The Pros & Cons of Outsourcing Investment Management

Presenters:

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Date:
From Banker to Bureaucrat
The Gresham Story

- Had limited knowledge about managing an institutional investment portfolio
- Was neutral about staff capabilities but concerned about risks
- Investigated what investment advisors did
- Liked why we learned
- Selling concept to city manager and city council was easy but investment officer was wary
The Gresham Story

- Investment officer had multiple duties; acknowledged need for more time and resources
- Issued RFP/selected advisor
- Results more than satisfying
- Investment officer:
  “Gee why didn’t we do this years ago?”
The Minneapolis Story
The Minneapolis Story

- Gladys Miller, City Treasurer 70 years ago
- First woman elected to City Treasurer
- Longest City Treasurer at MPLS (23 years), running for office every two years against only male challengers without ever campaigning.
- Knowing what to outsource and what to keep in house was a key to her success
The Minneapolis Story

- Due to budget cuts several years ago, City outsourced Investment Management to Investment Consultant overseeing Investment Managers with an active style.
- Like Terry, Had limited knowledge in managing an institutional investment portfolio.
- Also neutral about staff capabilities.
- $700 million investment portfolio with varying purposes.
- Currently, portfolio is yielding 60 basis points with a WAM of 1.6 years and AAA credit rating.
Definitions

• **Outsourcing** - what it *is* an *is not*

• **Active vs. Passive** Investing Strategy

• **Investment Advisors** - non-discretionary

• **Investment Managers** - discretionary

• **Investment Consultants** - as alternative
Portfolio Outsourcing

**Is/Does**
- Delegation of some work
- A time saver (a supplement to staff)
- Enhance earnings
- Improves investment policy
- Actively manages credit & rate risk
- Improves timely reporting
- Increases reputation

**Is Not**
- Abdication of responsibility
- Very seldom eliminates jobs
- A “yield chaser”
Active vs. Passive Style

- **Both styles can work**
- **Passive:** a buy-and-hold-to-maturity strategy or style
  - Requires less frequent attention but often earns lower than with active approach
- **Active:** buys with a buy-and-hold view but stays alert to possible swaps in order to enhance earnings
  - Requires more frequent attention but typically earns more than with passive approach
  - Ideally suited for use of an advisor or manager
Investment Advisors  
(non-discretionary)

- Specialize in governmental investing  
  (6 - 7 highly qualified advisory firms in US – all or most are GFOA members)
- Analogous to personal shoppers
- Know your policy and tailor recommendations to fit it
- Client retains decision-making control - advisor does not have the discretion to do so
- Are paid a flat fee – not for each transaction
- Tends to work better for governments than discretionary investment managers
Investment Managers (discretionary)

- Much the same as advisors except has discretion to make buy and sell decisions; the manager makes the decisions based on client’s investment policy and reports after the fact.

- Fee generally the same as investment advisors

- Less commonly used than investment advisors

- Not as frequently used by governments due to their need for controlling decisions
Investment Consultants
(an alternative to advisors or managers)

- An emerging trend that works for some
- Provides overall policy and strategy advice, available for periodic consultation, may assist with reporting
- Relationship less common than advisors or manager
- Providers are often also investment advisors
- Fees are lower due to less frequent involvement
- Can serve as a method to ease into a fuller advisory or management relationship later (a “toe in the water”)
What are the pros or advantages of outsourcing?

- Ability to focus on strategy (policy) and not execution
- Flexibility & Scalability of operations
- Access to the latest technology and expertise
- Credibility of professional oversight & better service guarantee
- Superior reporting and Enhanced earnings
- Staff development opportunities
What are the pros or advantages of outsourcing?

- Cost savings (lower transaction costs, also improved efficiencies in reporting & transaction execution)
- Typically no net cost (due to enhanced earnings)
- Continuity during staff turnover
- Enhanced risk management
- Expert investment policy development
# What are the Cons or Disadvantages of Outsourcing?

## Real
- Elected officials may have aversion to use of consultants
- Need to issue RFP and the process it entails

## Perceived
- **Added cost** (typically earnings actually *improve*)
- **Loss of control** (entities can require absolute control – no abdication!)
- "No need since we have good brokers" (*local brokers tend to cost more due to lack economy of scale ... also costs not transparent.*)
Cons of Outsourcing

Perceived

- Our portfolio is too small. (generally true under $30 mm)
- Our portfolio is too large. (portfolios range from $30 million to several billion)
- Quote from one investment manager with a $7+ billion portfolio: “I wouldn’t dream of managing my portfolio without an advisor”
Things we considered

What are you trying to accomplish?

We measure our success by compliance to the policy and against it’s performance benchmark.

(Right cash, at the Right place, at the Right time)

- People
- Process
- Tools/Technology

**Alignment of these three areas**
Things we considered

**People**

- Capability - Skills, knowledge, and abilities
- Expertise with *Government* portfolio management
- Communications
- How to best Build Trust
**Things we considered**

**Process**

- Time horizon of your investment portfolio ST = in house LT = outsource
- Bad publicity and Ill will to outsource
- Responsible Banking and Investing Ordinance
- Proper Controls (DVP) & maintaining your books and records
- Segregation of duties and Competition
Things we considered

Tools

- Do you have the right reporting tools?
- Best Access to Research and analysis
- I/T capacity to maintain and update
- What is allowed in your state statute?
If You are Trying to Decide
Things to consider: People, Process, Technology

- What are others doing?
- Your Accountability and engagement in the process (you can’t delegate responsibility)
- Ability to hire and retain employees Staffing morale
- Continuity and Risk Management
- GFOA Best Practice
GFOA Best Practice

Within the scope of SEC regulations, state & local laws, and any other requirements, relationships with investment advisers should address the following:

- Identification of adviser responsibilities
- Impartial procurement
- Ongoing review
GFOA Best Practice

Other key topics in the Best Practice:

- Criteria to be used in the selection process
- Risk control
- Risk tolerance
- Selection process
- Sources for potential candidates
- Advisory agreement development
GFOA Best Practice
Selection & Ongoing Review of Investment Advisors for Non-Pension Investment Portfolios

We recommend you read the entire text. To access it, go to GFOA website:

www.gfoa.org

Best Practices & Advisories
Treasury and Investment Management
Selecting and Maintaining Relationships with Professional Service Providers
Questions?
Thank you.

May your days be as pleasant as this.

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