

# SENIOR CONSULTANT

The Voice of the Investment Management Consultant

## Fiduciary Investment Management: The Role of the Investment Management Consultant

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In the current regulatory environment, fiduciary investors are becoming increasingly concerned about their legal obligations and are looking for help in understanding how to fulfill their fiduciary responsibilities. A helpful resource has recently been published that documents the most basic elements of the investment decision-making process for fiduciary investors. *Prudent Investment Practices: A Handbook for Investment Fiduciaries* was published in April 2003 by the Foundation for Fiduciary Studies and edited by the Personal Financial Planning Division of the American Institute of Certified Public Accountants. In this discussion I would like to recommend the appropriate response to this new handbook by the professional investment management consultant.

### Background

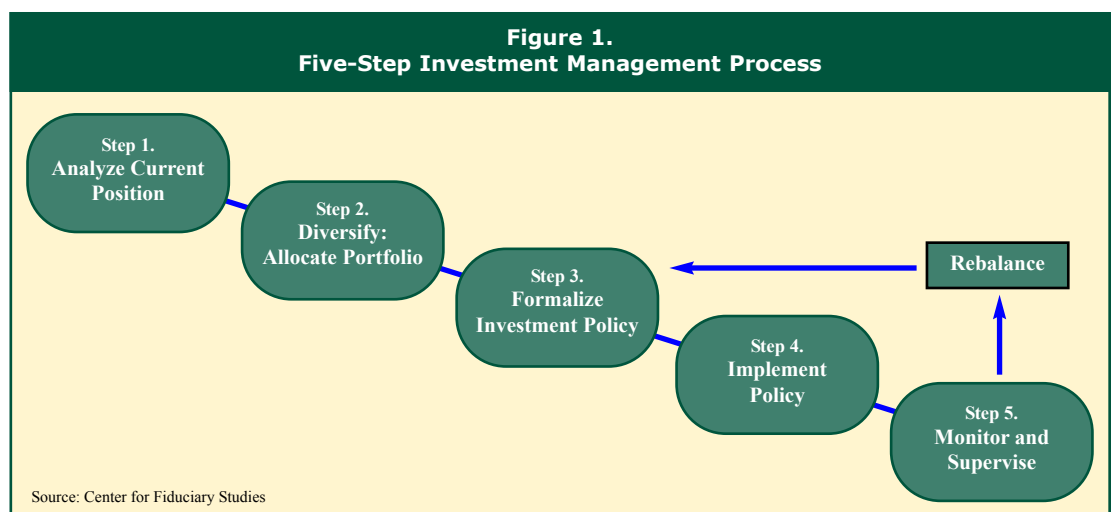
The Foundation for Fiduciary Studies was established in 2000 to develop and promote the practices that define a prudent process for investment fiduciaries. Under the leadership of Donald Trone, a veteran investment management consultant, the Foundation has identified seven Uniform Standards of Care (legislated standards) that are common to the major fiduciary investment laws. To help put these standards into practice, they mapped them to a traditional five-step investment management process (Figure 1). The result was 27 prudent investment practices, based on current

fiduciary investment law, that help to fulfill the fiduciary obligation for a disciplined and prudent investment process. All of this information has been incorporated into the 46-page handbook, *Prudent Investment Practices*, that can be purchased from the [Foundation's web site](http://www.fi360.com) (<http://www.fi360.com>).

A related organization to the Foundation is the [Center for Fiduciary Studies](http://www.cfstudies.com), (<http://www.cfstudies.com>) which is associated with the Joseph M. Katz Graduate School of Business, Center for Executive Education at the University of Pittsburgh. The Center teaches the five-step fiduciary investment management process, the 27 prudent investment practices and also offers the Accredited Investment Fiduciary™ (AIF™) and Accredited Investment Fiduciary Auditor™ (AIFA™) professional designations. The Center has also defined an auditing process to determine if a fiduciary has satisfied the requirements of the 27 prudent investment practices. They are currently training fiduciary auditors who will be looking for the evidence that a fiduciary has satisfied the 27 prudent investment practices.

