Greenwich Roundtable™

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2016

Best Governance Practices In Delegation and Consultant Selection for Long-Term Funds

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The Research Council enables the Greenwich Roundtable to host the broadest range of investigation that serves the interests of the limited partner and sophisticated investors. This group wishes to help investors document the allocation process. Their business activities serve as an example to all of their sincere desire to educate investors and of their belief in our mission. Members of the Research Council not only provide no-strings funding but they have also assisted the members of our Education Committee during the discovery process.

About the Greenwich Roundtable

The Greenwich Roundtable, Inc. is a not-for-profit research and educational organization located in Greenwich, Connecticut, for investors who allocate capital to alternative investments. It is operated in the spirit of an intellectual cooperative for the community of sophisticated investors. Mostly, its members are institutional and private investors, who collectively control $2.6 trillion in assets.

The purpose of the Greenwich Roundtable® is to discuss and provide current, cutting-edge information on non-traditional investing. Our mission is to reveal the essence of both trusted and new investing styles and to create a code of Best Practices for the sophisticated investor.

Education Committee

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The Education Committee has been working as a group of altruistic investors who contributed their time and worked to raise professional standards. The final result is intended to demystify the complexities of investing and to bring about greater understanding. Investing in alternatives is not well documented. The Education Committee is chartered to conduct original research and develop best practices from the investors' point of view.

THE PRINCIPLES OF DELEGATION AND CONSULTANT SELECTION

Primary principles of best practices, consistent with the fiduciary duties of "care, loyalty, and obedience,"[1] include:

- **Articulating the organization's long-term objectives and its unique needs.**
- **Evaluating realistically the organization's resources, both internal and external.**
- **Setting the investment governance and operational framework.**
- **Deciding on the delegation of the investment operations.**
  - **Hiring an internal chief investment officer.**

    or

  - **Organizing a decision-making process to evaluate outsourced service providers.**
- **Hiring and monitoring those who are accountable for the performance of our investment portfolio.**

These are fundamental principles, regardless of the nature of the organization or the size of the fund. There are many ways to apply these basic principles, and the rest of this paper is devoted to discussing the many effective approaches in applying them.

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Introduction

In recent years, more and more investment committees have been recognizing that they are ill-designed to make management decisions on their long-term funds.[2] They are confusing governance with management if they decide to hire and fire managers. They do not have the time nor the skill to do all the research required to evaluate the pros and cons of a consultant's recommendations, and they rarely have done the due diligence on the recommended investment managers. The committee should delegate this function.

The committee should be clear on its mission and its responsibilities before it takes any action to delegate management authority. The most important thing a committee can do is engage in a process of thorough self-examination that will enable it to know the purpose of its assets, its limitations as an organization, and what it can realistically hope to accomplish. This process may lead the committee down one of two paths of delegation. The first path leads towards building an in-house investment staff. The second leads towards an outsourced investment function. High-functioning committees will take the time to examine the appropriateness of each path knowing their decisions will have long-term consequences.

There has been a sea change in the role of consultants. Committees have been moving toward a model that assigns accountability where it belongs. Many organizations of all sizes have begun to delegate management decisions to discretionary consultants or outsourced chief investment officers, something that was relatively unusual 10 years ago.

The selection of external expertise is perhaps the most important decision an investment committee will make. An investment committee should go about the selection of discretionary or non-discretionary consultants with the same thoroughness and due diligence that it would expect a chief investment officer to use in selecting a key investment manager. The process is necessarily complex and time-consuming. But doing it right can have a major impact on the performance of the fund and the future of its organization.

The framework for making a delegation decision and the process of selecting external expertise is what this paper is about.

"Today the questions most investment committees are asking themselves: Should we hire a chief investment officer, should we outsource, or should we make our own decisions?"

- John Griswold

"Investment committees have been recognizing that they are ill-designed to make *management* decisions on their long-term funds."

- Ann Spence

Delegation

> "The committee must make a realistic assessment of the resources available to it."

> "The key question is not "are we winning?" but "what are we trying to accomplish."
>
> - Ann Spence

Where To Start – Know Thyself

The first job of an investment committee is to understand its own organization – its mission, strategic goals, business issues, spending plans, liquidity needs, the risks it can sustain, and the role of its fund in meeting its needs. A committee should ask itself:

- What is the purpose of our assets?
- What should be our investment time horizon? Should our assets be managed as a perpetual fund?
- Can we anticipate additional contributions to our fund in the years ahead?
- How important is it that our organization receive regular payments from our fund? How much volatility can it accept in these annual amounts?
- What are our objectives? What is our willingness to accept risk and in what forms?

Then, in considering whether to hire an internal chief investment officer or seek outside expertise, the committee must make a realistic assessment of the resources available to it – including the experience level and time commitment of its own committee members.

- Have any of our members ever managed or at least governed a long-term fund?
- Can we attract additional members who have?
- What level of portfolio complexity are we capable of overseeing?
- How much time are our committee members willing to devote?
- Is the committee highly functioning? It should be relatively small where each member takes his or her role seriously and is prepared for each meeting. Discussions should be constructive and respectful.[3]
- How able are committee members and our board to maintain a long-term strategy in the face of a market meltdown?
- How dependent will we be on external expertise? What value can *we* add?

Sometimes, a committee will try to invest like the highly successful Yale investment office even though it doesn't begin to have the resources and resident expertise of a Yale or other highly successful investment funds. The result has often been disappointment. The committee failed in its initial task to know thyself. The key question is not "are we winning?" but "what are we trying to accomplish to meet the particular needs of our organization?"

Active vs. Indexed Fund Investing

A decision to invest passively through index funds may substantially reduce the need for consultants, investment staff, and other expensive services. Index investing can simplify the investment process by providing daily liquidity and massively lower costs. Of course, without a discretionary consultant or internal staff, the committee still bears total accountability, so committee members should be familiar with the broad array of asset classes and should have deep expertise in asset allocation, index fund selection, and the liquidity characteristics of exchange-traded funds.

Many argue that most markets are fairly priced, and that using active managers is an unnecessary expense. Several studies have revealed that, given the magnitude of fees, the great majority of managers fall below their benchmarks.[4] For this reason, sophisticated investors are increasingly using index funds because they believe they are particularly efficient and manager fees cut into performance. Many believe that price discovery is almost perfect, and the cost of staffing is an expense that can be avoided.

Why would a rational committee opt for an active approach? Some argue that the secular bull market of the past 20 years has uniquely benefited the index approach. Others say that indexing creates non-economic anomalies that good managers can exploit. Others are convinced that private market investments can deliver higher returns than the public markets and warrant a place in the portfolio.[5] Finally, some organizations have a better information network, have less need for liquidity, and are better able to tolerate portfolio volatility.

Even if active investing can add value, outsourced providers may not be able to exploit that opportunity. Not all consultants are equal; some are better than others in delivering excess returns.

The debate about active vs. index investing comes down to an organization's particular needs and resources.

Evolution of Outsourcing

In the early days some investment committee chairs – such as John Maynard Keynes and Roger Murray – picked individual stocks and other securities for their portfolios. Large organizations delegated the responsibility to the chief financial officer, treasurer or comptroller, who acted as chief investment officer. Small funds hired a bank's trust department to select stocks and bonds and provide quarterly reports. The performance of banks' trust departments was typically unimpressive, leading to the formation of investment consulting firms to help long-term funds with their asset allocation, manager selection, and reporting. Also, over this period, funds became increasingly aware of how their performance compared with market index benchmarks, and many comparisons were not favorable.

Still, life was relatively simpler in the 1980s and 1990s, as most portfolios consisted primarily of stocks and bonds, and the bull market of those years enabled most funds to show favorable absolute returns. Then came the superior results of large funds that invested in hedge funds and private equity, and many consultants began suggesting to their clients that they, too, should include alternative investments in their portfolios.

More and more committees became aware that a consultant could do a better job if it had full discretion to make all investment decisions. Without a chief investment officer or a consultant who exercised discretion, the committees had to approve or reject the consultant's recommendations, sometimes selecting a manager after presentations by several managers. Committees, which bore the ultimate accountability, began asking, "what value can we add?" and many concluded, not much.

Others selected asset managers, specialty fund

"Index funds have price discovery already worked out. Picking the right managers or timing the market is folly. That game is over. After fees the great majority of managers fall below the benchmark. Avoiding the mistakes that other committees make will allow you to focus on the really important goals on a relative basis."

- Charley Ellis

"Committees became aware that a consultant could do a better job if it had full discretion to make all investment decisions."

of funds, or consultants to whom they gave discretionary authority over parts of their portfolios, leading to a vast middleground in the delegation of authority. Thus a continuum of discretion for specific investment tasks ranges from 100 percent to zero.

The Need for Delegation[6]

The need for delegation in the governance of long-term funds has never been greater. The three most influential factors are the recognition that the investment committee should govern, not manage; the rapid increase in portfolio complexity; and the relaxation of old trust law practices. In some cases, there became a legal obligation to delegate.

Endowment and pension management has always been guided by the dictates of the long traditions of personal trust law. Until the 20th century, nonprofit governance in the U.S. was a matter of common law, with principles based on English trust law concepts, usually held by one person for the benefit of another.

Historically, trusts were primarily used in instances where people left money in a will or created charities. A half century ago, it was common for trustees to manage endowment assets personally. Classical trust law held that a "trustee cannot properly delegate to another the power to select investments." While legal questions about delegation existed as late as the early 1970s, the need for delegation was recognized because people cannot manage considerable sums of money on a part-time basis.

Central to these questions is the role of a fiduciary, which can be defined as one who acts in a position of confidence or trust on behalf of another. To appreciate the role of a fiduciary, the concept of an endowment dates back at least to the Middle Ages, when endowments primarily consisted of land donated by the wealthy to religious groups that used rental income from the land for financial support.

The rules governing endowments in modern times the famous 1830 case of Harvard v. Amory that established "The Prudent Man Rule," which essentially stated that managers were free to make any investment they thought wise as long as they did not exceed the bounds observed by a prudent man.

A major breakthrough in endowment and public pension management occurred with the 1972 introduction of the Uniform Management of Institutional Funds Act. UMIFA established four key provisions: 1) that endowment funds could be pooled for investment purposes, similar to a mutual fund; 2) the "prudent man" rule could be applied to the endowment as a whole and not each individual investment; 3) trustees may delegate investment management responsibilities; and 4) capital appreciation may be spent without violating the prohibition against spending principal. In 2006 the Uniform Prudent Management of Institutional Funds Act, or UPMIFA, eliminated the "historic dollar value" rule, which impacted those funds whose value, owing to stock market contractions, was below the value of the original gifts.[7]

Today the rapid growth of US public pension fund assets, increasing portfolio complexity, and a change in the US trust law, the Restatement of Trust (Third)[8], formally permitting the delegation of investment decisions from trustee to internal staff or external agents, will drive the next stage of pension evolution. The trust law change permitted, often required, trustees to delegate investment decisions to those with the necessary skill and knowledge and forced committees to understand the parameters of a prudent delegation. A better understanding of these parameters, specifically when focused on delegation to internal staff, puts a spotlight on the need to prudently match staff resources (depth and skill set) with investment approach and portfolio complexity. The evolution of US public pension and large tax-exempt funds in the twenty-first century will be defined by how this matching is accomplished.

Accountability

Main Choices for Accountability

For all organizations – endowments, foundations, pension funds, insurance companies, sovereign wealth funds, and family funds – the board of directors is ultimately responsible for its investment funds. The board usually appoints an investment committee to advise it. This committee typically selects and annually evaluates one of the following:

- An internal chief investment officer, who is typically hired by the chief executive or chief financial officer with committee input. The chief investment officer will then hire the rest of the investment staff. It will then manage the entire investment program, subject to the oversight of the committee. The chief investment officer may often hire a consultant to supplement its staff.
- A discretionary consultant or an outsourced chief investment officer, who will manage the portfolio and have total discretion over all decisions. A discretionary consultant is subject, of course, to the oversight of the committee. The discretionary consultant may be a consulting firm or an asset manager who will manage the entire portfolio or manage a particular sector of the fund as an investment manager. A discretionary consultant will, of course, be accountable for the fund's performance[9] if its mandate encompasses the entire portfolio
- A non-discretionary consultant,[10] who will advise and make recommendations to the committee on investment policy, asset allocation, and the hiring and monitoring of all investment managers. By retaining decision-making authority, the committee will, in effect, be the manager and will be accountable for the fund's performance.

In practice there is a continuum between a non-discretionary consultant and a discretionary consultant, depending on which decisions the committee delegates to an outside firm. It is not necessarily an either/or decision. For example, the committee can give an outside firm total discretion over one or more asset classes, such as hedge funds or private equity, making the firm accountable for that asset class. In that capacity, the outside firm would be serving as the portfolio manager of that asset class. But the committee will bear accountability for its allocation to that program and for the balance of the portfolio.

To do this, most organizations have typically sent out requests for proposal, but their decision on whom to hire often came down to whom they knew, who they comfortably felt would provide the best fit. Now, *best fit* is crucial! But it is not sufficient. A committee needs to consider firms well beyond the range of their acquaintances in order to narrow their choices to those few that are most qualified. Then it needs to see which of those few should provide the best fit.

The Spectrum of Accountability

What is the difference between a discretionary consultant serving as a chief investment officer and a non-discretionary consultant who makes recommendations? The distinction is not always hard and fast.

