
Evaluating Proposals for Investment Advisory Services

Introduction

Selecting the right Registered Investment Adviser (“RIA”) to manage your assets is one of the most important decisions you make as a financial professional. You need to make sure to ask the right questions and request the appropriate level of supporting documentation to make the most informed decision. The questionnaire as a primary reference point for these evaluations is known as a *Request for Proposal* (“RFP”).

This paper focuses on several key points:

- Things to consider when drafting your RFP;
- Considerations to keep in mind when reviewing responses from RIAs;
- Supporting documentation to request as part of this process; and
- Data points to reconcile as part of this evaluation.

What Type of Account Are You Looking for?

Before you begin to put pen to paper and draft an RFP questionnaire for investment advisers to complete, the first thing you need to consider is what type of account you are looking to have managed. Are you looking for an actively managed account? A passively managed account? Would you like the investment adviser to have full discretion over the trading activity within your account? Would you prefer the investment adviser to first submit any trading activity to you for pre-approval? Are you simply looking for some overall guidance regarding asset allocation? These are all questions you need to think about and decide prior to writing question number one of your RFP.

Once you know the type of account, you can more effectively select the investment advisers that you wish to evaluate.

The RFP: Getting to Know the RIA

The RFP is an extremely effective way to weigh and measure the talents of registered investment advisers for the purpose of selecting the right one to manage your assets...if you ask the right questions and request the appropriate level of supporting documentation.

Think of the RFP as a registered investment adviser’s basic job application. You, as the employer, want to make sure that they are the best fit possible for your organization. To do this, you need to get a feel for who they are, their qualifications, their past employment history, their understanding of the job they are about to take on for you, and the way they plan to go about it. And, of course, you will want to check some references before you pull the trigger and hire them. So, let us get into the basic sections of an RFP, and what you should be looking for within the responses.

Cover Letter

The introduction to any RFP should consist of a one-to-two-page letter signed by an executive of the firm. Think of this letter as the introductory “handshake” at the outset of a meeting. This is the adviser’s chance to highlight the key points of what they believe makes them unique and best qualified to handle the management of your assets. This should not be a long-drawn-out section of the RFP itself; instead, it serves as a brief introduction, allowing the registered investment adviser (“RIA”) to place their best foot forward. This letter, if written well, can also

serve as a valuable reference during the RIA's finals presentation.

Executive Summary

In this section of the RFP, the investment adviser should provide you with a brief history of the firm and their experience managing the type of account that you are specifically looking for. This section should be a bit descriptive, as understanding the firm's history gives you a better picture of who they are and where their focus lies. You should look for a description of how the firm was founded, how long they have been in business, and a 50,000-foot view into their growth overtime.

Qualifications

This is the section where the investment adviser should get specific regarding their strategy for managing the type of account that you are looking to employ. This is the spot where the adviser should discuss the levels of experience of the firm's executive committee, as well as its portfolio management, operations, compliance, and administration departments. Understanding the level of experience contained within each of these departments will allow you to begin to weigh and measure which firms may manage your account most efficiently not just from an investment management standpoint, but as an all-around relationship. Make sure you ask questions surrounding the firm's annualized turnover rate.

References

This is an extremely important section, as it gives the investment adviser the opportunity to refer you to a number of their existing clients in order to get an independent feel for who they are and what they do. Our recommendation is to request at least three references from the investment adviser within your RFP. Once you receive the RFP, make sure you contact all the references provided. During the conversations, make sure you ask not just about the effectiveness of their investment management, but about their level of client service, professionalism, compliance, and operational efficiency. Allowing the RIA to

describe themselves is always a good thing; however, hearing it from independent third parties give you an additional level of understanding.

Conflicts of Interest

Conflicts of interest is another important topic to address within any RFP, as they are inherent within the business of being an RIA. Types of direct conflicts of interest may include an RIA that maintains an affiliated broker dealer with which they intend to trade your assets. Another conflict of interest that you need to be aware of is any type of side-by-side management being conducted by the adviser (i.e., an adviser that manages client accounts within the same investment mandate as accounts that generate a performance-based fee). These are just a few of the conflicts that you need to be aware of prior to entering into an RIA contract with a registered investment adviser.

