are his/her credentials and experience?
- What is their style of communication?
- Will they value collaboration?
- Is their personality and style a good fit for us?
- Have they worked with similar clients before?
- How easily and quickly will the consultant respond to changing circumstances and ad-hoc requests?
- Do they seem to understand the mission and history of our organization?
- Is there a process in place to monitor their work and recommendations?
- Who backs them up when they are out of the office?

Fee Structure

- Fixed fee
- Percentage of assets
- Performance-based incentives
- Commissions
- Revenue sharing
- Combination of these

Are fees comparable to other consulting firms?

Financial Incentives

- Are there any areas of potential conflict of interest?
- Do advisors recommend only their own products or strategies, or are they entirely free to recommend outside, unaffiliated managers?
- Do they take payments from managers they recommend?
- How are individual consultants compensated?
- Are they willing to share with you a total view of fees and expenses that you will be charged?

For information about our foundation and investment advisory services, please [e-mail](#) or call Jennifer Christian Murtie, Director of Foundation Services at 617-350-8999.