> "The distinction between a discretionary consultant and a non-discretionary consultant is an evolving field, with a range of ways to delegate authority between the committee and the discretionary consultant."

> "A discretionary consultant will, of course, be accountable for the fund's performance."

Accountability (cont.)

“The discretionary consultant may be better suited than the committee alone to address portfolio complexity and to contend with an increasingly rigorous regulatory environment.”

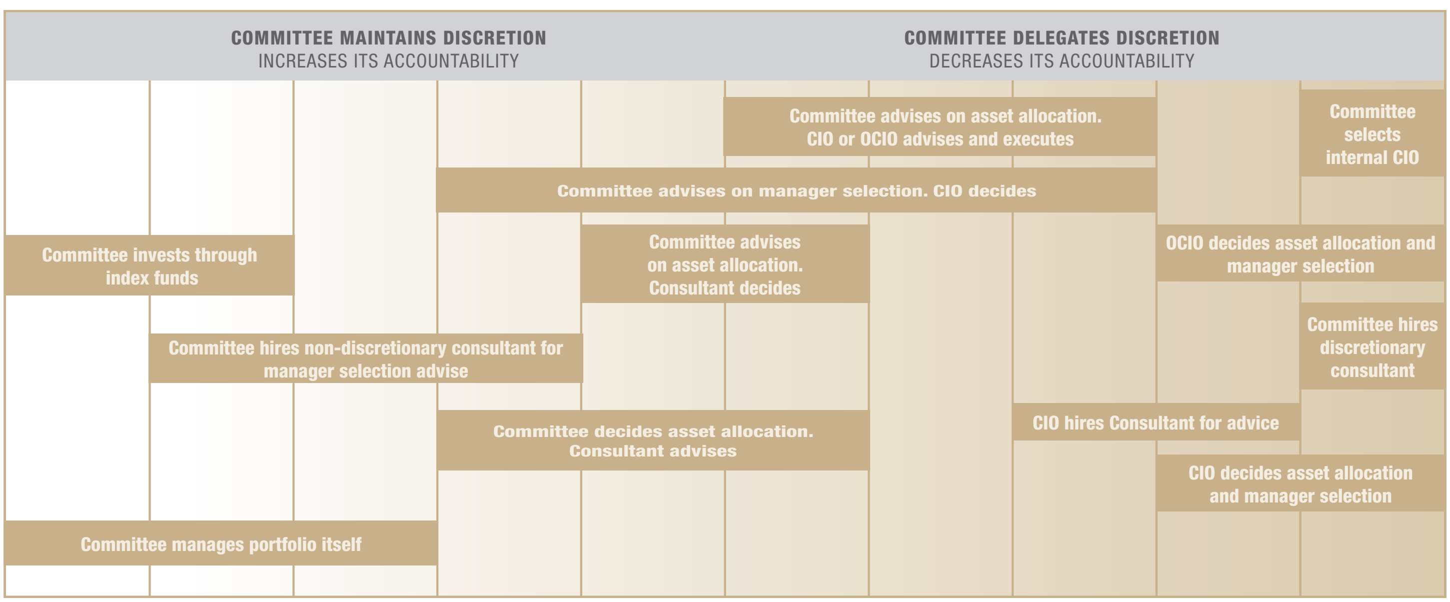
- Ray Gustin

We define the discretionary consultant here as one, like an internal chief investment officer, who has total discretion and accountability within the objectives set by the investment committee. But this is an evolving field, with a range of ways to delegate authority between the committee and the discretionary consultant.

On one end of the spectrum, the discretionary consultant has complete discretion and is accountable for the results. This consultant may be a consulting firm or a well-diversified commingled investment fund whose investment strategy is consistent with the organization’s objectives. On the other end of the spectrum the committee makes all asset allocation and manager selection decisions. By making those decisions, the committee assumes responsibility for the resulting investment performance. It must be aware that it is assuming operational responsibility, beyond governance, and is accountable for the results.

The discretionary consultant can make and implement decisions in a timelier manner, without the extra work of gaining committee approval for each decision. The discretionary consultant may have more investment expertise, better holistic judgment, a fully developed network of relationships, and better access to quality managers than members of the committee. The discretionary consultant may be better suited than the committee alone to address portfolio complexity and to contend with an increasingly rigorous regulatory environment.

THE CONTINUUM OF ACCOUNTABILITY



0% **Scale of delegation.** The left pole represents zero delegation or 100% committee accountability. The right pole is100% delegation, with delegation with the committee still responsible for review and the decision to retain the consultant. 100%

DIAGRAM 1.

Internal Chief Investment Officers

If an organization has enough assets, it may establish an internal chief investment officer and staff. Many large funds prefer to do so in order to avoid the costs of relying solely on a consultant. But that can be the wrong reason, because it is very costly to build a staff that can cover all strategies in a globally diversified portfolio. This is not a place to scrimp. Building an internal management team requires the ability to attract and retain talent, which may be difficult if the organization is not located near a major metropolitan area.

All too often an organization may have problems paying competitive salaries to attract the best investors. And even if its compensation is competitive, high-performing internal staff can be more costly than expected, as its top talent is bid away by other funds. It is important to find the right person who has a personal commitment to the organization.

Valid reasons for internal management include greater control and stakeholder comfort. Internal management also affords the opportunity to leverage the organization's reputation to attract the best talent and obtain better deal flow, networking opportunities, and contract terms. Moreover, when internal staff gains access to an attractive private investment opportunity that is in short supply, it can usually take as much of the available commitment as it wants, while a consultant has to allocate the available commitments among its various clients.

An internal chief investment officer may be selected by the investment committee or, with the committee's input, by the organization's chief executive or chief financial officer. The chief investment officer will then hire the staff.

Many internal chief investment officers also hire a non-discretionary consultant, often as an extension of their staff. Consultants can provide specialized knowledge and deeper due diligence on a wide range of investment managers. They can support internal research and provide second opinions on portfolio construction, as well as advice on manager monitoring, risk reporting, performance attribution, and strategy timing. In this way, consultants can add value to the staff's primary research and decision making. The purpose of a consultant is to improve performance, not to provide cover for the chief investment officer in case an investment performs poorly.

Many internal chief investment officers understand that they should select securities internally in only those asset classes where they can excel. While they and their staff can often competently select marketable securities, they should use outside managers wherever those managers can add value.

Specialist consultants provide advice or in some cases fully discretionary management for a single asset class, such as hedge funds or private equity. By focusing exclusively on just one specialty these consultants, through the economies of scale, can provide their in-depth, non-conflicted research for reasonable fees.

Recently some of the larger more successful internal chief investment officers have begun managing assets for external clients by commingling outside assets with those of their organization.

"As a committee we need to be testing the quality of the thought process of the people who are making decisions."

- Myra Drucker

"It is very important to find the *right* person who has a commitment to *your* organization."

- Bill Jarvis

"A discretionary consultant can make and implement decisions in a timelier manner, without the extra time and work required to gain committee approval for each decision."

"Not all consultants are equal; some are better than others in delivering excess returns."

Discretionary Consultants

If the committee finds an outstanding external firm that can invest its fund competently and in a way that is consistent with the needs of its organization, then delegating the entire management of the fund, or even a portion of the fund, can be a highly prudent decision.[11] The committee, however, will still bear responsibility for the prudent selection of any consultant and for reviewing at least annually its actions and performance in order to decide whether to continue retaining it. In any case, the committee must continuously test the quality of the thought process of the people making the decisions.

Until recently, outsourcing has been seen exclusively as a solution for small funds. But some organizations with an internal chief investment officer might find a discretionary consultant less expensive than a fully staffed investment office. A consultant can supply the organization with substantial investment infrastructure for far less than the cost to build it in-house. Moreover, a consultant may have developed a network of relationships to gain better access to quality managers than an internal chief investment officer.

The role of discretionary consultant is relatively new, and many players have now entered the field. The distinctions among various types of consultants is increasingly blurred. A discretionary consultant may be a consulting firm or an asset manager that will design a customized portfolio in a separately managed account based on the client's particular objectives and risk tolerances. A discretionary consultant may also be an outsourced chief investment officer firm that has spun-out from an internally managed organization, or a fund of funds that provides a well-diversified commingled portfolio that the investment committee believes is managed in a way consistent with its own objectives.

By having total discretion over the portfolio, as previously mentioned, a discretionary consultant can often make and implement decisions in a timelier manner, without the extra time and work required to gain committee approval for each decision. More and more organizations are showing interest in a discretionary arrangement. This is because:

- Unless there is a well-staffed internal investment office, the committee does not generally have sufficient expertise and time to deal with the difficulty of in-depth due diligence and portfolio construction in both public and private markets.
- Global markets are more and more complex and evolving rapidly. A consultant with discretionary authority can respond to them more effectively than the committee can.
- Regulatory pressures have been growing, and a discretionary consultant enables the investment committee to outsource a significant portion of the management accountability for meeting regulatory requirements (while retaining oversight accountability, which it can never shed).
- Outsourcing may reduce (but not eliminate) potential litigation against the fund's owner or sponsor with respect to portfolio-related issues.
- A full-service[12] discretionary consultant can extend its management into a client's back office.

Accountability (cont.)

Because of its broader responsibilities and its legal accountability, a discretionary consultant charges higher fees than a non-discretionary consultant.[13] Even so, the committee will still bear responsibility for the prudent selection of the discretionary consultant. While a discretionary consultant reports to the investment committee that hired it, it also has a strong dotted line relationship with the organization's chief financial officer and chief executive, with whom it must work hand-in-glove on cash flows, contracts, legal issues, and committee communications.

Commingled Portfolios. If the committee chooses a commingled portfolio, it will have little influence, so the portfolio's investment policies and asset allocation should be those that the committee endorses as its own. The fund will own units of that portfolio and not directly the underlying assets. The difference is moot until such time as the committee wishes to redeem its assets. Then it can be faced with delays resulting from lockups, from required notice prior to redemptions, or from gates that limit the amount of a commingled fund that can be redeemed at any one time. If the committee wants to redeem in kind, that may or may not be an option. Withdrawals from a commingled portfolio may still be required to prefund uncalled commitments, pay fees on unredeemed assets, and effect a dilution on remaining investors.

In choosing between a commingled portfolio and a customized portfolio, it is advisable to consider overall fees, liquidity restrictions, and whether a commingled portfolio owns its underlying assets or is subject to possible lockups on some of its portfolio investments. Commingled portfolios enjoy the equitable distribution of high-quality, limited-supply investments across the entire investor base. Customized portfolios may be faced with equitable allocation issues with capacity constrained managers. Finally, a commingled portfolio often involves a lower initial investment which may be attractive to the organization.

The committee might alternatively choose to use two or more commingled portfolios. In that case, the committee would retain accountability for selecting them and allocating assets among them. The committee would be acting as its own chief investment officer and would bear the accountability.

As clients have become more receptive to considering the external management of their assets, a small but elite group of entrepreneurs have migrated from larger firms to form boutiques that make outsourced chief investment officer service their sole focus. Many accept only a limited number of clients and assets. At the same time, established consulting firms and asset managers, with their deep staffs, have added outsourced chief investment officer service to their product mix. Clients will want to know how these firms allocate the limited capacity of the best investment managers between their outsourced chief investment officer and non-discretionary clients.

The outsourced chief investment officer may be a firm that offers commingled funds for asset allocation categories, a consulting firm offering an outsourced chief investment officer relationship, or an internal chief investment officer spinning out of a long-term fund who now accepts other institutions' funds to invest in separate accounts.

"The committee will bear responsibility for the prudent selectioin *and retention* of the discretionary consultant."

"Withdrawals from a commingled portfolio may still be required to prefund uncalled commitments, pay fees on unredeemed assets, and effect a dilution on remaining investors."

"David Swensen's client is Yale University. He says, that active strategies demand un-institutional behavior from institutions creating a paradox few can unravel. Establishing an unconventional profile requires accepting uncomfortably idiosyncratic portfolios that often appear imprudent in the eyes of conventional wisdom. The real hero was the Yale Investment Committee. They were the buffer between the administration, the alumni, and the appearance of imprudence."

- Peter Bernstein

The Outsourced Chief Investment Officer

The Ford Foundation in 1969 commissioned a study which found that most endowments chronically underperformed their rate of spending. It issued a grant of $2.8 million to create a Common Fund for Nonprofit Organizations. In 1971 the Commonfund was founded to pool the assets of colleges and universities, to relax the restrictive interpretations of the prudent man rule, and to provide professional investment management along the lines of Modern Portfolio Theory. The first outsourced investment model was created.

Harvard formed an investment management company in 1974 to exclusively manage its endowment. Meanwhile in Charlottesville, the University of Virginia appointed its first investment officer, initially to fulfill the wishes of the investment committee. In 1985, Yale hired David Swensen as chief investment officer. Swensen set the gold standard for endowment investing with a set of principles that emphasized broad diversification and an equity orientation, avoiding asset classes with low expected returns such as fixed income and commodities. Particularly revolutionary at the time was his recognition that less liquid investments offered better returns, which led Yale to make early investments in hedge funds and venture capital. Swensen also pioneered other innovative principles such as regular portfolio rebalancing and hiring small managers who stayed disciplined in the size of their fund. Yale's model became the blueprint for other early adopting investors. Endowments got larger, becoming a competitive advantage in hiring professors. Some universities were getting 30 percent of their budget from their endowment. Diversification into alternatives started to outperform traditional strategies by a wide margin. Performance was coming from talented managers rather than market direction. Due diligence became more important. A dedicated CIO and staff were needed to manage the myriad of investment options.