One last point to consider: conflicts of interest come in all shapes and sizes within this industry. It is key to understand how these existing conflicts are identified, addressed, and monitored by the firm on an ongoing basis. Make sure that you request that the RIA go into a level of detail about how conflicts of interests are dealt with at the firm.

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Investment Management

So now that we have gotten a high-level understanding of the firm, it is now time to get into the weeds a bit. This section of the RFP should be extremely detailed, and require that the RIA describe in detail:

- its overall investment philosophy,
- how investment decisions are made (from macroeconomic evaluations to individual issuer research),
- the various tools used by the investment adviser to execute and allocate trades on behalf of their clients,
- the process by which the RIA selects its broker/dealers with which to trade and their ongoing evaluation of their performance, and
- the electronic and manual controls surrounding compliance with clients' investment guidelines and regulatory restrictions.

The bottom line here is that an RIA should be able to describe in detail its key process -

managing your assets as a fiduciary in a way that it is easy to understand.

Performance Measurement

Once you get an understanding of how the RIA plans to manage your assets and the tools with which they are working, it is also important to understand how they are going to weigh and measure performance. In this section of the RFP, it is important to request that the RIA describe to you how performance is measured for your account, and the applicable indices to which your account will be measured. It is also important to gain an understanding of why the selected benchmark indices to be used as a measuring stick are appropriate for your assets.

One thing you want to make sure you ask every RIA is whether their performance composites are GIPS verified by an independent third party. If the RIA's composites are GIPS verified, you have an additional level of comfort regarding the firm's performance calculations as well as the methodology inherent with measuring how your assets are doing versus the agreed upon benchmark.

Operations

Operations is a core function of any RIA, as its ability to settle all trading activity performed on behalf of your account daily in an accurate and timely manner is incredibly important. Make sure that your RFP includes questions surrounding the RIA's operations department staffing levels, levels of experience, and electronic tools they employ to ensure that your account is properly reconciled.

Compliance, Ethics, Culture of Compliance & Risk Management

Compliance is another core function of any RIA. Its core function and responsibility is to ensure that the firm continues to follow all client-specific and regulatory guidelines for all accounts on a full-time basis. The firm's compliance department should utilize a combination of electronic and manual tools and processes to provide a level of ongoing monitoring of the firm's key processes and controls.

The compliance department is also primarily responsible for the company's ethics. This department:

- monitors employee personal trading,
- the giving and receiving of gifts and entertainment,
- political contributions,
- outside business activities,
- identification of conflicts of interests,
- approval of marketing materials to ensure that we accurately describe how we do what we do, and
- conducts firmwide annual compliance training to maintain a high level of ongoing awareness.

Make sure you ask questions within your RFP that pertained to the compliance department's staffing levels, levels of experience, and the tools that they utilize to perform their key functions. Another question you want to ask pertains to reporting lines: the firm's Chief Compliance

Officer should have a level of authority and access to the firm's executive management team, so that any concerns or observations can be disclosed at the proper level to ensure effective and prompt attention. As a potential client of the RIA, you need a strong understanding of how the firm oversees your assets...as well its own ethical framework.

Another important concept to take into consideration is the RIA's *Culture of Compliance*. Your RFP should contain a series of questions that elaborate on the RIA's tone from the top, including how this tone is communicated firm wide on an ongoing basis. The RIA(s) that you select to manage your assets need to be trusted fiduciaries – and their Culture of Compliance is the bedrock on which their firms are built.

Client Service & Reporting

Another key function of an RIA is its ability to provide timely and accurate client service once you become an account under their management. Again, questions within this section should focus on three keys: people, process, and technology. Make sure you ask questions within this section pertaining to staffing level, levels of experience, and electronic tools utilized by this department to ensure that they provide you accurate responses to any questions you may have in a timely manner.

As part of any RFP, it is recommended that you request a sample of some of the reporting documentation that you can expect to receive on an ongoing basis that summarizes the activity within your account(s). These reports should be easy to understand and designed to provide you with the information you need in a clear and concise manner.