The Foundation has developed the investment profession's first practice standards for investment fiduciaries. How should the professional investment management consultant respond to these developing investment standards? Clearly our primary response has to be to help our clients understand and implement

Figure 1.  
Five-Step Investment Management Process





these practice standards on a daily basis. Here are five major concepts that will help us focus on how we can use these new standards to help our fiduciary clients fulfill their obligations:

1. Define “fiduciary” for your clients
2. Show your fiduciary clients how to document their process
3. Describe the role of the investment management consultant
4. Identify the relevant investment management consulting qualifications
5. Explain how to hire an investment management consultant

### Define “Fiduciary” for Your Clients

Most of the investors with whom I’ve talked do not understand the definition of fiduciary. I would think that your clients might be similarly confused. The first step to help your clients is to define who is a fiduciary. I like to describe the fiduciary as someone who exercises discretion or control over assets, or renders on-going investment advice. The Center for Fiduciary Studies estimates that there are approximately five million investment fiduciaries in the U.S., who, in turn, manage 80% to 90% of the nation’s investable wealth. Clearly it is important to define who is a fiduciary as it pertains to investment management.

After determining who is a fiduciary, you need to determine which fiduciary laws apply to your fiduciary entity. Some of the obvious categories of fiduciaries (by relevant fiduciary laws) include ERISA plan sponsors, board members of foundation and endowment funds, trustees of irrevocable trusts and the trustees of public pension funds like school district retirement funds, fire relief pension plans and police relief pension plans. Obviously, both the fiduciary investor and their investment management consultant have to understand and monitor the relevant fiduciary laws that apply to their specific fiduciary entity.

The primary role of the fiduciary is to manage a prudent investment process (see Figure 1) without which the components of an investment plan cannot be defined, implemented or evaluated. Many fiduciary investors confuse investment performance with successful fulfillment of their fiduciary obligations. The Center teaches the critical concept that “liability is not determined by investment per-

formance, but rather, by whether prudent investment practices were followed. It’s not whether you win or lose – it’s how you play the game.”

### Show Your Fiduciary Clients How to Document Their Process

If the primary role of the fiduciary is to manage a prudent investment process, it will be critically important for someone to document the fiduciary’s investment decision-making process. This will become more apparent to the fiduciary when they learn that a fiduciary auditor may make a future visit to audit their decision-making process. Fiduciary auditors could originate from the regulatory authorities (i.e., the State Auditor wanting to audit the investments of a public fund or the Department of Labor examining ERISA plan documents), or the fiduciary audit could be ordered by the fiduciary entity itself to identify weaknesses in their current investment management process. Either way, the fiduciary auditor always asks for the documentary evidence to make a determination about any gaps in the investment process.

Most fiduciary clients with whom we’ve talked want help in the documentation of their decision-making process. Examples of these documents include the documentation of the asset allocation decision, the written investment policy statement, due diligence research on investment managers, service agreements with the investment managers and quarterly performance reports. Fiduciary auditors are currently being trained to look for specific evidence of the fiduciary’s investment decision-making process. The documents most

likely to be requested by a fiduciary auditor (Figure 2) are included and outlined in great detail in the *Fiduciary Auditor’s Handbook*, which is published by the Foundation for Fiduciary Studies. The investment management consultant can be one of the primary financial professionals to assist the client with the preparation and organization of these documents that record the fiduciary’s investment decision-making process.

### Describe the Role of the Investment Management Consultant

The two primary players in the fiduciary investment management process that need to be defined for the fiduciary client are the professional investment manager and the professional investment management consultant. We like to use the medical profession as an example of the generalist-specialist relationship that is used in the fiduciary investment management process. The investment management consultant is the “generalist” who works with the fiduciary investor on the overall investment process, which includes the 27 prudent investment practices, while the professional investment managers are the “specialists” who focus their attention on a specific asset class or a specific style of investment management (Figure 3). The investment management consultant assists the fiduciary investor in the process of selecting and monitoring their investment managers. The professional investment manager focuses their attention on specific security selection and also on the various sectors of the market that they want to overweight or underweight based on the market outlook.