In the suburbs of Philadelphia in 1988 Jonathan Hirtle left the Security Sales Division of Goldman Sachs to launch an outsourced CIO service for private investors. Hirtle, Callaghan & Co as an independent, for-profit model was unique in its day because it adopted an open architecture approach to portfolio management and the best fiduciary practices for its management culture. Participating in a larger pool provided families and foundations with extraordinarily broad diversification and access to investment opportunities that would generally not be accessible.

More recently, the success of Yale, Harvard, and Stanford to generate attractive returns prompted a number of former endowment investment teams to open outsourced CIO firms. In 2003, Investure was the first with Smith College as its first client. Smith began allocating its portfolio to less liquid strategies in the 1990's. The complexity of these strategies had grown significantly. Smith, Haverford, and Bryn Mawr started to explore ways to collaborate and to pool their resources, with the aim of creating a shared investment office. For several reasons the vision of a shared investment office became impractical. Later that year, Smith's investment committee members met with Alice Handy who was leaving the University of Virginia. Smith agreed to help her launch Investure, the first OCIO endowment specialist. Investure, working with an enviable list of manager relationships, built a high-performing portfolio for Smith College. Moreover, Handy cultivated a strong staff and limited the number of clients. Investure's subsequent strong performance caused other endowment CIOs to spin-out. Their multi-asset class experience and their relationships provided a distinct client advantage. Investment committees were freed to function at a more strategic level.

Today the broad flow of intellectual capital, top chief investment officers, from sophisticated endowments and pension funds, is moving into entrepreneurial structures that offer OCIO services. They tend to be small capacity-constrained boutiques. Their partners align their mission and their incentives with their clients. Their manager relationships are personal. They backed them early-on and they funded them when these managers were down. They have weathered many storms and all have done so with full portfolio accountability. The best communicate their philosophy and overcome differences with their investment committees.

However the endowment specialist model is not a best fit for all. The large consulting firms and investment banks may be more appropriate for most long-term funds, especially those in remote geographies. These firms can provide a wide range of services for a wide range of needs. The endowment specialist model, like the Yale model, is not for everyone, nor should it be viewed that way.

> "Today the broad flow of intellectual capital, the top chief investment officers, from sophisticated endowments and pension funds, is moving into entrepreneurial structures that offer OCIO services."

"In practice there is a continuum between a non-discretionary consultant and a discretionary consultant, depending on which decisions the committee delegates to an outside firm. It is not necessarily an either/or decision."

- Ray Gustin

Non-Discretionary Consultants

Non-discretionary consultants typically bring recommendations for asset allocation decisions and for the selection of investment managers. Non-discretionary consultants customize their advice on a client-by-client basis based on each client's particular objectives and risk tolerances.

With funds that have an internal chief investment officer, the non-discretionary consultant brings recommendations for asset allocation and manager selection decisions to the chief investment officer and his staff.[14]

Where there is no internal chief investment officer or staff, the consultant brings recommendations directly to the investment committee. The committee makes those decisions and must be aware that it is assuming operational responsibility, beyond governance, and is accountable for those results. The committee is confusing governance with management if it decides on the hiring and firing of its managers.

Committee members who work with a non-discretionary consultant are more directly involved. The committee has the opportunity to question the consultant on the due diligence underlying each recommendation. A committee member who is a seasoned long-term investor can often work with the consultant to help source better investment managers and seek better outcomes.

If the committee decides to hire a non-discretionary consultant, members must make a commitment to devote additional time to understand, question, and decide each of the consultant's recommendations. Members must also be willing to be available for special meetings on short notice to decide issues that may arise between regularly scheduled meetings. An alternative is to appoint a subcommittee to make such interim decisions. In any case, deferring decisions for another three months can incur opportunity costs.

We describe the difference between a discretionary consultant and a non-discretionary consultant as if it is an either/or decision. In practice, there is a continuum, depending on which particular decisions are delegated to a consultant and which decisions are retained by a committee.

A committee can gain some of the benefits of holding the non-discretionary consultant accountable without the extra cost of a discretionary consultant if, in each case, it asks the consultant to make a single recommendation rather than a choice of alternatives, and the committee expects to approve each of those recommendations. But the fiduciary responsibility would still reside with the committee. By deciding whether to approve each recommendation, the committee would be riding a fine line between *managing* the portfolio and *governing*.

Conflicts of Interest

Some consultants have supplemented their fees with services that involved conflicts of interest. Some consultants have been affiliated with firms that manage money. Some have supplemented their fees with rebates from investment managers through sponsorship of pay-to-play client conferences,[15] or through special services offered to investment managers.

Conflicts arise when firms make recommendations from a short-list or a platform where the criteria is more oriented to a manager's capacity or is more driven by how a provider runs its business than by what is truly best for a client's portfolio.[16] Conflicts of a discretionary consultant or non-discretionary consultant can potentially be eliminated if 100% of a firm's compensation in any form is from long-term funds seeking advice. The reasons for anything less than 100% must be fully transparent and understood – and that is not always the case.

Some firms offer a choice of discretionary *and* non-discretionary services. This has the potential for conflict. Who gets the best attention and opportunities? The same potential for conflict may exist for the allocation of limited capacity managers for a customized portfolio – which portfolios gets a full position?

The Outsourcing Marketplace

What are consultants and what services do they provide? It is important to understand the business model of the firm we intend to hire. Consultants, especially those with non-discretionary or specialty business models, can supplement an internal staff's skill and reach. Their fee structure typically employs a retainer and fee-for-service pricing model. Consultants offer many potential services such as asset allocation, manager search, manager selection, manager monitoring, performance attribution, benchmarking, peer research, and committee education. These non-discretionary consultants operate on a best-efforts basis with generally no fiduciary responsibility or accountability for portfolio returns.

With discretionary consultants it is even more important to understand the business model of the firm we intend to hire because the committee will effectively be marrying the firm. The consultant with a full discretionary mandate acts as internal staff without being carried on the organization's payroll. It provides investment decision-making and operations functions for the organization. Discretionary consultants are typically compensated with a management fee plus a performance fee pricing model. Compensation is similar to a fund of funds' management and performance fee. Outsourcing to a discretionary firm may provide a better alignment of interests. Discretionary mandates can range from a one-size-fits-all commingled fund to a customized portfolio in separate accounts. Some firms allow a limited degree of discretion as the committee gets comfortable with the relationship. But remember that limited discretion will limit the degree of accountability for portfolio returns.

"Some consultants have supplemented their fees with services to managers that involve conflicts of interest."

The Selection Process

> "A rigorous and transparent process reduces our fiduciary risk and the appearance of imprudence."

After the committee has thoroughly analyzed its organization and decided to delegate its investment operation, what are the next steps? Outsourcing has a broad array of choices and implications. Becoming an educated consumer takes patience and a commitment to the process. Moreover a rigorous and transparent process reduces our fiduciary risk and the appearance of imprudence.

Firms To Consider

What kinds of firms should we, the investment committee, consider for our consultant (discretionary or non-discretionary)? There are at least five types of firms:

- Consulting firms that will customize a client's entire portfolio through asset allocation and manager selection in a separately managed account. Such firms may offer both discretionary and non-discretionary relationships with clients, with respect to asset allocation, manager selection, or both.
- Investment banking and diversified asset management firms that will customize a client's portfolio through direct security management in separate accounts or a fund of funds with a selection of external managers. Such firms often favor their own in-house products or funds, but they are usually willing to engage in an open-architecture structure as well.
- Outsourced chief investment officer firms that have spun out from successful in-house investment offices, to operate independently and to manage other organizations' long-term assets. These firms offer either customized portfolios in separate accounts or commingled funds, or both.
- Large organizations that manage their long-term funds in-house and will commingle outside assets either with their entire portfolio or with specific asset classes.
- Asset management firms that manage commingled funds, some of them appropriate for a client's entire portfolio and others in specialized asset classes. Some of these firms may also offer discretionary and non-discretionary services such as asset allocation, as well as investor education, shareholder communication, and administrative services.

What To Look For

To be considered for best fit, a candidate should meet the following criteria:

- Independence (lack of any conflicts of interest) and organizational stability of the firm.
- Meaningful experience with similar clients.
- Willingness to accommodate the degree of discretion, or lack of discretion, that the committee might want.
- Ability and willingness to help establish investment policy in the context of the client's overall financial condition and needs.
- Ability to provide superior investments.

- Willingness to accept MRI (mission related investing) or ESG (environmental, social, and corporate governance) investing goals if those are important to us.
- Reasonableness of fees.

Sequential Steps

From the start, we should recognize that selecting a consultant is a *big*, time-consuming job that is likely to take five months or more. The first step is to send each candidate a request for proposal. To elicit adequate information, the request for proposal will be complex. Committee members should commit the necessary amount of their time to thoughtfully design their request for proposals. Members should commit the time to understand and evaluate the response from each candidate, to discuss and compare them, and finally to reach the crucial decision. If every committee member cannot commit that amount of time, then we may want to appoint several members to form a subcommittee that will do the initial evaluation of the candidate responses.

There are some specialty consultants who can help us manage the outsourcing process. After assessing our special requirements they may be most useful in referring us to a range of best fit providers as well as analyzing and summarizing the completed request for proposals.[17]

To simplify the process, we might use a two-step process. The first step might be a request for proposal of less than 40 key questions that tend to differentiate the most crucial competencies among consultants. We might send this initial request for proposal to five to ten firms. Their responses should enable us to narrow the field down to two or three finalists.

To the finalists we would send a second, follow-up, request for proposal of perhaps over 100 due-diligence questions designed to ferret out weaknesses. This request for proposal would also include any follow-up questions needed to clarify responses to the initial request for proposal.

What are the right questions to include in our request for proposals? The main part of this paper consists of two model request for proposals.[18] In our models, questions are in black type. Most questions are followed by green type providing the reason for asking the question as well as criteria that we might use in evaluating the response. In each case, we will want to take the time to tailor each request for proposal to our own situation and needs, and tailor it also to each candidate we send it to.

Toward the conclusion or our search, we should invite one or two candidates to make a presentation to us. Their presenters should include the person who would be our lead consultant or the person making our decisions. Beforehand, we should review all of our outstanding concerns so we can address them at the meeting. Ultimately, we must apply our organization's objectives and risk parameters through the selection of a discretionary consultant or non-discretionary consultant. And we must be comfortable with the person who will be our lead consultant or our outsourced chief investment officer, as we should expect it to become a long-term working relationship. Finally, it is advisable to visit the finalist's offices to complete our due diligence, to verify their onsite capabilities, and to get a first impression of the firm's culture.

In any case, we should document and retain permanently our entire request for proposal

"There are some specialty consultants who can help us manage the outsourcing process."

"Take the time to tailor each request for proposal to our own situation and needs, and tailor it also to each candidate we send it to."

> “If our decision should ever be challenged, the record of our *process* is our best defense as exercise of the fiduciary duty of care.”

process, including meeting notes and committee minutes. If our decision should ever be challenged, the record of our *process* is our best defense.

Even if, over time, we are well satisfied with our selection, it is prudent practice to go through the request for proposal process every eight or 10 years – of course, including our current consultant among the candidates.

Purpose of the Request For Proposal

What do we want to accomplish?

Do we want a firm that will become our fund’s discretionary consultant, with total discretion and accountability? In that case, we could consider firms that offer either of two basic options:

- *A customized portfolio*, where the discretionary consultant would tailor our asset allocation and manager selection to the particular objectives of our fund, both initially and on a long-term basis in a separate account. By taking total accountability, the discretionary consultant would, of course, be assuming greater fiduciary responsibility than a non-discretionary consultant. Moreover, the custom portfolio is portable. If we fire our consultant we still have possession of the portfolio
- *A single commingled fund*, which would typically have an established asset allocation and track record. We would have to decide if its asset allocation and management was consistent with the objectives of our fund.

> “There’s no reason why committees can’t wait to decide which alternative they prefer until they receive responses to their request for proposals.”

Or do we want a non-discretionary consultant who would recommend both asset allocation and individual investment managers, with our committee assuming the responsibility to approve or reject each recommendation?

Or do we want a discretionary consultant who performs all manager selecting responsibilities but who allows our committee to retain the asset allocation decision? This consultant would then make asset-allocation recommendations on a non-discretionary basis.

Or do we want a firm that will have total discretion over only certain asset classes, and with the balance of our portfolio offer only non-discretionary recommendations? Or one who has total discretion over asset allocation and manager selection, but where our staff handles back office or administrative responsibilities?

Or do we want a full-service consultant that can offer a continuum ranging from discretion to non-discretion with respect to a particular committee’s preferences? In such cases, in order to clarify accountability, there should be specific agreement on which types of decisions belong to our committee, and which belong to the consultant.

Perhaps we have not yet decided which of these alternatives we want to pursue. Many committees are in this position, and there is no reason why we can’t wait to decide until we receive and evaluate the responses from all request for proposals.