The RIA should also be able to provide you with online access to your account information via a secure portal. As part of your RFP process, you should request a summary of the RIA's online portal, the available dashboard reporting that can be viewed through it, and the corresponding data security controls in place to ensure that

your account data is effectively protected when the portal is utilized.

Technological Controls & Cybersecurity

We cannot stress how important cybersecurity is to an RIA. This is a section of any RFP that should go into a high level of detail regarding the RIA's internal controls surrounding:

- physical access to its servers as well as its hardware,
- logical access to any of the applications that the adviser utilized to perform key tasks,
- Management and oversight of its mobile devices, and
- the firm's core defenses against cyber-attack (i.e., firewalls)

Make sure you also ask questions pertaining to how the RIA performs a level of periodic due diligence on key vendors utilized by the firm to protect it electronically from malicious attacks.

Business Continuity

This is another important section of any RFP, as the RIA needs to be able to evidence the fact that they will continue to be able to provide their services effectively for you, the client, if any event occurs which would limit employees access to the firm's offices. Make sure you go into some detail with your questions here about the firm's plan, the last time it was tested, any issues that arose during testing, and the firm's plan for reintroducing its employees to the company's offices in a post-COVID environment.

Supporting Documentation

Three important words to remember here: ***trust but verify.***

The adviser's RFP responses have now painted a vivid picture of who they are, and how they do what they do. You, as the potential new client, now need to review supporting documentation that backs up everything they just told you. This review will take some time if it is done correctly, so make sure you budget a significant number of hours to review the supporting documentation. Let us start with the RIA's disclosure documents: The Form ADV.

Fees

Now that we have covered all of the key departments within any RIA, it is important to get an understanding of how much these services are going to cost you. You also need to obtain an understanding of the RIA's fee structure, any performance-based fees that your account may be charged, as well as any other ancillary fees or benefits that the adviser may receive because of managing your account (i.e., soft dollar or CSA credits, or other payments made by broker/dealers on behalf of the adviser for hardware or software or connectivity used to manage your account).

One thing to point out here: while soft dollars and CSA credits are not illegal, they do pose an inherent conflict of interest that you need to be aware of. Things to consider regarding hiring an RIA that manages / trades equity securities include:

- the approximate percentage of brokerage commissions paid via trading activity on your account into such arrangements,
- what the firm's soft dollar budget is used to pay for,
- how much, as a percentage of the total of soft dollars generated your account may be expected to contribute, and
- how the soft dollar budgets with any applicable broker dealers are overseen by the investment adviser.

You also need to get an understanding of the average commission rate paid by the RIA for "full service" trading as compared to execution-only trading.

Form ADV

The Form ADV Part 1 is the primary disclosure document that every RIA must file with the US Securities and Exchange Commission (“SEC”). Each section of this document includes information that you need to be aware of. So, let us walk through it:

- **Item 1** provides the reader with the basic information of the investment adviser’s name, address, phone number, locations, the name of the chief compliance officer, and any additional regulatory contacts within the firm that you may need access to. This item also gives you the understanding of the firm’s size as well as location of its other offices, both domestic and international. Finally, it also describes the firms that are responsible for maintaining any required books and records.
- **Item 2** continues to give you an understanding of how large the firm you are considering is in assets under management, and what states they are registered in. It also discloses any other related registered investment advisers.
- **Item 3** describes what type of organization the firm was created as (corporation, sole proprietorship, LLP, etc.).
- While **Item 4** solely focuses on successions, **Item 5** discusses information about the RIA’s advisory business, its employees, clients, and compensation. Here is where you will get an understanding of how many employees the adviser maintains, how many of them perform investment advisory functions, and how many are registered representatives. It also gives you a breakdown of how many client accounts are managed by the RIA, and the corresponding assets under management. Another key point to consider is what type of fees the adviser collects for the services rendered, whether it be a percentage of assets under management, hourly rates, subscription fees, fixed fees, commissions, or performance-based fees. Data points from this section can also be reconciled to what has been disclosed in the written portion of the RFP responses.