**Figure 2.**  
**Fiduciary Audit Documents**

<u>Fiduciary Audit Documents (Examples)</u>	
1. <b>Analyze</b> .....	Articles of incorporation, trust documents, by-laws
2. <b>Diversify</b> .....	Risk profile questionnaire, expected returns
3. <b>Formalize</b> .....	Investment policy statement, spending policy statement
4. <b>Implement</b> .....	Due diligence research, investment manager contracts
5. <b>Monitor</b> .....	Quarterly performance reports, brokerage statements

Source: Center for Fiduciary Studies



**Figure 3.**  
**Fiduciary Investment Strategy**



Source: The Bromelkamp Group, RBC Dain Rauscher

Most fiduciary investors understand that they are not prudent experts when it comes to security selection so they wisely choose to hire professional investment managers to select individual securities for their portfolios, but a common problem develops when a fiduciary client hires a professional investment manager directly, without the assistance and expertise of a professionally trained investment management consultant. The fiduciary's inevitable unhappiness with the professional investment manager has nothing to do with the expertise and competence of the manager but everything to do with the missing steps of the investment process and the related 27 prudent investment practices. Often the client chooses to hire the professional investment manager directly because they do not see the value provided by the professional investment management consultant.

The professionally trained investment management consultant adds a great deal of value to the fiduciary investor. The role of the professional investment management consultant is to guide the fiduciary client through each of the five steps in the investment management process (Figure 4). The investment manage-

ment consultant is positioned to assist the fiduciary investor with all 27 of the prudent investment practices. The sophisticated investment fiduciary will be searching for a professional investment management consultant who is knowledgeable about the 27 prudent investment practices and has developed an

**Figure 4.**  
**Roles and Responsibilities**

	<u>Board</u>	<u>Committee</u>	<u>Consultant</u>	<u>Manager</u>
1. <b>Analyze</b> .....		Yes	Yes	Yes
2. <b>Diversify</b> .....	Yes	Yes	Yes	
3. <b>Formalize</b> .....	Yes	Yes	Yes	
4. <b>Implement</b> .....	Yes	Yes	Yes	Yes
5. <b>Monitor</b> .....	Yes	Yes	Yes	

Source: Center for Fiduciary Studies and The Bromelkamp Group, RBC Dain Rauscher



investment consulting practice that helps the fiduciary meet their fiduciary obligations.

In contrast to the investment management consultant, the investment manager has a narrowly defined role to select market sectors and individual securities for a part of the fiduciary's investment portfolio. Clearly, the comprehensive, five-step investment management process is more efficiently and objectively supported by a professionally trained investment management consultant who can focus on the whole portfolio.

You will have to differentiate your professional advisory services by explaining your investment process, your understanding of their fiduciary obligations and your unique role as a professional investment management consultant.

### Identify the Relevant Investment Management Consulting Qualifications

Another important factor to explain to fiduciary investors are the relevant qualifications for the investment professionals they will want to hire to assist them with their portfolios. A respected professional designation for a professional investment manager would be the Chartered Financial Analyst (CFA) designation, which is awarded by the [Association for Investment Management and Research](http://www.aimr.org) (AIMR, <http://www.aimr.org>). The equivalent professional designations for professional investment management consultants would be the Certified Investment Management Analyst (CIMA) and the Certified Investment Management Consultant (CIMC) designations, which are both awarded by the [Investment Management Consultants Association](http://www.imca.org) (IMCA, <http://www.imca.org>).

IMCA is clearly the primary professional association for the investment management consultant. The growth of IMCA over the past 18 years shows a steadily increasing demand for professional training for investment management consultants (Figure 5). This is a very positive message that you can eagerly share with your fiduciary clients. But to put this in context for the fiduciary investor, there are only 4,400 members of the Investment Management Consultants Association and 2,600 Certified Investment Management Analysts (CIMAs) while there are over 662,000 Series 7 licensed

Registered Representatives in the U.S. as of September 2003. Some quick math on the back of the envelope shows that less than 1% of the registered representatives in the United States are members of the Investment Management Consultants Association. The vast majority of the traditional stockbrokers in the United States are not members of the Investment Management Consultants Association (IMCA) and do not hold the Certified Investment Management Analyst (CIMA) professional designation.