The Cover Letter

The committee chairman or the organization's chief investment officer usually writes the cover letter, although the letter could be written by one of the committee members who is more experienced and will take the lead in the search. The letter should include the following:

- A brief description of the organization or sponsor of our fund, the size of our fund, and its general objectives.
- A brief statement as to whether we are interested in a discretionary or a non-discretionary relationship, or whether we are not sure or wish to assign discretion for some parts of the portfolio but not others. If we have already decided what level of discretion we are willing to cede to the consultant, and which decisions we want to retain for the committee, we should, of course, spell that out.
- A request to keep responses to our questions concise and to the point. Respondents may append attachments providing greater detail.
- The name, title, position, telephone number, and email address of the person to whom the response should be addressed.
- The date by when the recipient should provide a notice of intent to respond (perhaps 10 working days), and the date by when the recipient's response should be received (perhaps a month from now).
- Requirements for the response, such as:
  - The name, title, position, telephone number, and email address of the responder.
  - All numbered questions should be restated prior to the respective response.
  - All pages should be numbered.
  - Enclosures may be appended.
  - The number of copies of the response (usually one for each of our committee members plus a digital copy).
- Name of our fund's custodian or actuary, unless we want the firm to recommend one.
- A statement that the responder might contact us if he or she needs clarification about any particular question in our request for proposal – provided we are willing to field such questions. We should add that we will make available to *all* request for proposal recipients our response to any such question unless the question includes information that is proprietary to the inquirer.
- A notice that any respondent that is to be given further consideration will receive a second, more extensive request for proposal.
- The respondent must affirm that our committee can rely upon its responses as being a true and accurate representation from its firm.

Some organizations include the names and a one-paragraph bio on each member of the investment committee. This can help the responder to speak to the disciplines of the investment committee.

"A two-step request for proposal process is an effective approach. The first step to evaluate a range of candidates, the second to do due diligence on finalists."

The Selection Process (cont.)

Following are model two-step request for proposals. In the course of adapting them for our use, we should delete any questions that do not seem relevant to us, and we should add any information that would seem of special interest about our situation. In each case, we should carefully customize the questions to each particular firm to whom we are sending a request for proposal. A respondent is likely to take more care in responding to a request for proposal if he or she believes it is not just boilerplate.

"Some active managers will clearly add value at times. The question is how confident are you that your consultant or your committee can pick managers far enough in advance to hire them? This is devilishly hard to do."

- Jay Vivian

A Model Two-Step Process

Note on word usage in the request for proposals:

To make the RFPs applicable for sending to a consulting firm or an asset manager, the word "firm" refers to either of the above.

The word "recommend," when applicable to a discretionary consultant, should be interpreted to mean "use," as a discretionary consultant acts rather than recommends.

STEP ONE

Organization and Background

1. With which regulatory agencies are you licensed or registered?

2. Briefly describe your firm and the year it was founded. Please append a copy of your firm's standard marketing brochure.

   It is helpful to review this brochure in the context of the firm's responses to this RFP.

3. Describe the ownership structure of the firm with specific detail regarding the company, affiliates, etc. Provide the names of the individuals who possess ownership, including their position in the firm, along with their percentage ownership and other business interests. Please discuss any material changes over the past five years, as well as any negotiations by the firm for a change in ownership regardless of whether it was consummated.

   Who owns the firm is important. The most advantageous ownership is by the firm's investment professionals, especially if ownership is shared among a group of them, as they are more likely to be focused on the firm's long-term success, leading to a stable staff. When other owners are involved, questions can be raised about competing interests.

4. Do you anticipate any change in ownership over the next 12 months?

   A change in ownership can be disruptive, leading to staff turnover. Conflicts can emerge from the new owners looking for synergies or changing the firm's business model.

5. What lines of business are your firm and each affiliate engaged in? Does your firm or an affiliate offer any investment products?

   If there's a parent company, we need to know what other kinds of business other affiliates are engaged in. Could their businesses have an impact on the firm's consulting business?

6. Provide the number of clients and assets under management (AUM) among your firm's client base by discretion, partial discretion, and non-discretionary services. How has that changed over the last five years? Use Diagram 2 as a guide.

   Depending on our interests, it is important to know if a consultant's primary business is discretionary or non-discretionary?

   A large firm is likely to have a deeper staff but may tend to consider only larger investment managers that it can use across its many clients.

7. Provide the number of clients and AUM

"Today's chief investment officer has three responsibilities to: be an allocator of assets, be able to communicate the process and be able to run a business."

- Alice Handy

The RFP (cont.)

> "Any other source of income – or services or privileges – raises the question of conflict of interest and diversion of attention."

Year ends	Number of Clients					Assets Under Management				
	2015	2014	2013	2012	2011	2015	2014	2013	2012	2011
Discretionary										
Partial										
Non- Discretionary										
Total										

DIAGRAM 2.

Year ends	Number of Clients					Assets Under Management				
	2015	2014	2013	2012	2011	2015	2014	2013	2012	2011
Endowments										
Foundations										
Pension Funds										
Insurance Co.										
Sovereign Wealth										
Family Funds										
Total										

DIAGRAM 3.

among endowments, foundations, pension funds, insurance companies, sovereign wealth funds, and family funds. What has been your total number of clients and their AUM in each of the last five years? Use Diagram 3 as a guide.

It is worth knowing how experienced the firm is in our kind of organization.

8. Provide an organization chart of your firm and staff.

9. Does your firm receive 100% of its income from long-term funds seeking your advice? Has your firm, any affiliate or any staff member either directly or indirectly received any compensation, services, or privileges from any service provider or any manager that serves those long-term funds? If so, from whom have you received compensation, services, or privileges, for what reason, and what was the amount you received in each of the last two years?

The cleanest arrangement is for the firm to earn 100% of its income from the fees of discretionary or non-discretionary clients. Any other source of income – or services or privileges – raises the question of conflict of interest and diversion of attention. Of particular concern would be the rebate to the consultant of any portion of a client's investment management fees.

10. Please provide the name, address, phone number, contact name, and title for two current clients and two past clients – especially clients that are similar in nature and size to ours. For each client, please indicate the nature of the service, length of the relationship, and range of the account's size relative to ours.

Our discussion with current and prior clients can provide some of the most useful insights about the dynamics of working with the firm as well as the firm's stronger and weaker capabilities. Calling clients on the phone can be time well spent.

11. Do you offer customized portfolios or commingled funds or both?

    This is important to establish up front.

    We should be aware that commingled funds add certain risks not normally associated with customized portfolios, because we own a share in a portfolio vehicle, not in the underlying assets.

    - Redemption risk. If the manager of the commingled fund puts up a gate in markets such as 2008 when many co-investors tried to exit, we may have to wait many months or longer before we can redeem our assets.

    - Counterparty risk. A commingled vehicle could have problems with its banking counterparties.

    Some may see these as minimal risks, but we should at least be aware of them.

12. Discuss your firm's philosophy about the management of a long-term fund. What are the most crucial elements that will make the fund successful in the long run, and how are you able to help the client accomplish that? What characteristics distinguish your services from those of other advisers?

    This is an opportunity for the firm to express its philosophy about managing a long-term portfolio and identify the most distinguishing advantages it offers its clients.

Fiduciary Responsibility

1. Do you offer (check all that is applicable):
   - full discretionary services
   - non-discretionary consulting services
   - partial discretionary services

If partial discretionary services, for what services will you accept discretionary responsibility?

Client Performance

1. For all accounts with long-term investment strategies where your firm has full discretion, what has been your 1, 3, 5, 7, and 10-year performance, net of all fees, relative to their benchmarks? Please show the benchmarks.

   If we aren't interested in the possibility of a discretionary consultant, we would omit this question.

   Otherwise, we need to understand how successful the firm has been with other clients that have long-term investment strategies. Has the firm added value to their benchmarks? In each case, we should understand the composition of the benchmarks and assess how challenging the benchmarks were.

2. For all client accounts with long-term investment strategies where your firm is a non-discretionary consultant for all or any part of the portfolio, what has been their 1, 3, 5, 7, and 10-year total fund performance, net of all fees, relative to their benchmarks? Please show the benchmarks.

"We should be aware that commingled funds add certain risks not normally associated with customized portfolios."

"Being contrarian takes the courage to be wrong and alone for extended periods of time. Contrarian investing is not for sissies."

- Peter Bernstein

We also need to understand how non-discretionary accounts have performed. In assessing these results, we must remember that all decisions in a non-discretionary account were made by the client. But a portion of the accounts should compare well with those for which the firm was the discretionary consultant.

3. How has your clients' performance compared with that of college endowment funds as reported in the annual Commonfund/National Association of College and University Business Officers[19] (NACUBO)?

Many firms like to show clients how they performed relative to clients they consider their peers. This comparison may or may not be challenging, depending on the peers. We also like to compare our results with the best managed long-term funds. College endowment funds are often considered the best-managed long-term funds, and their returns are compiled by Commonfund/NACUBO.

NACUBO reports returns by the size of a college's endowment fund. Typically, the larger the fund, the better long-term returns it has achieved. We can compare our returns against college funds the same size as ours. And if we have a world-class consultant, we might also compare our returns with college funds of over $1 billion. We can make direct comparisons only if the discretionary consultant is responsible for the entire fund.

Investment Policy and Asset Allocation

1. How would you go about recommending rate of return and volatility objectives for our particular organization? Would the recommended objectives be absolute or relative objectives? Why?

One of a firm's first steps is to help the client establish its investment policy statement (unless the client already considers an existing policy statement a given). The policy includes a rate of return objective plus a volatility objective that serves as a constraint on the client's investment decisions. We need to understand how the firm goes about recommending these objectives.

A consultant typically has a model investment policy and asset allocation for funds that have long time horizons. But in each case the firm should study that client's mission and goals, spending policy, and any other unique considerations before it tailors its model policy and asset allocation to that client. The result can lead to a recommendation to minimize the portfolio's acceptable volatility or, alternatively, to sustain greater volatility, allowing a higher long-term target return.[20]

2. Please give examples of any innovative asset allocation or other investment strategies that you have recommended to your clients.

One way to spur performance is to adopt creative, new investment ideas. Often it is considered risky, from a standpoint of career risk or reputation risk, to depart far from what is considered the norm. Has the firm recommended such investment approaches?

At times, an outsourced chief investment officer or consultant may come upon a highly attractive but offbeat investment opportunity that may require more thorough due diligence and more careful explanation to the committee. Unconventional behavior can lead to superior investment results. The bottom line is not whether we dare to be wrong, but whether we dare to look wrong.

3. Describe your philosophy about tactical versus strategic asset allocation.

   To what extent does the firm try to time certain sectors of the market?

4. (*if relevant*) Do you provide advice on MRI (mission-related) or ESG (environmental, social, and corporate governance) investing? Do you offer MRI or ESG investment products?

5. (*if relevant*) How do you measure success of a DB pension plan? If you recommend LDI (liability-driven investing), how do you manage it and measure success?

   If the firm believes that a pension plan's funding ratio is its principal measure of success, how does it advocate implementing LDI?

Commingled Portfolios

If you offer a commingled portfolio that could fill a discretionary mandate for a client, or a commingled portfolio that could serve as a partial discretion, please respond to the following questions:

1. What is the investment policy of your portfolio?

2. What is the current total market value of your portfolio? What was it at the end of each of the last five years?

   How has the fund grown? Should we realistically expect the fund to perform as well with larger assets as it did when it was smaller?

3. What benchmark do you use for your portfolio, and has that changed over the last five years?

   Might a change in benchmark indicate a change in the portfolio's strategy?

4. What is your portfolio's current asset allocation? What has it been at the end of each of the last five years? What has been your thinking behind the changes?

   Understanding changes in allocation and the underlying thinking behind them can help us gain a better understanding of the firm's investment approach.

5. What has been the portfolio's performance, and how has that compared with its benchmark and that of college endowment funds as reported in Commonfund/NACUBO's annual endowment study?

   This is where the rubber meets the road.

6. What has been the volatility of your portfolio? What is the greatest decline in market value that your portfolio has experienced?

   We should know if volatility is out of the ordinary.

7. Does your portfolio invest in hedge funds and private equity? If so, what is your allocation to hedge funds and private equity, and how has that changed over the last five years?

"Understanding changes in allocation and the underlying thinking behind them can help us gain a better understanding of the firm's investment approach."

"Investors are optimistic. They convince themselves they can pick the active managers that will outperform."

- Jay Vivian

We should know the portfolio's use of hedge funds and private equity.

Recommending Investment Managers

1. Please discuss your views on the use of passive investments vs. actively managed funds.

   We should understand the firm's view on traditional index funds as well as alternative index funds that are designed to capture investment factors or market inefficiencies in a rules-based and transparent way.

2. In each of the following asset classes, how did your clients' aggregate returns compare with their benchmarks over the last 1, 3, 5, 7, and 10 years? Please identify the respective benchmarks. And please provide this information separately for accounts over which you had total discretion and for accounts over which you did not have total discretion.

   US equity
   Non-US developed equity
   Emerging markets equity
   US fixed income
   Hedge funds

   A key reason we are hiring a firm is to help us benefit from the best investment managers. We want a firm that has had proven success in doing this.

3. To what extent do you consider investment managers with limited capacity? How do you go about allocating the capacity of such managers among your various clients? Do discretionary clients get priority?

   A large firm has a problem considering investment managers with limited capacity, and if it considers them, how it allocates that capacity among its clients. A firm that serves both discretionary and non-discretionary clients has a built-in conflict of interest.

   Any firm with more than one client, without a commingled fund, faces a potential conflict when it allocates limited capacity opportunities. Transparency on this process matters.

Hedge Fund Recommendations

For this purpose, hedge funds include all private funds that have redemption provisions.

Are you well-equipped to recommend hedge funds to a client if appropriate? If so, please respond to the following questions:

Give credit to a firm that acknowledges that it is not an expert in hedge funds! Many firms have for many years helped long-term funds perform well by using only marketable securities. Also, firms that invest only in marketable securities may charge lower fees.