Item 5 also goes into a level of detail about the percentage of the RIA’s assets under management are invested, by security type. This information can be reconciled to the responses within the RFP pertaining to the firm’s assets under management and their specialty. For example, an RIA may say they are primarily an equity manager, but when you look at the Form ADV Part 1, Item 5, you may see that 85% of the assets they manage are exchange-traded equity securities. Doing this simple reconciliation will allow you to ask effective follow up questions during any in person meeting.

- **Item 6** is where the RIA must disclose other business activities such as maintaining an affiliated broker/dealer, being a real estate broker, an insurance broker, a registered municipal adviser, a swaps dealer, etc.
- **Item 7** briefly describes financial industry affiliations, and Item 8 focuses on some possible conflicts of interest - namely participation or interest in client transactions. This is a very important section to review as part of the RFP process. As a potential client, you need to obtain an understanding of whether the RIA has any proprietary interest in the transactions that they will execute on your behalf.
- **Item 9** requires that the RIA disclose if they maintain custody of any client assets, and **Item 10** discloses any control person(s) that directly or indirectly controls the firm.
- **Item 11** is another key section that you need to review as part of this process. This is the section that requires the investment adviser to disclose if there have been any criminal actions, regulatory

actions, civil or judicial actions or issues with a foreign regulator that the adviser may have incurred.

- **Item 12** allows the investment adviser to disclose whether they are registered as a small business,
- **Schedule A** of this filing discloses the ownership structure of the firm, its direct owners, and its executive officers. Schedule B discloses any indirect owners of the RIA, and then finally, Schedule D is a miscellaneous section. Make sure you read this last section carefully, as some investment advisers may use Schedule D as a dumping ground for information that you may consider to be valuable in your decision making.

If the RIA does not provide a current copy of their Form ADV Part 1, you can locate the filing on the U.S. Securities and Exchange Commission's website: <https://adviserinfo.sec.gov/>

The RIA should also provide you with a Form ADV Part 2A. This filing provides the reader with a high level understanding of the type of business that the adviser maintains, the fees and compensation charged for their services, whether or not there are any performance-based fees or side-by-side management considerations for you to understand, the types of clients managed by the adviser, the firm's investment strategies methods of analysis and corresponding potential for risk of loss, its disciplinary information, its Code of Ethics, any participation or interest in client transactions, personal trading information, brokerage practices, account reviews, client referrals, other compensation, and proxy voting information. In short, this is a very valuable document to review, as it will provide you with additional information that may have been omitted within the written RFP responses. It gives you an opportunity to enhance your understanding of the adviser with which you are considering doing business.

Professional Biographies

While the form ADV Part 2B gives you a level of information regarding the investment professionals responsible for managing your assets, you also need an understanding of the other key professionals that will assist you with operational, compliance, and client service questions. Make sure you request a copy of the employee biographies that each RIA maintains.

Being a strong fiduciary for clients comes down to three things: people, process, and technology...but first among these is *people*. The foundation of any strong adviser is its employee base, so get an understanding of who the key employees are that you will be dealing with, their levels of experience, and background.

Strategy Profile Sheets

Each firm will have basic profile sheets for every strategy that they maintain. Make sure you request a copy of the applicable strategy profile sheet(s) that you are interested in. These sheets will briefly describe who manages the account, its performance over time, and other key information such as the allocation of assets among security types. This type of information will allow you to reconcile whether the strategy you are considering carries with it a level of risk in line with your investment goals.

FORM ADV PART 2B

Make sure to also request a copy of the adviser's **Form ADV Part 2B**. This disclosure describes the investment professionals that are responsible for managing client assets, their business background, their education, any kind of professional designations, and reporting lines. This is another opportunity as well to discover any type of disciplinary information on record for any of these investment professionals. Lastly, it requires disclosure of any other outside business activities that these investment professionals maintain, or any other type of additional compensation generated by the investment professional.

GIPS Composite Report(s) and Verification Letter

Make sure to ask for a copy of the firm's GIPS report and verification letter. This report will evidence the fact that an independent third party reviewed the adviser's composites and performance information to ensure that its clients can accurately weigh and measure the RIA's results to the agreed-upon benchmark(s).

