Retail Advisor to Institutional Consultant

Challenges for the Transition

By Tom McAuliffe

Retail investment advisors periodically may come across opportunities to work with institutional clients such as foundations, endowments, pensions, and other retirement plans. Although the process an institutional client follows at times may appear to be the same as that of a retail investor, an institutional consultant needs to deal with different nuances when working with institutional client assets. This article focuses on various challenges that a retail advisor faces when transitioning to become an institutional consultant.

What is an Institutional Consultant?

Institutional consultants historically have provided the following general services to clients:
- Development of investment policy statements and guidelines
- Asset allocation advice
- Manager searches
- Investment performance reviews

The investment consulting industry has been evolving constantly over the years and institutional consultants have had to evolve their businesses as well. Much of the industry today requires consultants to provide services above and beyond the general services listed above, including proactive advice and risk management techniques. Trends also show institutional consultants shifting their business models to include more discretionary capabilities for clients such as implemented consulting, outsourced chief investment officer, or discretionary management. Thus transitioning to become an institutional consultant also means that over time a retail advisor’s business practice and model will have to keep up with changing trends in the institutional consulting industry.

Different Needs of Different Clients

Institutional consultants deal with diverse client needs and demands. Not all institutional clients are the same even when they may appear similar in philosophy and makeup. Understanding nuances of different types of institutional clients can be challenging. For example, when working with pension plan clients one needs to be concerned with and understand the pension plan liabilities and how to construct a portfolio of assets best-positioned to meet pension benefit payment obligations. Thus an institutional consultant must be familiar with asset-liability modeling (ALM) and liability-driven investing (LDI) as well as the differences among strategies for different types of pension plans (e.g., traditional defined benefit plans versus cash balance plans) and how to deal with “frozen” pension plans and the various funding status of plans.

For foundation and endowment clients, the institutional consultant must understand the client’s spending policies and portfolio construction techniques to meet those needs. Institutional consultants also need a deep understanding of alternative investments and hedging strategies, which are used heavily by foundation and endowment clients.

Working with Boards vs. Individual Decision Makers

Most institutional-client assets are governed and controlled by trustees, boards, or committees, rather than a sole decision maker. So institutional consultants must understand the various personalities and guiding principles of each board member and how the individuals work collectively. Institutional consultants need to recognize that many board or committee members serve on a part-time basis and may not be experts in institutional asset management. The board or committee may consist of other investment professionals such as portfolio managers, investment consultants, and economists. Therefore the presentation of investment concepts, themes, and ideas must be tailored to the committee. These dynamics require that the institutional consultant be the expert in the room who can explain the most complicated of investment themes in the most basic of terms and accommodate all levels of investment sophistication.

An institutional consultant also must work with a client’s other advisors and service providers such as actuaries, lawyers, and custodians, each of whom are working for the client’s benefit and require the institutional consultant to understand their impact on the board’s or investment committee’s decisions. The nature of working with boards and committees requires the consultant to do much more work on a regular basis and generally includes quarterly meetings as well as updated portfolio “snapshots” and analytics as needed as markets change.

Resources and Investments Tailored to Institutional Clients

A big challenge for a retail advisor who wants to work with institutional clients is accessing the people, research, portfolio construction techniques, so-
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Institutional clients expect their consultants to have advanced credentials that indicate skill with relevant investment concepts and techniques. Retail advisors looking to transition to institutional consulting should challenge themselves by pursuing advanced education, or a credential such as the CIMA®, CAIA®, or CRPS designations, and tailor this education to the types of clients they want to serve.

Understanding Legal and Regulatory Guidelines
Understanding the myriad legal and regulatory requirements that govern various types of institutional clients is a significant challenge. Institutional consultants generally provide services as registered investment advisors with the Securities and Exchange Commission and are charged under the Investment Advisers Act of 1940 to act in the best interest of clients and appropriately address conflicts of interest. All employee benefit plans (except for church and government plans) generally are covered by the Employee Retirement Income Security Act (ERISA) of 1974, as amended, which sets forth standards for plan fiduciaries. The Department of Labor's (DOL) Employee Benefits Security Administration interprets and enforces ERISA's provisions. Institutional consultants who deal with employee benefit plans need to understand and adhere to ERISA when advising plan sponsors. Prohibited transaction rules are complicated and limit activities for plan assets, plan sponsors, and plan service providers—including institutional consultants. By definition ERISA does not extend to government plans, but many state and local governments have borrowed heavily from ERISA for rules about the investment of their pension funds. Accordingly, not only should an institutional consultant be familiar with ERISA, but if they are providing services to a government plan, they need to understand all the federal and state laws and rules that apply to that specific plan.

The Uniform Prudent Investor Act (UPIA) guides the actions of trustees and the Uniform Prudent Management of Institutional Funds Act (UPMIFA) applies to funds held for charitable purposes by nonprofit institutions. Most states have adopted these uniform state laws, which were established by the National Conference of Commissioners on Uniform State Laws (www.nccusl.org).

Perhaps the most challenging aspect for institutional consultants is staying apprised of the ever-changing landscape of these regulations, such as the currently proposed DOL changes to ERISA's definition of "fiduciary and the "five part test," the Pension Protection Act of 2006, the enactment of UPMIFA to replace its predecessor UMIFA, and ever-changing federal and state legislation regarding public funds.

Conclusion
An investment committee may ask a prospective institutional consultant, "How many clients like us do you personally service today?" They want to hear about the individual consultant's personal experience, not that of the firm. So a retail advisor who is developing an institutional practice will benefit from alignment with an experienced institutional consultant. This type of partnership will help the retail advisor learn the intricacies of institutional clients while building a base of representative clients.

Tom McAuliffe is managing director and head of institutional consulting for Bank of America Merrill Lynch, where he is responsible for business strategy, execution, improving risk management, and delivery of institutional consulting solutions for endowments, foundations, nonprofits, and retirement plans. Contact him at tom.mcauliffe@baml.com.