It is true that long-term funds with better long-term returns have made liberal use of hedge funds and private equity, but they have had the capability to select well above average hedge funds, not an easy thing to do.

The average hedge fund[21] over the 10 years 2005-14 returned less than 6% per year, about 1% per year below that of the MSCI

All World Index, but with about half the volatility. Is that worth the complexity and the limited liquidity that go with hedge funds?

1. How many clients with long-term objectives do you advise on hedge funds, what is your current allocation to hedge funds, and how has that changed over the years?

   We must understand the extent that the firm recommends hedge funds.

2. Please provide your clients' hedge fund performance by category (such as equity market neutral, event driven, distressed securities, global macro, or funds of funds) and also show their respective benchmarks.

   If we want to consider hedge funds for our portfolio, we want a firm that can lead us to well above-average hedge funds. We may not be satisfied with just average returns. And we would want hedge funds that add diversification benefit to our portfolio.

Private Equity Recommendations

For this purpose, private equity includes all private funds that the investor generally cannot redeem.

Are you well-equipped to recommend private equity to a client if appropriate? If so, please respond to the following questions:

Again, a firm deserves credit for acknowledging that it is not an expert in private equity. Many firms have for many years helped long-term funds perform well by using only marketable securities. Also, firms that invest only in marketable securities may charge lower consulting fees.

It is true that long-term funds with better long-term returns have made liberal use of private equity, but they have had the capability to select the best private equity funds – not an easy thing to do.

Through 2013, the median venture capital and private corporate equity fund with vintage years of 1994 through 2010 has earned an IRR of barely 9.9%.[22] Would we be willing to incur the illiquidity and complexity of private equity for that kind of a return? First quartile private equity returns have typically been in the 20% range, but returns on a quarter of all funds fell below 3%. We need to know that our consultant should be able to get us into the best funds.

Many long-term funds add private equity because it lowers the volatility of their *reported* returns. Private equity is frequently carried at book value or at an estimated market value that doesn't begin to reflect the volatility in the fund's underlying assets. Many people believe that in estimating the volatility of private equity, they should be estimating the volatility of the underlying asset class.

1. How many clients with long-term objectives do you advise on private equity, what is your current allocation to private equity, and how has that changed over the years?

   We must understand the extent that the firm recommends private equity.

2. What is your typical target allocation to private equity for accounts with long-term investment strategies, and how does it vary

"Would we be willing to incur the illiquidity and complexity of private equity?"

"We need to know that our consultant should be able to get us into the best funds."

"How do you build a portfolio to protect against disaster when everyone wants to outperform?. Everyone can't be above average. Being average is actually a skill. It's an accomplishment."

- Andre Perold

by the size of the client's account?

What range of private equity allocation might the firm recommend for our fund?

3. For your clients' commitments to private equity funds that were made four years ago or longer, please provide their IRRs by category (such as venture capital, buyouts, real estate, and natural resources), and also show their vintage year quartile in that category.

If we want to consider private equity for our portfolio, we want a firm that can lead us to well above-average funds, as we wouldn't be satisfied with median returns. And we would want a diversity of private equity funds.

Unfortunately, because of the J-curve in a private equity fund's returns, IRRs for shorter than four years can be a misleading indication of the fund's eventual IRR.

Other

1. Do you have a dedicated risk management team? Is the risk management team independent from the portfolio management team?

The best firms have a dedicated and independent risk management team.

2. Append a sample quarterly report. Please highlight any competitive strengths in your performance reporting.

Fees

1. What fee schedule, or fee alternatives, would apply to our fund?

Many fees are a scaled percentage of a client's account. Some firms offer performance fees. Others offer a fixed fee depending on the kind of services a client wants. Still others price research documents or special services separately. We should be aware of the full range of fee structures the firm offers.

2. What services are included in your proposal? What additional fees, if any, might we encounter?

STEP TWO

A. Organization and Background

1. May we have your SEC Form ADV Parts I and II submissions for the last two years?

We can learn, for example, the number of fully discretionary clients, the proportion of the firm's total income it earned from their fees, and how this has changed over the last two years.

2. What are your management succession plans?

This can impact our judgment about the firm's long-term viability. Firms that are owned by the investing staff are typically more client focused. One such partnership uses the following mechanism to ensure a smooth transition: The partnership agreement establishes mechanics governing the departure of a manager. It contains a formula for this compensation based on his or her vested ownership interest in the firm, payable over five years. Ownership interests for this purpose vest over 10 years.

3. Please append your firm's latest annual report or statement of financial condition, as well as similar information about any external owner of the firm.

   We want a consulting firm or diversified commingled fund that will be able to continue in business and to compensate its staff well enough to retain good people.

4. What percentage of the parent's total revenues does your firm generate? How much of its profits does the parent allow it to reinvest in its business?

   We should understand how important the firm is to the parent company, an indication of how much support it is likely to get when it needs it.

5. What are your firm's business objectives with respect to future growth?

   There is such a thing as an optimal size of a consulting firm or diversified commingled fund. If the firm is too small, it may not be able to afford highly experienced staff nor have sufficient clout in negotiating with investment managers. If it is too large it may be difficult to execute limited capacity ideas across a large asset base. As with investment managers, size can provide limitations on flexibility. Besides the dangers of bureaucracy, some large firms may research mainly (or exclusively) large investment managers and may ignore smaller managers who may not be able to accept enough money to make the effort worthwhile for the firm. Some of the better investment managers are smaller firms.

6. How many clients have left your firm in the last three years? Please provide the contact details for three former clients, indicating the nature of the service, length of the relationship, and range of the account size.

   Departed clients can often provide alternative insights about the dynamics of working with the firm, as well as the stronger and weaker capabilities of the firm.

7. May we have your code of ethics, privacy statement and conflict of interest policies along with your methods of enforcement?

Fiduciary Responsibilities

1. Is your firm independently certified as meeting or exceeding fiduciary standards, as by CEFEX[23], for example?

2. If you should be granted investment discretion, would you accept that appointment under ERISA section 3(38) or its equivalent for a non-ERISA engagement? If you were *not* granted investment discretion, would you accept that appointment under ERISA section 3(21) or its equivalent for a non-ERISA engagement?

   By properly appointing and monitoring an authorized 3(38) investment manager, a fund sponsor is relieved of all fiduciary responsibility for the investment decisions made by the investment professional. But the sponsor is still responsible for the continued retention of that fiduciary.

   A 3(21) investment fiduciary is a paid professional who provides investment recommendations to the fund sponsor. The sponsor retains ultimate decision-making

“Departed clients can often provide alternative insights about the dynamics of working with the firm, as well as the stronger and weaker capabilities of the firm.”

"Governance is an issue. In theory, pensions are long term pools of capital that can take liquidity risk. In practice, you can get fired after two years of underperformance. Pension committees still try to make decisions. They hold beauty contests organized by the staff and wind up hiring all the contestants because they can't decide."

- Larry Kochard

authority for all investments and may accept or reject recommendations. Both the consultant and the fund sponsor share fiduciary responsibility.

3. Please append your policies and procedures relating to soft dollars, commission recapture, best execution, and proxy voting.

   We should know what the firm thinks about directing investment managers to use specific brokers in order to recapture a part of their commissions and apply them to reduce our investment management fees.

   We want to know that all proxies are voted and how the firm goes about handling that, including proxies involving ESG issues.

4. Does your firm or any employee have business arrangements with any securities, brokerage, custodial, auditing, or investment management firm that might lead to a conflict of interest?

   Another opportunity for possible conflict.

5. Please describe the nature of any relationship that your firm or any of its people has had with our organization (such as our directors, committee members, or staff) during the last three years?

   Members of our investment committee should be aware of any such relationships.

6. Please disclose any other potential conflicts of interest that may arise.

7. Has your organization or any of your employees or clients been involved in litigation or the subject of an investigation, such as by the Department of Labor, SEC, FINRA, IRS, DOJ, or any regional authority? If so, please provide the particulars.

   Typically, the response to this question is negative. If the firm has had an incident, we need to understand it, its potential ramifications, and what it might say about the firm.

8. Please indicate the amount of insurance your firm carries for errors and omissions, fiduciary liability, cyber insurance, and fidelity bonding. Please note if these are in the aggregate for all of your operations.

   The firm should carry fiduciary and cyber insurance of at least $10 million.

Staffing

1. For each investment professional, please provide a brief biography, including the year each joined the firm, prior experience by year, education, and present responsibilities or area of specialty, and the location of his or her office?

   Many organizations omit dates in their staff biographies. Dates are important so we know how long each person has been with the current and previous firms.

2. Do any of your portfolio managers, researchers, and analysts have additional client-service responsibilities?

   Researchers and analysts can be most effective if they can devote full time to their work without the distraction of having to meet with clients. Yet at some point, we might want to have direct access to one of the firm's research analysts.

The RFP (cont.)

3. Provide the turnover of professional staff over the last three years. Include a list of professionals who have left the firm, their titles and years with the firm.

   This is important information to enable us to assess not only the amount of turnover but also the nature of the turnover. Many consulting firms, especially non-discretionary ones, struggle to keep their staff.

4. Discuss any prospective change in personnel you anticipate over the next 12 months.

5. Describe any incentive structure you use to attract and retain staff. Are bonuses influenced by a staff member's own performance?

   This helps us understand the likelihood of future turnover. The best staff people typically want to be a part of the ownership of the firm.

6. Do your firm's marketers receive a portion of the fees paid by clients that they recruit?

   This can help identify a commissions-oriented culture, with heavy emphasis on growth of AUM.

7. With whom, if any, of your staff do you have non-compete/non-solicit terms?

   Without such terms, key staff members could more readily resign and start their own business.

8. Who would be the proposed lead consultant (or account executive) with primary responsibility for our account? Please provide a brief biography, how many other lead consulting relationships he or she has, and with what kind and size of clients? Has the consultant ever lost a client? If so, what was the reason?

   The particular person assigned to our account will be particularly important to us. We want to know about that person's experience and workload so we can anticipate what kind of service we may expect from him or her.

9. How much discretion is left to the individual consultant?

   We should know how closely the consultant is required to stick to the party line.

10. Would there be a backup consultant or account executive? If so, please provide biographical information.

Investment Policy and Asset Allocation

1. Outline the issues and items that you recommend in a typical investment policy statement.

   Is the firm's concept of an investment policy statement consistent with our own?

2. Describe your process for developing and recommending a client's policy asset allocation. Please provide a sample asset allocation for an investment fund with a long-term horizon.

   It is helpful to understand a consultant's model asset allocation for a long-term fund and how he goes about tailoring that to an individual client.

3. What, if any analytical tools do you use during the portfolio construction process?

> "One of the least articulated principles of governance is to do no harm. Some will argue that any committee that honestly believes it can add value by selecting securities or managers will do harm, albeit unintentionally."
>
> - Charley Ellis

"Like a good marriage, I need to communicate my philosophy and overcome differences with the committee. Turnover on the committee can be frustrating 'tho a properly constructed committee is a pure delight. I have a no-surprise policy with my committees."

- Alice Handy

We should know how the firm uses an efficient frontier optimization program, and how it derives assumptions for return, volatility, and correlation. Because all of these assumptions are necessarily flawed, leading firms consider optimization results from many alternative sets of assumptions.

4. What changes have you made in recent years in your philosophy about an appropriate benchmark for a client's total portfolio?

   We want to understand the evolution of the firm's thinking about portfolio benchmarks.

5. Describe your approach to rebalancing asset allocation and manager allocations.

   Rebalancing is an important function of portfolio management, and we should know how the firm goes about it.

6. Do you ever recommend that a client leverage a low-volatility asset class? If so, under what circumstances, and how would you suggest that the leverage be implemented?

   Some firms believe that a low-volatility asset class that has a low correlation with the stock market can be leveraged to provide about the same expected risk and return as the stock market, and because of its low correlation, it can add meaningful diversification to a portfolio. Does the firm favor any strategies like this?

7. How willing are you to recommend investment managers other than hedge funds that use derivatives in their portfolios? If so, which derivatives? And what controls do you advocate?

   We should know what the firm thinks about managers using derivatives and what kinds of control it advocates. Is it possible for a manager's use of derivatives to cause losses beyond the particular amount of money it has been assigned to manage?

8. Do you recommend portable alpha? If so, under what circumstances?

   Portable alpha involves, for example, investing in futures, which provide the beta for an asset class, and then instead of investing the cash in T-bills as is assumed, investing it in an asset with an expected return higher than T-bills, intended to provide the "alpha" for the asset class of the futures.

9. Have you ever recommended retaining cash because you are uncomfortable with current investment opportunities or want to be in a position to make an opportunistic investment if it should come along?

   Retaining cash entails *two* decisions – when to hold cash, and then when to deploy it. Some investors have had notable success in retaining cash but find it hard to deploy at a more favorable time. As a result, relatively few investors have been able to earn more than their opportunity costs.

   Holding cash for some opportunistic investment may be less rewarding in the long run than retaining very liquid equity (or other higher-returning) assets that can be sold overnight at any time for a special opportunity. The long-term total portfolio return by many investment managers is typically lower than their total return excluding cash.

10. For clients of our size, what is your typical recommended allocation to investments that can meet immediate cash demands? Of that allocation, how much do you recommend be kept in cash or cash equivalents? Do you take steps to help clients minimize their allocation to cash?