Code of Ethics

Always ask for the RIA's *Code of Ethics*, as it will describe to you the ethical foundation of the firm. Within this *Code*, you should see mentions of controls surrounding personal securities trading, gifts and entertainment, political contributions, conflicts of interest, outside business activities, and the firm's overarching requirement for ethical behavior. Along with this document, you should also make sure to ask questions with the RFP surrounding annual compliance training as well as any tools used by compliance to maintain an ongoing level of awareness.

Summary of RIA's Internal Control Structure

A RIA's *first line of defense* against any type of error or issue that could affect any client account or the firm itself resides within the various business lines. The *second line of defense* for any RIA is its Compliance Department, tasked with oversight and monitoring of these key controls to ensure ongoing adherence to all investment guidelines and regulatory restrictions. The RIA's *third line of defense* would be any independent assessment performed by a third party focused on the evaluation of its internal controls. As part of any RFP, you should ask the RIA to summarize its overall internal control structure.

Sample of a Training Deck

Make sure to request a copy of the firm's training deck utilized during its annual compliance training sessions. This will give you a sense of the level of detail provided to its employee base to ensure a high level of ongoing awareness.

Annual Compliance Report

Every RIA completes an Annual Compliance Report, which is required under Rule 206(4)-7 of the Investment Advisers Act of 1940. While these reports are normally considered confidential, as part of any RFP process you want to ask your RIA to confirm that there were no material issues / concerns identified as part of this annual review process.

Third Party Reporting

RIAs may elect to hire independent third-party vendors to periodically assess their internal control structure. While these reports are also normally considered confidential, as part of any RFP process you want to ask your RIA to confirm that there were no material issues / concerns identified as part of this review.

Business Continuity Plan

The RIA's business continuity plan is also a key document to review as part of the RFP process. Reviewing the firm's BCP will allow you to maintain a level of comfort that the adviser can provide ongoing service to your account if an external event occurs which limits employees' access to the firm's offices.

During the last 15-16 months, the entire industry has been basically operating under firms' BCP mandates. As a result, you may want to also ask for a copy of the RIA's pandemic plan.

Cybersecurity Training Deck

I cannot stress enough how important cybersecurity training is, as the primary control surrounding an investment adviser's defense against malicious technological attacks is the employee base and their high level of ongoing awareness. The ability for employees to identify phishing emails or any other type of email that appears suspicious and take proper action in a timely manner is key to protecting the firm's—and all clients'—data.

Make sure to ask when the last time annual required training was provided to the employee base, whether any type of quiz/test was required, and the corresponding results. If an employee failed a quiz/test, gain an understanding as to what corrective measures were taken by management to ensure that this employee understands what to look for and why it is important.

Final Thoughts

There are three key thoughts I want to leave you with:

- The RIA should be able to describe who they are and what they do **in a manner that is both detailed yet concise**. They should answer the questions you pose without providing copious additional information that you did not ask for. Responses to your questions should be easy to understand.
- ***Trust but verify***. Once you read the RFP and its entirety, make sure you spend enough time reviewing the RIA's supporting documentation. Reconcile what you are told in the RFP to what is disclosed in the supporting documentation.
- The primary asset of any investment adviser is its employees, so make sure that they are provided with the proper levels of **ongoing training and** ask for supporting documentation to evidence that fact.

In early June 2021, Chandler provided an educational session for its clients and prospects which provided additional color regarding the Evaluation of Proposals for Investment Advisory Services". This session, along with numerous others on timely industry subject matter, can be found at <https://www.chandlerasset.video/>. This white paper supplements our recorded discussion, in the hope of assisting you with the important responsibility of selecting the RIA that is right for you. In addition, Chandler has drafted a checklist, entitled "**7 Things to Look for When Choosing an Asset Management Firm**", which provides high level considerations to also keep in mind. This checklist can be found by visiting our website, www.chandlerasset.com.



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Questions?

Please contact Chandler at info@chandlerasset.com, or toll free at 800-317-4747 with any questions or to learn about investment management solutions for public entity investment programs.

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