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Assessing the Broker, Advisor Approach in Bank Investment Portfolios

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Investment portfolios and overnight cash positions have grown significantly at many financial institutions due to a recent surge in deposits and lower loan demand. Carrying excess cash on the balance sheet has been costly, given record low interest rates.

These factors are forcing executive teams to re-focus on the investment portfolio as a way of reducing net interest margin pressure stemming from declining earning asset yields. In general, banks have two options for managing the investment portfolio: the broker and the advisor approach.

The Broker Approach
Bankers have the option of working directly with brokers and brokerage firms to make investments for the portfolio. Usually, brokers present different products for consideration often via frequent emails. Building personal relationships is often how brokers “win” ongoing bond business. But executives are ultimately responsible for understanding the investment, determining how it fits on the balance sheet and ensuring best-trade execution. The broker is compensated through trade commission.

The Advisor Approach
Partnering with an investment advisor is a co-management approach, where the bank executives and advisor work together on strategy development and execution. Experienced investment advisors consider the entire balance sheet when making investment recommendations. Advisors are typically independent and are often compensated by an advisory fee.

Neither approach is universally right or wrong, but one could be a better fit for your institution. A common mistake institutions make is failing to properly monitor their brokers or advisors. However, it is important to periodically evaluate these relationships, to make sure the investment process is complementing overall balance sheet objectives.

Have you been relying on your brokers for investment ideas and managing the portfolio? How are they doing? Have their recommendations resulted in above-peer performance? Has your advisor delivered on their value-added proposition?

If you are considering a change from the broker approach to the advisor approach or switching advisors, below are seven benefits of working with an investment advisor:

- **Investment Management from a Whole Balance Sheet Perspective**: Financial institutions’ bond portfolios should never be managed as a stand-alone group of assets. Instead, it should be viewed in concert with the overall balance sheet, serving as a key component alongside loans and deposits.
- **Accountability and Transparency**: An investment advisor is a fiduciary who is completely aligned with your institution’s objectives. Portfolio returns are advisors’ report cards, and they are accountable to their clients. In contrast, brokers’ have an inherent conflict of interest from commission-based compensation. These commissions are often opaque and can vary significantly depending on the bond.

- **Strategy and Relative Value Analysis**: Experienced advisors constantly analyze the relative value of various sectors when making portfolio-specific recommendations. Advisors spend a lot of time identifying securities to improve your institution's portfolio returns.
- **Better/Best Execution for Security Transactions**: Investment advisors utilize a wide network of securities underwriters and dealers to improve trade execution. Robust investment technology and daily market participation allows experienced advisors to achieve pricing transparency.
- **Exclusive Product Access**: Investment advisors with a proven track record have access to a wide network of deal underwriters and have significant leverage to dictate favorable deal structure. Brokerage firms often do not have the same access to other firms' exclusive deals.
- **Staying in Control**: Partnering with an independent investment advisor should not feel like a sacrifice of control. The key is finding an advisor that acts in a co-management capacity, freeing bank executives from time-consuming tasks while retaining important strategic decisions such as asset allocation, duration and credit profile.
- **Redirected Productivity**: Executives often lack the time needed to manage the investment portfolio. Fielding brokers calls and responding to emails is time consuming. Managing the investment portfolio should not be a part-time job, and investment advisors are dedicated to the oversight of this earning asset.

Taylor Advisors Take

With weaker loan demand and growing overnight cash balances, investment portfolios are playing a greater role in overall bank profitability. Many financial institutions have relied heavily on the broker approach for investment advice, but should wary of hidden costs and potential conflicts of interest.

One reason that institutions partner with an independent investment advisor is to improve portfolio performance within context of risks. To evaluate your bank's investment portfolio performance relative to peers, start by studying the most recent quarterly data. Executives should understand where their institution's portfolio yield ranks, compared to institutions in their market. Below-average portfolio yield may indicate a strategy/process that needs adjustment.

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