FIDUCIARY LEADERSHIP

Investment Best Practices | Risk Management | Valuation

SERVICE PROVIDER DUE DILIGENCE

Dr. Susan Mangiero, AIFA, CFA, FRM

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DR. SUSAN MANGIERO, AIFA, CFA, FRM BIO SKETCH

- Dr. Susan Mangiero is a managing director with Fiduciary Leadership, LLC. Dr. Mangiero is a CFA charterholder, certified Financial Risk Manager and Accredited Investment Fiduciary Analyst™. She has provided testimony before the ERISA Advisory Council, the OECD and the International Organization of Pension Supervisors as well as offering expert testimony and behind-the-scenes forensic analysis, calculation of damages and rebuttal report commentary for various investment governance, investment performance, fiduciary breach, prudence, risk and valuation matters. She has over twenty years of experience in capital markets, global treasury, asset-liability management, portfolio management, economic and investment analysis, derivatives, financial risk control and valuation. This includes work on trading desks for several global banks, in the areas of fixed income, foreign exchange, interest rate and currency swaps, futures and options.

- Some of her recent engagements include: (a) analysis of DB plan funding status for a private equity buyer of a closely-held company (b) analysis of an investment manager's actions by a group of union plans (c) review of annuity terms for DB and DC plans (d) review of investment policy statement language in the aftermath of bank downgrades (e) assessment of damages by an asset manager that did not properly hedge positions (f) review of benefit distributions by a plan sponsor that is being investigated and (g) analysis of fees paid by a large trust. Dr. Mangiero has provided insights about asset allocation, fiduciary duties, risk management, modeling, hedge effectiveness, hedge funds, private equity funds, ERISA, valuation and industry best practices for consulting clients and employers that include the General Electric Company, Prudential Retirement, PricewaterhouseCoopers, Mesirow Financial, Bankers Trust, Bank of America, Chilean pension regulator, World Bank, Pension Benefit Guaranty Corporation, RiskMetrics, U.S. Department of Labor, Northern Trust Company and the U.S. Securities and Exchange Commission. Dr. Mangiero is the author of *Risk Management for Pensions, Endowments and Foundations* (John Wiley & Sons, 2005), a primer on risk and valuation issues, with an emphasis on fiduciary responsibility and best practices. Dr. Mangiero has written chapters for several books, including the *Litigation Services Handbook* and *The Handbook of Interest Rate Risk Management*.

- She is a frequently invited speaker and has keynoted or led workshops for organizations such as the Stable Value Investment Association, Harvard Law School, Florida Public Pension Trustees Association, New York State Department of Insurance, