



ADVISORY

A GFOA ***advisory*** identifies specific policies and procedures necessary to minimize a government's exposure to potential loss in connection with its financial management activities. It is *not* to be interpreted as GFOA sanctioning the underlying activity that gives rise to the exposure.

Selection of Investment Advisers for Pension Fund Assets (2000) (CORBA)

Background. Boards of Trustees of many state and local government pension plans have augmented their fiduciary responsibility to invest pension plan assets by retaining advisers to perform various portfolio services, ranging from advice-only consultation to fully discretionary management. As the use of professional investment advisers has become more commonplace, federal regulatory scrutiny of the relationship between investment advisers and public funds has increased.

Recommendation. The Government Finance Officers Association (GFOA) has consistently recommended that state and local governments exercise caution in their selection of investment advisers for pension plan assets. This is particularly important because the fiduciary responsibility for pension plan assets cannot be delegated to an investment adviser. GFOA urges state and local government pension plans to develop policies regarding the procurement of investment advisory services prior to retaining an investment adviser. In accordance with state and local statutes, pension regulations, or other requirements, these policies should address the following:

1. The responsible public official or the governing board should appoint a pension investment consultant and/or review committee to conduct the search process.
2. A competitive, merit-based procurement process for selection should be employed.
3. Responsibilities of the investment adviser should be clearly stated in writing.
4. The consultant and/or review committee should determine the criteria to be used in the selection. Criteria may include, but are not limited to
 - style parameters based on portfolio, including asset class and specialty focus as appropriate,
 - number of years the firm has been in business,
 - dollar amount of other public pension assets under current management,
 - dollar amount of the total assets in the specific style being considered,
 - investment performance versus appropriate benchmarks, and
 - education and experience level of key personnel
5. The consultant and/or review committee should determine the sources for candidates to be considered, including but not limited to
 - consultants' database on investment advisory firms,
 - industry reports and articles,
 - marketing materials,
 - references from other pension plans or jurisdictions, and
 - other governmental entity resources and information.

6. The consultant and/or review committee should, through the use of the RFP process, perform due diligence on candidates, including but not limited to:
 - quantitative information,
 - organizational structure of firm,
 - experience and depth of personnel in firm, including turnover of key personnel,
 - firm-specific investment philosophy and portfolio management strategies,
 - trading process, and costs,
 - system of risk management safeguards, investment policy compliance,
 - management fees, and favored nations pricing, if available,
 - references from other pension clients,
 - interviews with finalists,
 - delivery of investment advisory Form ADV Part I and Part II (including Schedule I) prior to contract execution.

After the consultant and/or review committee has made a recommendation regarding the selection of the pension plan investment adviser, the investment management agreement should include the following:

- identification of account management personnel and their fiduciary responsibilities,
- determination of professional liability insurance for errors and omissions,
- reporting requirements,
- establishment of fee and terms of invoicing and payment,
- procedure for termination of contract by either party,
- specifications related to nondiscrimination in contracting and ethics rules,
- procedure for immediate notification of any changes in firm ownership or key personnel,
- certification that the investment adviser will adhere to the investment policy.

The pension board or administrative officer managing the investment adviser contract should comply with the following ethical considerations:

- adherence to all jurisdiction's and pension board's ethics laws, rules and regulations related to procurement and involvement with contractors, including those related to political contributions,
- disclosure to pension board of any inherent or potential conflicts of interest in dealing with specific investment advisers prior to taking any official action, and
- adherence to the GFOA Code of Professional Ethics.

The pension board should develop and implement an ongoing risk control program, including ongoing compliance reviews.

- periodic due diligence review and investment and performance monitoring
- independent audits
- timely reconciliations and
- other appropriate internal control measures.

References

- *An Elected Official's Guide to Investing*, M. Corinne Larson, GFOA, 1995.
- *An Introduction to Investment Advisers for State and Local Govts*, M. Corinne Larson, GFOA, 1996.
- *Investing Public Funds*, Second Edition, Girard Miller with M. Corinne Larson and W. Paul Zorn, GFOA, 1998.

Approved by the GFOA's Executive Board, 2000.