    Cash and cash equivalents are a drag on long-term performance. Consultants should help us raise cash just in time and keep our money market accounts as close as possible to zero. What alternatives to cash does the consultant recommend to provide for immediate cash demands?

11. How much meeting time with clients do you devote to committee education in addition to the implicit education that goes with manager recommendations?

    A key role of a consultant is not just to find a client's comfort level and bring recommendations accordingly, but instead to teach the client about more effective ways of investing. This typically entails special meetings oriented specifically to committee education, supplemented with broadening publications.

12. Besides managing a client's funds, are you equipped to provide suggestions relating to a client's overall treasury operations, liquidity requirements, payout policies, back-office operations, overall budgeting, stakeholder communications, or other functions?

    Some firms will go beyond helping the client's long-term fund to provide counsel on managing the client's operating cash account and evaluating the organization's overall level of risk.

13. May we have your latest SSAE 16 Report[24] on controls?

    As part of their auditor's examination, some firms receive an SSAE 16 Report on their controls.

14. Do you provide custody services or require the use of a specific custodian? If not, do you find most clients' existing custodians satisfactory to work with? If needed, do you help clients find a custodian?

    Will our existing custodian be acceptable? Or if we need a new one, how helpful will the firm be?

Commingled Portfolios

If you offer a commingled portfolio that could serve as a discretionary mandate for a client with long-term objectives, or a commingled fund that could serve as a partial discretionary mandate, please respond to the following questions:

1. What is your portfolio's performance record *by asset class* vs. your respective benchmarks?

   In which asset classes do the manager's primary strengths lie?

2. How do you handle the ongoing liquidity of your portfolio so that no participant can redeem enough assets to consume too great a portion of the fund's liquid assets?

   Can an astute investor make a large redemption just before a drop in the market that sharply reduces the portfolio's liquidity? How can an investor get his money out of a commingled private equity fund?

"Educate your constituency, your investment committee or your clients. Education is very important because it helps the staff articulate its investment philosophy and its decision-making. Then they're comfortable with your strategy when the markets go against you. The urge to sell at the bottom is an indication that the governing body is not always thoughtful and education hasn't been done very well."

\- Ellen Shuman

"Boards face two questions. What business are we in? What defines success, and how do we know we're successful?"

- Keith Ambachtsheer

3. If we were to invest in your portfolio, would we have to sell our present holdings in order to invest cash in your commingled portfolio? Or would you accept our holdings and sell them as necessary to conform to your commingled portfolio?

4. How much advance notice would be required before we could exit your commingled portfolio?

5. Should we choose to exit, would we receive cash or a pro-rata slice of the commingled portfolio?
6. Does any of your staff members receive additional compensation for a client's use of your commingled portfolio?

Recommending Investment Managers

1. Do you manage any assets yourself? Why?

   A chief investment officer should manage internally only those assets in which it can excel, and it should use outside investment managers whenever they can add value.

2. How do you determine an investment manager's style and appropriate benchmark? How often do you create customized benchmarks, and how do you go about it?

3. Describe your manager sourcing process, starting with the database you use to monitor and evaluate investment managers. How many managers are covered by your process, and how do you research these managers? Is your database proprietary, or do you use a third-party vendor?

   How wide a net does the firm cast?

4. How soon after a new client has established its policy asset allocation would you expect to make recommendations of all investment managers to fill out that asset allocation?

   Once the client has settled on an investment policy and asset allocation, the firm should be prepared to promptly recommend a full portfolio of investment managers so no time is lost through the client being temporarily under-invested.

5. In considering investment managers, do you include both mutual funds and other commingled institutional funds among the managers you consider?

   Some firms prefer separately managed funds. If so, we should understand what advantage the firm sees relative to that of a flagship fund, on which the manager's public reputation is based.

6. Do you favor your own products over others, perhaps on a favored fee basis?

7. How do you calculate the standard deviation of investment returns, and the correlation of an investment manager or a portfolio with a benchmark or with another fund?

   For intervals of three years or longer, volatility and correlations should be calculated on the basis of rolling 12-month returns, even though this has the drawback of serially underweighting the first and last 12 months of an interval.

   Many firms base volatility calculations on the standard deviation of monthly returns annualized (that is, multiplied by the square root of 12, or 3.464). This is a measure critically important to a trader, but to a long-term investor it can be irrelevant, and even misleading. The long-term investor is interested in annual volatility.

The difference wouldn't matter if the two measures were roughly the same. But often, they aren't – sometimes by a wide margin. This is because monthly returns often tend to compound one another. As a result, for many stock indexes and hedge funds, the standard deviation of rolling 12-month returns can be materially greater than the standard deviation of monthly returns annualized. And the difference can also be wide for correlations.

8. Describe other measures of volatility you rely on in evaluating the track record of a manager – such as Sharpe ratio, Sortino ratio, information ratio, and the depth and extent of drawdowns. How do you calculate them?

   Many firms use other measures of volatility, and we should understand them.

9. Describe your manager due diligence process. How do you judge a manager's *future* expected returns, volatility, and correlations?

   This is the hardest judgment for anyone to make about a manager, but it is also the most relevant. A manager's track record is a starting point, but building a portfolio simply from managers' track records is typically a losing proposition. The firm must evaluate the predictive value of a manager's track record, and that predictive value can range from high to zero, depending on a great many subjective factors. Somehow, the firm must base its selection of managers on a judgment about their expected future performance.

10. Has your firm or any of its staff members ever recommended a manager that has blown up? Please describe the situation.

    Did the firm miss a step in its due diligence?

11. Describe your criteria for recommending the termination of a manager.

    This is another difficult judgment, and it is useful to know how the firm goes about making that judgment.

12. What tools do you use to evaluate an investment manager or fund? Which tools, if any, do you believe are unique to your firm?

    It is helpful to know what techniques a firm uses to evaluate a manager, and how those techniques might differ from those used by other firms.

13. How much of your investment research is proprietary, and how much is third party? What kind of information technology do you provide to support your analysts?

    We should know if the firm does its own research on investment managers, or whether it relies either partially or entirely on outside services.

14. How many visits to the head office of investment managers does your firm conduct each year?

    This is one measure of the extent of a firm's research. A visit to a manager's office is not by itself an indication of adequate research, but generally, research on a manager is

"Good governance is having the right people making the right decisions about the right issues. The biggest weakness is committees who haven't spent time thinking about how they should be spending their time."

- Myra Drucker

> "Avoiding blowups will allow compounding to do its job."

rarely thorough without a visit to his office.

15. Currently, by asset class, on how many managers have you done reasonably up-to-date due diligence within the last 12 months? How do you define due diligence for this purpose?

    This will help us understand the range of the firm's current manager research. Its response becomes meaningful only once we understand the firm's definition of "up-to-date."

16. Are your manager recommendations restricted by a short list of approved managers? Do you do due diligence on only those managers who could be used in a large portfolio? How does a manager *not* on your firm's approved list get considered for a full due diligence work-up?

    We should know the size of the firm's approved list and how willing the firm is to approve a client's use of a manager that is not on the approved list.

    Not surprisingly, firms tend to recommend those managers whose assets under management (AUM) are large enough to serve multiple clients.[25] This was confirmed in the 2013 paper by Jenkins et al,[26] which showed that the AUM of recommended managers was four times the AUM of managers not recommended. This was true of managers of active large, midcap, and small U.S. equities.

17. Do you research, recommend, or allocate to small managers?

    This may be a concern for a large consultant.

18. In allocating limited capacity of an attractive investment manager, does a discretionary client have precedence over a non-discretionary client?

    The answer could be favorable or unfavorable, depending on whether or not we would be a discretionary client.

19. How do you allocate an investment manager's limited capacity among your clients? What is your manager allocation policy?

    The response could have a material impact on our portfolio.

20. If you change your recommendation on a manager, what is the risk that your clients might try to buy or sell at the same time and hurt the price of their transactions?

    This could be a concern for a large consultant.

21. How many managers currently used in client accounts are closed to new money? How do you prioritize which clients gain access to managers who have limited room for new clients?

    Some managers recognize that taking on too much money to manage can hurt their performance, so they close to new clients, and sometimes they even close to additional money from existing clients. Where this is the case, we should know whether our account can gain access to managers who limit the amount of money they will manage. The firm may find it hard to provide as good performance for us as for existing clients.

22. On any manager seriously recommended by a highly experienced and well-connected member of our investment committee, would you do thorough research on the manager, and then make an independent positive or negative recommendation to our committee?

    If one of our committee members who is highly experienced and well connected in the investment world suggests a particular manager, we want to be sure that the firm is willing to do serious research on the manager and then make an independent positive or negative recommendation. In some cases, a particular committee member may have deeper experience than the firm, especially in a given area. But we would still want to hold the firm accountable.

23. When you learn of a manager from whom you expect better future performance than from an existing manager (even though the existing manager may be doing a good job), do you take the initiative to recommend a replacement?

    Few firms recommend a replacement as long as an existing manager is doing a good job.

24. Can you negotiate more aggressive fee schedules than a client could obtain by itself? With what percentage of managers? And by what typical percentage discount? What is your ability to offset a manager's 12(b)(1) fees, finders' fees, or other embedded fees?

    Sometimes a firm, with the combined money of a number of clients, can negotiate better terms with a manager than an individual client can do by itself, especially with a hedge fund or private equity fund.

25. Do you manage commingled portfolios within certain asset classes that you can use in multiple client portfolios? How do you handle fees on these funds?

    Sometimes, a firm will form a commingled portfolio for a particular asset class and recommend that clients use that instead of individual managers. If the commingled portfolio represents the firm's best manager selections in that asset class, it might be a good choice for a client, especially if the portfolio has achieved an attractive performance record. The use of a commingled portfolio should, if anything, provide a small break on fees.

26. If you were our discretionary consultant, would you manage any of our assets in-house, either separately or through a commingled fund?

    A chief investment officer or a discretionary consultant should manage internally only those assets in which it can excel. It should use outside investment managers whenever they can add value.

27. Do you recommend securities lending? Why, or why not?

    Securities lending is controversial. If the firm recommends securities lending for interested clients, we should understand how it proposes to go about it, and what the risks and prospective returns are.

28. Do you recommend meeting with clients more frequently than normal if there are manager-related issues that could profitably be resolved sooner than the next regular meeting?

> "Sometimes a firm, with the combined money of a number of clients, can negotiate better terms with a manager than an individual client can do by itself."

"Running an investment office as a business is often overlooked but essential."

Some firms do not want to meet with clients more than once every three months. If there are outstanding issues to be resolved, the firm should recommend an interim meeting. The firm and client also need to establish a mechanism to deal with issues that arise between quarterly meetings, as timely actions can add materially to long-term success.

29. Do you recommend that clients meet with any or all of their investment managers on a regular basis? If so, how often? If not, on what occasion would you recommend that a client meet with its investment manager(s)?

    It is important to understand what the firm thinks about investment committees meetings with managers.

30. At least annually, would you assess and articulate to us why you believe each manager in our portfolio has the best expected future performance of all alternative managers you track?

    Consultants should make it a practice to put in writing once each year their reasons for retaining each of their managers of liquid investments, and why they continue to believe each manager should provide the best overall performance.

Hedge Fund Recommendations

For this purpose, hedge funds include all private funds that have redemption provisions.

1. With what size clients do your recommend the use of hedge funds? Under what circumstances do you recommend funds of hedge funds?

   How likely is it that the firm will recommend hedge funds for our portfolio?

2. What do you believe is the purpose of a stand-alone hedge fund portfolio, and how do you evaluate how well it has fulfilled that purpose?

   We should understand what the firm believes is the role of hedge funds in a portfolio and how it measures success.

3. Do you sometimes recommend certain hedge funds as part of a client's *equity* portfolio? Or as part of its *fixed-income* portfolio? Why, or why not?

   Some people believe that certain hedge funds, because of the high correlation of their returns with those of the world stock index, should be used as part of a fund's equity portfolio.

4. How many hedge funds have you recommended that are now soft-closed to new investors? How many are hard-closed to new investors?

   If the firm has a good track record in recommending hedge funds, how many of its recommended hedge funds are now closed to new investors? We need to judge how likely it is that the consultant will be able to steer us to hedge funds that are both attractive and open.

5. Explain your process for
   a. sourcing of hedge funds
   b. initial evaluation
   c. evaluating side letters and exit and gate provisions
   d. pre-recommendation due diligence
   e. post-recommendation due diligence

We should understand how the firm goes about its hedge fund research and how thorough is its due diligence, including due diligence about the hedge fund's back office.

We might try phoning a few hedge funds and asking them which consultants send the most capable analysts and do the best due diligence.

6. Onsite visits:
   a. Do you always conduct on-site visits for each hedge fund manager prior to recommending that fund?
   b. How often do you conduct on-site visits to the manager of hedge funds already held in your clients' accounts?
   c. In the last three years, for how many hedge funds have you conducted on-site visits where you have not recommended that fund?

Many investors believe that in order to really understand a manager, it is necessary to visit the manager's office, meet with several of its key people, and become familiar with the ambience of the office.

7. How do you monitor the back office of a hedge fund? How do you monitor counterparty risk?

The quality of a hedge fund's back office is very important and often overlooked by investors.

8. Currently, how many hedge funds are on your approved list – ones you could recommend immediately?

9. What criteria do you use to remove a hedge fund from your approved list? What criteria do you use to recommend that a client's hedge fund be replaced?

Use of a hedge fund involves two decisions – one to commit to it, and one to redeem.