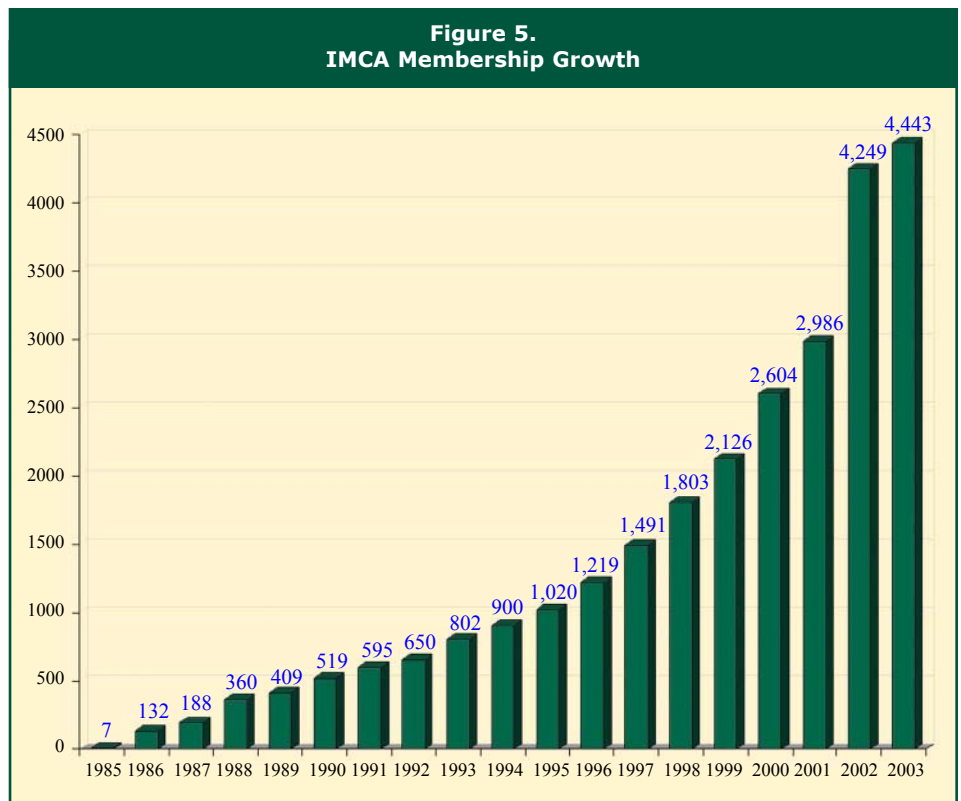
The recently developed designations from the Center for Fiduciary Studies show the increasing demand for specialized professional investment training for both fiduciary investors and the investment professionals who advise them. Helping investors understand your commitment to the investment management consulting profession and the related subspecialty of fiduciary investment management will help them identify the relevant professional training and designations they should be looking for in a professional investment management consultant.

