Lynx Investment Advisory

Investment Management for the Nonprofit Industry: Hiring Outside Advisors

Lynx Investment Advisory is pleased to summarize a series of guidelines associated with hiring an outside investment advisor. This review is designed to assist nonprofit institutions as they embark on selecting a professional advisor that should help save, grow and protect the assets under its purview.

What may not be well understood is that nearly anyone can consider themselves a financial advisor, financial planner or Outsourced Chief Investment Officer, with minimum qualifications required. Therefore, there are a few important points to consider during the selection process.

Education and Experience

- To begin, a review of a prospective advisor's educational background and experience must be performed. It is important to understand why an advisor may or may not be in the right position to help with the financial circumstances of the nonprofit. An advisor should be able to prove that she/he has and is capable of applying their knowledge to develop the optimum strategy for the nonprofit.
- A review of the advisor's website, related articles and all independent information available through the resident state or U.S. Securities and Exchange Commission (SEC) is imperative. An assessment of the FINRA website should also be completed, if the advisor has an association with a brokerage firm.

Certifications

- Successful advisors are always taking additional steps to increase their knowledge base. Therefore, there should be an understanding for the designations held by individual research and consulting team members. Such designations may include, but are not limited to, the Charted Financial Analyst (CFA) and Certified Financial Planner (CFP), designations, as well as the Chartered Alternative Investment Analysis (CAIA) and Certified Investment Management Analyst (CIMA) titles. A business school degree can also be a valuable credential as it provides graduates with a wide variety of business related skills that can assist in both a nonprofit's investment goals, as well as with its general management approach.
- It has been Lynx's experience that of all the potential designations, having a research team consisting of CFA charter holders adds the most value from an investment, portfolio and ethical perspective for nonprofit accounts.
- To become a CFA charter holder, a candidate must have worked for 48 months in the investment industry and must pass all three levels of the CFA Program. Each test is six hours in length, is offered annually worldwide, and is considered the most comprehensive, rigorous and highly competitive test available within the industry.

Fees and Conflicts of Interest

- Understanding an advisor's compensation structure is a key element in the due diligence process. By understanding how an advisor gets paid, the nonprofit will have a clear perspective for how the advisor is incentivized and what conflicts of interest may exist.
- Typically, an advisor is paid through one of a few options: fee based on the underlying assets in the portfolio, is commission based or paid on the products and trades they place in the portfolio, or charges a flat or hourly fee for their advice.
- Lynx believes the ethical and fair approach to advisor compensation is the fee only based method, this could be in the form of assets under management or a flat fee. Any other alternative opens the door to potential conflicts of interest, while it increases the likelihood an advisor will prioritize his/her own interests over the clients' or to possibly "churn" a portfolio more than necessary.
- Additionally, it is imperative that consideration be taken to understand all costs involved aside from those charged by the advisor directly. There are often many fees associated with an underlying investment recommendation, such as expense ratios and trading cost, all of which could potentially roll up to a much more significant "all-in" cost. Having full transparency and grasp of every cost involved is of utmost importance.

Fiduciary versus Suitability Standard

- There is a very important distinction between these two standards. While an advisor held to the fiduciary standard is required to act in a nonprofit's best interest at all times, one that is only required to adhere to a suitability standard is allowed to sell any product they consider to be "suitable" and not necessarily ideal or in the nonprofit's best interest.
- It is the opinion at Lynx that only those advisors that uphold the fiduciary standard on all client related matters is the only option. This point is non-negotiable in Lynx's opinion.

Nonprofit Specific Services

- A list of services included in the advisory fee must be examined. It is important the fee includes not only a comprehensive scope of services available to any classification of investor, but that it also contains services designed to specifically meet the needs of a nonprofit client.
- The advisor should be able to provide insights as to how the nonprofit's assets might be managed under their counsel.
- The advisor should be able to supply a few current nonprofit clients as references, which should provide insight in to the firm.

Nonprofit/Advisor Communications

- As a part of a nonprofit's advisor search, there should be a clear understanding for how often and in what form the relationship will operate. How often the advisor reviews investment policy statement, investment results and allocations etc. with the nonprofit is an important component and must align with the needs and expectations of the nonprofit investment team, board of directors or any related associates.
- Lynx believes quarterly contact with the nonprofit is ideal in terms of formal meetings/calls, while the nonprofit should feel comfortable contacting the advisor at any point, with any related matters. Additionally, quarterly reports/letters should be distributed or reviewed in person and an annual meeting to assess the nonprofit's investment policy statement (IPS) should be conducted.

Working Relationship

- Lastly, it is important to feel that there is a strong and comfortable rapport between the nonprofit and advisory teams. The nonprofit members should feel they have a connection with their advisor and can seamlessly communicate on any related question or concern.

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