10. Do you have staff dedicated to hedge fund research? If so, please provide the names of your hedge fund professionals, including title, with the following information about each:

    – years of full time experience dedicated to hedge funds
    – specific expertise within the hedge fund industry
    – how many times he or she has taken the lead in recommending a hedge fund that was added to your approved list

The capability of a firm to recommend quality hedge funds depends entirely on the experience and capability of its hedge fund staff. We must make a judgment about its staff.

"Committees should be in the business of optimizing their resources whether they're internal or external. Get into the business of thoughtfully evaluating those resources."

- Myra Drucker

> "If turnover is high on an organization's staff and committee, institutional memory can be lost."

I. Private Equity Recommendations

For this purpose, private equity includes all private funds that the investor cannot redeem.

1. With what size clients do you recommend the use of private equity funds, and under what circumstances? With what size clients do you recommend the use of funds of private equity funds?

   How likely is it that the firm will recommend private equity funds for our portfolio?

2. Do you recommend secondary funds? Why, or why not?

   By definition, partners in a private equity fund must remain in that fund for its life. Some limited partners don't want to wait and are willing to sell their interest in that fund – called a secondary interest – for a negotiated price. Secondary funds are ones that form a portfolio of secondary interests in a diversified range of private equity funds.

3. What is the minimum expected return you require of an illiquid fund in order to recommend it to a client?

   Many people believe that, in order to accept the illiquidity and complexity, we should expect a private equity fund to earn an IRR of at least 10% *real*, and materially more than that for risky ventures.

4. How do you report both absolute and relative performance of a client's portfolio of private investments? How do you evaluate the success of a given private equity investment?

   Absolute returns should be cash-flow rates of return (IRRs) based on the latest valuation. It is also important to understand what benchmarks the firm uses to evaluate the fund's relative return.

5. Do you benchmark each of a client's private investments against a hypothetical but analogous liquid investment based on the same cash flows?

   Investors believe they should earn a large premium return for giving up liquidity in order to invest in private equity. A good way to benchmark this is to maintain a phantom account of a public market equivalent – such as NAREIT for private real estate, or a micro cap index for venture capital. The IRR of the private equity fund is compared with that of the phantom account in which every cash flow in the private investment is invested in, or redeemed from, the relevant public market index.

6. How many sponsors of private equity funds that you have used successfully in client accounts are unlikely to accept money from new investors in future private equity funds that they may sponsor?

   The best private equity managers often seem like clubs, in that the managers accept money for their new funds almost entirely from their prior investors, leaving little or no opportunity for new investors. The consultant's track record may include some of these great managers, but it may not be able to duplicate its private equity record for new clients.

7. Explain your process for
   a. sourcing private equity funds
   b. initial evaluation
   c. pre-recommendation due diligence

   d. post-recommendation due diligence

   We should understand how the firm goes about its private equity research and how thorough is its due diligence.

8. Onsite visits:
   a. Do you always conduct on-site visits for each private equity manager prior to recommending that fund?
   b. How often do you conduct on-site visits to the manager of private equity funds currently held in your clients' accounts?
   c. In the last three years, for how many private equity funds have you conducted on-site visits where you have *not* recommended that fund?

   Many investors believe that in order to really understand a manager, it is necessary to visit the manager's office, meet with several of its key people, and become familiar with the ambience of the office.

9. If a private equity fund should make some of its payments to investors in kind (that is, in shares of stock, for example), how do you advise going about (or if a comingled fund, how do you handle) the retention or sale of those assets?

   A firm typically selects managers but does not manage individual stocks or bonds. Upon receiving payments in kind, the firm must deal with individual assets. We should understand what its procedure and capabilities are.

10. Do you have staff dedicated to private equity research? If so, please provide the name of each private equity professional, including title, with the following information about each:

    – years of full time experience dedicated to private equity funds

    – specific expertise within the private equity fund industry

    – how many times he has taken the lead in recommending a private equity fund

    – in which of the above categories of private equity did he take the lead

    The capability of a firm to recommend the best private equity funds depends entirely on the experience and capability of its private equity staff. We must make a judgment about its staff.

11. Describe how you would go about building a private equity portfolio based on a recommended private equity allocation of X% for a client that has no initial private equity investments.

    Because there is a reasonably high correlation among the returns on private equity funds of the same vintage, a private equity portfolio should be diversified by time. Therefore, to build a private equity allocation of X%, it is often likely to take five years to form a time-diversified portfolio. And because it takes multiple years for a private fund to take down its commitments and then multiple years to pay out its receipts of cash, an investor always needs a portfolio of private equity commitments that is greater than the current value of its private equity investments. We should understand how the firm proposes to handle this.

"The chief investment officer should take a long-term perspective, keep his powder dry, and wait for others to blow up."

- Andre Perold

"Consultants should routinely stress test client portfolios to highlight potential risks under adverse market conditions."

- Rusty Olson

Risk Management

1. How do you conduct risk management? What systems and procedures do you use?

2. How do you compensate your risk management staff relative to your research and portfolio management staff?

   How much importance does the firm give risk management? Are risk management staff members second-class citizens?

3. On a regular basis, do you stress test client portfolios and quantify where risks are concentrated? How?

   Client portfolios should be routinely stress tested to highlight potential risks under adverse market conditions?

4. May we have your Services Organization Controls Report[27] (SOC 1 report)?

   Few firms do this, but their clients should ask for it.

Reporting

1. Do you follow the Global Investment Performance Standards[28] (GIPS) for calculating and presenting your firm's performance history?

   GIPS standards are a rigorous set of investment performance measurement standards adopted in 37 countries and recognized around the world for their unparalleled credibility, integrity, scope, and uniformity, enabling investors to compare a firm's track record directly with those of other firms.

2. Do you use an on-line, real-time system for reporting to enable clients to access up-to-date values and analysis?

   This is an important question if we want to have real-time access to our portfolio. If that's not important to us, we might delete this question.

3. How do you monitor the accuracy of your reports?

4. How soon after the end of a month do you issue reports?

   We should know what to expect.

5. Would we be readily able to download your key reports, including quantitative reports onto a spreadsheet?

6. Is your reporting software proprietary? If not, who is providing the software?

   If the firm's reporting software is not proprietary, the firm may have less flexibility to tailor its reports to our preferences.

7. To what extent can you customize your reports to meet an individual client's needs?

   If the firm's standard reports don't provide all the information we need (or too much information), might the firm consider our request for changes?

8. Do you report a portfolio's overall performance net of all fees, including your own?

   Reports on the overall fund should be net of all fees, including the firm's fee. Reports on investment managers should be net of their fees.

9. Does your portfolio performance report on a fund and its managers also show parenthetically the manager's track record net of fees on a pro forma basis for years prior to when you hired the manager?

   In the firm's performance report on the fund and its individual managers, it is helpful if that report shows not just the manager's returns since it was hired, but also returns on a pro forma basis for longer intervals. The firm needs to distinguish these pro forma returns by the use of parentheses or some other format.

10. Do your reports compare the aggregate performance of the portfolio's *liquid* assets (net of all fees) with the performance of the liquid asset classes in its policy asset allocation (its benchmark portfolio) and also with that of its allocation benchmark (the index performance of its actual asset allocation as of the end of the last prior quarter)?

    Almost all firms regularly provide the return on a client's benchmark portfolio and its allocation benchmark. The difference between the fund's actual returns and the allocation benchmark is an estimate of how its investment managers performed relative to their benchmarks. The difference between the benchmark portfolio and the allocation benchmark is an estimate of the value added (or subtracted) by deviations from the allocation of the benchmark portfolio.

    For intervals shorter than five years, these benchmarks are more helpful if they pertain solely to *liquid* assets, as the inclusion of illiquid investments, with their lack of market values, muddies the benefit we can draw from these benchmarks.

11. How do you create and maintain a valid comparative peer group for individual clients?

    Many firms show their client's returns in comparison with "peer" portfolios. These can be helpful comparisons, but we should know how the firm selected our peers, and we should judge how appropriate and challenging that comparison is.

12. How would you keep track of the ongoing liquidity of our fund to provide for required payouts and other commitments over the upcoming 12 months?

    This is a crucial function of our consultant, especially if we have a meaningful portfolio of hedge funds and illiquid investments.

13. Prior to a meeting with a client's committee, do you send committee members copies of your presentation materials to give them an opportunity to review them in advance? How far in advance?

    All committee members should receive presentation materials well in advance of a meeting. This should allow them to review the materials in advance and be prepared to discuss all of them at the meeting.

14. Will your reports include an accounting of all fees and expenses paid?

    The firm should provide a transparent accounting of all fees paid from our account.

15. Do you give support to clients for tax, audits, and compliance?

"A consultant should provide a transparent accounting of all fees paid from our account."

- Rusty Olson

This is a useful question to include if we are interested in receiving help on these matters.

Back Office

1. Please describe your legal and compliance structure. Please list any third-party providers of legal, compliance, audit, custody, and other services.

   We should know which of these functions are performed in-house and which are contracted out.

2. May we also have your latest SSAE 16 Report[29] on controls?

3. Does your compliance department review all marketing documents in advance?

   Review by the firm's compliance department should strengthen the credibility of marketing documents.

4. Please describe your firm's disaster recovery provisions and your policies and procedures for protecting client records and information.

   We need to know that the vast amount of information that the firm accumulates relative to our account and our portfolio is not in any danger of being somehow lost.

Fees

1. For how long would you guarantee your fee schedule?

2. If you offer a performance fee schedule, please provide a sample.

3. Some consultants offer a performance fee schedule, but only for accounts on which they have total discretion.

4. Are any of your fees bundled with those of one or more external managers?

   If there is any bundling of fees, we should know about it.

5. Do you receive rebates from any investment managers? If so, do you apply the rebates solely to lower fees for the clients who use those managers?

   Any rebates that are not spread among client portfolios are a conflict of interest.

6. Do you provide continuing most-favored-nation assurance on your fees?

   We will want to include a most-favored-nation clause in our consulting contract, one that is limited by any new fee schedule that the firm may offer a new or existing client.

The Follow-Up

After We Receive Responses to Our Request for Proposals

Once we have received all responses to our initial request for proposals, we should distribute copies to committee members. Each member should review every response with the following mindset:

- As we review the response to each question in light of the comments printed in green in this white paper, what follow-up questions are raised in our mind?
- Is there a clear reason why this firm would be inappropriate for our fund? Inform our chairman of our reasons why.
- Write our chairman with the pros and cons as we see them as well as a summary for each respondent, with copies to all other committee members.

The committee should then meet for the purpose of deciding which respondents to consider as finalists to receive our second request for proposal, and which follow-up questions to send to each.

The chairman or finance director should send a letter to each respondent who is no longer being considered, expressing appreciation for the time and effort the firm put into its response to our request for proposal. We want to maintain our reputation as a valued client, even though we don't plan to do any business with that firm in the foreseeable future.

Once we get responses to our second request for proposal we will go through the same process until we have narrowed the field down to one or two firms that we wish to invite to make personal presentations to the committee. It is helpful, however, if *we*, rather than *they*, control the presentation. We can do this by developing key questions we want to pursue further.

One thing to consider is: time horizons for evaluating a firm's results, and how we shall measure success. Unless we can agree on the criteria for success, we will have a breakdown in our ongoing communications. We will also want to be sure we will be important enough to the consultant for it to give us the appropriate time and attention.

It is important that the particular person who would be our lead consultant or account executive be articulate, someone we can understand and with whom we believe we can build a comfortable long-term relationship. At the same time, we must be mindful that there is a very low correlation between articulateness and investing competence. We must focus primarily on content and not be awed by the commanding presence of a presenter. That is why a major portion of our ultimate decision should be made *prior* to inviting the respondent for a personal presentation.

Before we make a final decision, it is a good idea – especially if the firm will serve as a discretionary consultant – for two or three of our committee members to visit the firm's office and meet with a range of its key people.

Once we have reached a final decision, we should review the draft contract to see if there is anything we might consider red flags, and to be sure the agreement clearly assigns accountability for different tasks to the discretionary consultant, the custodian, and the client. Then we submit the draft with suggested changes and

> "The first test for a committee is 'do you understand what's going on in the market'? If you do then you'd say 'what are we trying to do different because our institution has different needs'?"
>
> - Charley Ellis

> "Do you in-source or outsource? Do you have the scale to in-source? Or what's the most effective way to outsource? Strategically, these are the ongoing, value-for-money considerations for the committee."
>
> - Keith Ambachtsheer

questions to our attorney. After changes have been negotiated, our CEO should sign it.

If we have hired a non-discretionary consultant rather than a discretionary consultant, then we should be prepared for the possibility of having multiple meetings within a short interval to establish our investment policy statement and to move the fund's assets at an early date into a new asset allocation and portfolio of investment managers.

Ongoing Committee Responsibilities

We might work with our discretionary consultant or non-discretionary consultant to delineate measures of progress and define what we will consider success. We should expect our committee members to be on a continuing learning trajectory.

Some committees appoint a small subcommittee on an ongoing basis to vet a non-discretionary consultant's recommendations before they are presented to the full committee. The committee should ask hard questions as the consultant discusses investment policy and recommended investment managers. For example:

- First and foremost, are the consultant's recommendations consistent with the fund's policy statement? Or is the consultant suggesting, in effect, that we consider modifying our policy statement?
- Has the consultant researched all of the right questions relative to:
  - Character and integrity of a recommended manager
  - Assessment of the *predictive value* of the manager's track record
  - Nature and relative pricing of the asset class itself
  - Credentials of the manager's key decision-makers
  - Depth of the manager's staff
  - The manager's decision-making processes and internal controls
  - The range of risks and opportunities
- What alternatives did the consultant consider?
- Have adequate constraints and controls been established, especially with respect to liquidity and any derivatives that a manager might be authorized to use?
- Do the fees *and expenses* seem reasonable relative to those of comparable funds?