### Explain How to Hire an Investment Management Consultant

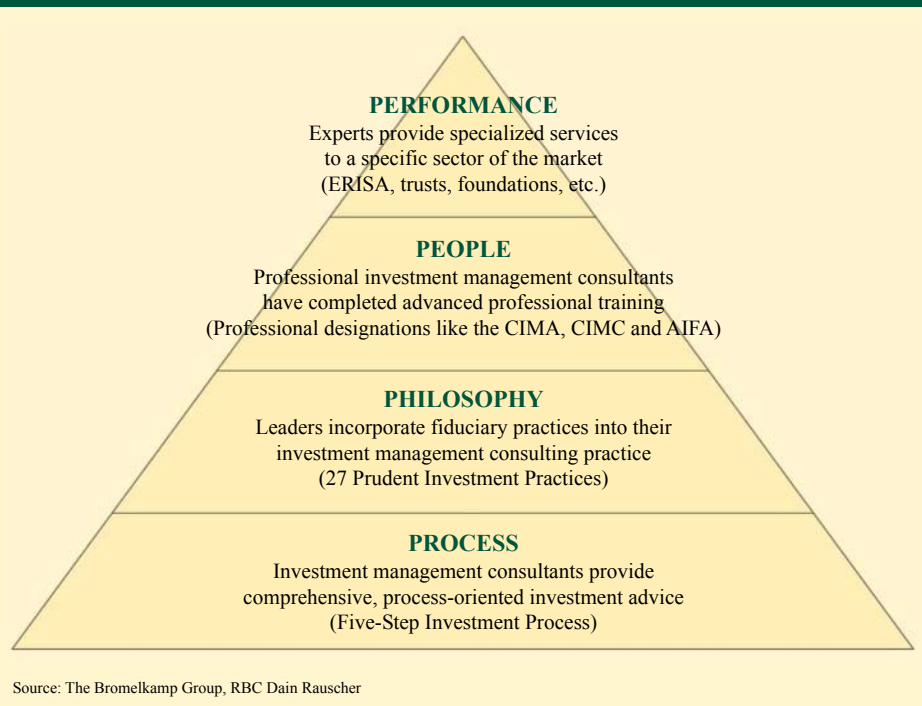
One important way to help fiduciary investors is to help them learn how to successfully search for and hire a professionally trained investment management consultant. Figure 6 shows the simplicity of the four P's of manager selection that can be applied to both investment managers and to investment management consultants. The four P's are Process, Philosophy, People and Performance. These are the types of questions you can recommend that fiduciary investors ask as they look to hire a professional investment management consultant:

1. Process
  - Do you have a defined investment management consulting process?
  - Is your investment management advice comprehensive in nature or a la carte?
2. Philosophy
  - Do you have a defined investment philosophy?

Figure 5. IMCA Membership Growth



**Figure 6.**  
**How to Hire an Investment Management Consultant**



- Is it based on generally accepted prudent investment practices for fiduciaries?
3. People
- How many years of consulting experience do you have?
  - What professional consulting associations do you belong to?
  - What are your professional certifications and designations?
4. Performance
- Are all of your client's portfolios managed in the same way?
  - Do you have specialized knowledge about specific types of fiduciary entities?
  - How much experience do you have with these types of fiduciary entities?

The average fiduciary client is overwhelmed by the many various sources of investment advice and is looking for a logical way to select a professional investment management consultant. Help them by providing them with the relevant questions to ask in their search for investment advice.

**Call to Action**

The 27 prudent investment practices are published and available – that is a fact. Your fiduciary clients are stressed out about the fiduciary scandals they are reading about in the newspapers – that is a fact. You, as the professionally trained investment management consultant, are being presented with an opportunity to provide incredible value to fiduciary investors in the coming years. Adapt your investment management consulting practice to these developing investment practices stan-

dards. Here are a few suggestions for immediate action:

- Go out and buy the Handbook and read it.
- Study the 27 prudent investment practices.
- Incorporate these practices into your investment philosophy.
- Adopt the five-step investment management process into your practice
- Assist your fiduciary clients by giving them the information they need to make prudent decisions about their fiduciary investment management process

The investment management consultants who have the courage to incorporate these fiduciary investment standards into their daily advice will not only help their fiduciary clients but will provide leadership for the investment profession in providing more value to every fiduciary investor. ■

**About the Author**

David J. Bromelkamp, CIMA, CIMC, is a Senior Vice President with RBC Dain Rauscher in Minneapolis and is a member of the RBC Dain Rauscher Senior Consulting Group. He has earned the Accredited Investment Fiduciary Auditor (AIFA) designation from the Center for Fiduciary Studies at the Joseph M. Katz Graduate School of Business, Center for Executive Education at the University of Pittsburgh. He is currently serving as a member of the Board of Directors of the Minnesota State Society of Certified Public Accountants, where he also teaches CPE courses on Fiduciary Investment Management.

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