A committee member who is a seasoned long-term investor can sometimes work with the consultant to help source better investment managers. He or she can work synergistically with the consultant for a better outcome.[30]

One of the least productive committee meetings is when a consultant brings a series of investment managers to a meeting for the committee to decide which to hire – an event some refer to as a beauty contest. The committee can, at best, determine how articulate a manager is, but articulateness has a low correlation with investment capability. In a short meeting, committee members can't bring the perspective of having met with hundreds of managers, as the consultant's staff has done.

A more productive approach is to ask the non-discretionary consultant to make a single recommendation rather than a choice of

The Follow Up (cont.)

alternatives. We must remember that it is the consultant and its staff who have performed due diligence on all prospective managers. In cases where our committee has retained authority for all investment decisions, we should be hesitant to decline the consultant's recommendations. If we do that often, we should probably be looking for a new consultant.

We should ask the same hard questions of a discretionary consultant that we would ask of a non-discretionary consultant, except it will typically be after the fact.

At times a consultant may come upon a highly attractive but offbeat investment opportunity that requires much greater due diligence and more careful explanation to us than traditional opportunities. But unconventional behavior is a primary road to superior investment results. We should accept short-term disappointment in this respect. Unusual or contrarian investments aren't for everyone. In addition to superior skill, successful investing requires the ability to look wrong for a while and survive some mistakes. The bottom line is not whether we dare to be wrong, but whether we dare to *look* wrong.

With hindsight, consultants will make mistakes. We must expect this and evaluate the firm on overall results, on how often it was right, and on the reasoning and due diligence behind its recommendations. Of course, if a given action potentially has bad consequences that are absolutely unacceptable, the expected value of all its consequences – both good and bad – can be irrelevant.

At least once a year we should review our policy statement and our consultant. Certainly, a consultant should be changed only *in*frequently and for long-term considerations. But its retention should be a *conscious* decision. We might devote a separate meeting each year to this consideration.

"Investment committees should not be making investment decisions."

- Myra Drucker

Appendix A

Consulting Contract Provisions

This brief summary focuses on some of the main contract provisions an organization should, with the help of its counsel, negotiate with a consultant. A contract with a discretionary consultant should meet a fiduciary standard equivalent to ERISA section 3(38). The summary that follows excludes some of the more routine provisions and any contracting requirements of state and local governments.

Fiduciary Responsibility. The client will usually want the consultant held to fiduciary standards pursuant to applicable fudiciary standards. Some clients do not require a consultant to assume fiduciary responsibility but merely to assist in the fulfillment of the organization's fiduciary responsibilities. The organization and its investment committee, however, can never delegate away their fiduciary responsibility to a consultant.

Scope of Services. The scope of services for a general consultant will be very different from those asked of a specialty consultant, who would commit to specific services, often within a set time frame. Specialty assignments are common for alternative asset classes, such as private illiquid assets.

General consultants are typically expected to provide recommendations on objectives, investment policy, asset allocation, rebalancing, and the hiring, evaluation, and firing of investment managers. Services generally include committee education and performance reporting relative to benchmarks. Provisions may specify the timeliness and frequency of reports and the frequency and location of meetings to attend.

Discrete Consulting Services. Some contracts specify certain services that the consultant will provide upon request, but for additional fees. An example might be an asset/liability study. The client, of course, will want to minimize the number of services that would incur an additional fee.

Cost of Services. The most common structure today is a fixed annual fee for a specified number of years. This flat fee is typically called a retainer. Longer-term fee contracts might be subject to an annual increase, perhaps based on CPI. An alternative is an asset-based fee. This was more common in the past but is less so today – based on the idea that the level of services provided does not typically vary with the level of plan assets.

Most Favored Nation (MFN) Provisions. An MFN provision for fees is relatively common. If the consultant charges another client less for a similar service, then it must adjust our fee at the same time. The definition of "similar services" sometimes makes MFN concepts hard to enforce. Stronger MFN provisions require the best price not just on the retainer but also on services for which the consultant charges an additional fee.

Standard of Care. A standard of care greater than fiduciary responsibility provides the strongest protection. Such a statement might establish a standard beyond the normal "ordinary person" standard, one that is based on the competence, skill, diligence, prudence, and expertise of a professional consultant. Ultimately, the standard of care that a consultant must adhere to should be read within the context of both the established fiduciary duty and indemnification provisions of the contract. Without an explicit statement of a standard of care, the standard under basic fiduciary responsibility applies, subject to relevant case law interpretation.

<u>Indemnification</u>. An indemnification provision protects a plan by holding the consultant financially liable for mistakes (and their results) that the consultant makes in his services or advice. The strongest indemnification (specified by ERISA) defines mistakes as "negligence." Consultants will often try to limit indemnification to "gross negligence", which is a lower standard than mere negligence. Indemnification commonly covers all damages (and other losses) costs, expenses, and legal fees. The client should try to obtain indemnification coverage for board members, officers, agents and employees.

<u>Key Person Provision</u>. A key person provision requires the consultant to notify the client within a specified number of days if certain named consultants are unable for any reason to continue to provide advice. Strong key man provisions often give the client the right to terminate the contract immediately. Others stop at notification to permit negotiation. Key man provisions help to assure continuity in consultant services.

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Appendix B Resources

Help With RFPs

Because the process of sending and evaluating RFPs is such a crucial but time-consuming job, help is available. In recent years several firms, many boutiques, have begun offering the service of sending the RFPs and vetting the respondents on the committee's behalf. These firms should not offer either discretionary or non-discretionary services, as candidates might be less likely to share candid information with potential competitors.

The following is a partial list of service providers.

Rosalie Wolf
Botanica Capital
New York
rwolf@botanicacap.com
212-209-3000

Bruce Graham
CAPTRUST
Greenwich, CT
Bruce.Graham@CaptrustAdvisors.com
203.869.0033

Charles Skorina
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San Francisco, CA
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415-391-3431

Tom Iannucci
Cortex Applied Research Inc.
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tiannucci@cortexconsulting.com
416.967.0252

Barclay Douglas
Criterium Advisors
Medfield, MA
Barclay@criteriumadvisors.com
508-359-0052

Brian Temoey
Curio Webb
Pennington, NJ
curiowebb.com
609-737-4100

Jennifer Cooper
DRC – Diligence Review Corp.
New York
diligencereviewcorp.com
212-203-7051

Jeff Leighton
Jeff Leighton, CPA
Crescent City, CA
Jeff@jeffleighton.com
415-412-7170

Bryan Decker
Mesa Investment Consulting
Greenwich, CT
bryan@mesainvestment.com
203-286-4625 x103

Nanci Morris
New England Retirement Consultants
Boston, MA
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617-535-6946

Tony Johnson, Sr.
RV Kuhns and Co.
Chicago, IL
OCIOSearch@rvkuhns.com
312-445-3116

InHub
The RFP Concierge
Chicago, IL
hello@theinhub.com
773 688 8801

Erick Odmark
Odmark Consulting
San Francisco, CA
erick@odmarkconsulting.com
925-258-9039

Strategic Investment Solutions
San Francisco, CA
mrg@sis-sf.com
415-362-3483

Martha Tejera
Tejera & Associates
Bainbridge Isle, WA
Martha.tejera@tejera-associates.com
206-855-0791

Roger Broderick
White Oak Advisors
Indianapolis, IN
rbroderick@whiteoakadvisors
317-218-1573

Appendix C: Footnotes

1. These three duties are "standards *for a governing board's stewardship of an institution," per the Association of Governing Boards of Colleges and Universities. The duty of obedience refers to the obligation to advance the mission of the institution, to act in a manner that is consistent with its mission and goals. These standards are consistent with fiduciary responsibility under ERISA, which requires pension assets to be invested for the sole benefit of plan participants and defines prudence as how a prudent person would act "in the conduct of an enterprise of a like character and with like aims*."
2. See Greenwich Roundtable, "Best Governance Practices for Investment Committees," 2014.
3. Ibid, see pages 2-14 for a discussion on the qualities of competent investment committees.
4. Busse, Jeffrey, Amit Goyal, and Sunil Wahal, "Performance and Persistence in Institutional Investment Management", Journal of Finance, 2010, pp. 65, 7656-790.
5. Kaplan, Steven, and Schoar, Antoinette, "Private Equity Performance: Returns, Persistence, and Capital Flows," Journal of Finance, August 2005, vol. LX, p. 1793.
6. Excerpted from "Modern Pension Evolution and the Parameters of Prudent Delegation", Von M. Hughes, PAAMCO, and "History of the Commonfund", John Griswold, Commonfund Institute, 2015. Used with permission.
7. www.UPMIFA.org
8. Restatement (Third) of Trusts §80(1), was adopted by the authoritative American Law Institute in 1990 and was tracked by the Uniform Prudent Investor Act (proposed in 1994).
9. Subject to ERISA section 3(38) if an ERISA account, or the equivalent if a non-ERISA account.
10. Subject to ERISA section 3(21) if an ERISA account, or the equivalent if a non-ERISA account.
11. Such a decision is endorsed by UPMIFA if the committee honors the standard for delegation and supervision in the law of the state in which the organization is located. UPMIFA (the Uniform Prudent Management of Institutional Funds Act) was approved in 2006 by the National Conference of Commissioners on Uniform State Laws and has been adopted with variations by most states.
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13. R. V. Kuhns & Associates, Inc. "Considering the OCIO Option: Not an Everyday Decision for Fiduciaries," February 2013. The website www.iiforums.com/cfr/presentation/cfr13-ocio.pfd reports that non-discretionary Consultants typically charge annual retainer fees in the range of 4 to 10 basis points and OCIOs charge between 30 and 100 basic points.
14. Goyal, Amit, Wahal, Sunil, "The Selection and Termination of Investment Management Firms by Plan Sponsors," Journal of Finance, August 2008, pp. 64, 1806-1847, reports that larger plan sponsors are less likely to retain non-discretionary consultants to assist the Committee in manager selection and monitoring, presumably as they possess better resources to employ more sophisticated investment staff.
15. Conferences where clients can meet a range of investment managers, and where the investment managers compensated the Consultant for the opportunity to be included.
16. Reidy, Bernard, "Outsourcing: Writing Your RFP", Commonfund, Mission Matters, Winter 2011, p.4. Used with permission.
17. See Appendix B Resources for a parial list of firms that provide help with RFPs.

Appendix C: Footnotes

18. See www.GRBestPractices.org for an electronic RFP.
19. The Commonfund NACUBO Study of Endowments www.nacubo.org/Research/NACUBO-Commonfund_Study_of_Endowments.html
20. Cambridge Associates, "Have You Considered Your Portfolio's Enterprise Risk?" Enterprise Series, February 2015. Also NMS Management, "A Total Enterprise Approach to Endowment Management," The NMS Management Investment Bulletin for the Endowment & Foundation Community, January 2012, pp. 1, 8-15.
21. Hedge fund indexes differ from those for marketable securities because they are based only on those hedge funds that choose to report their returns to the indexers. Only those hedge funds with superior returns tend to choose to report to the database, and funds with poor returns sometimes stop reporting. Possible backfill and survivor bias can tend to inflate index returns.
22. Source: Cambridge Associates. Based on vintage year returns reported by the Venture Economics database. Used with permission.
23. CEFEX is an independent global assessment and certification organization. It works closely with investment fiduciaries and industry experts to provide comprehensive assessment programs to improve risk management for institutional investors. CEFEX certification is an indication of the trustworthiness of investment fiduciaries.
24. Statements on Standards for Attestation Engagements (SSAEs) are issued by senior technical bodies of the American Institute of Certified Public Accounts (AICPA) designated to issue pronouncements on attestation matters. Report number 16, Reporting on Controls at a Service Organization, addresses examination engagements undertaken by a service auditor to report on controls at organizations that provide services to user entities when those controls are likely to be relevant to user entities' internal control over financial reporting. www.aicpa.org/Research/Standards/AuditAttest/Pages/SSAE.aspx.
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26. Jenkinson, Tim, Jones, Howard, and Vicente Martinez, Jose, "Picking Winners? Investment Consultants Recommendations of Fund Managers," Said Business School, University of Oxford, September 2013, p. 5. www.umass.edu/preferen/You%20Must%20Read%20This/PickingWinners.pdf
27. SOC 1 reports are intended to meet the needs of those that use service organizations and the CPAs that audit their financial statements.
28. GIPS are rigorous ethical standards that apply to the way investment performance is presented to potential and existing clients for apples-to-apples comparisons. The foundation for the GIPS standards was established in 1987 with the creation of the AIMR Performance Presentation Standards, voluntary performance guidelines. GIPS is maintained by the CFA Institute, the successor to the Association for Investment Management Research (AIMR). www.cfainstitute.org/ethics/codes/gipsstandards/Pages/index.aspx.
29. SSAE 16 is a regulation for redefining and updating how service companies report on compliance controls.
30. According to UPMIFA 3(e)(6), "A person that has special skills or expertise, or is selected in reliance upon the person's representation that the person has special skills or expertise, has a duty to use those skills or that expertise in managing and investing institutional funds."

Notes

Notes

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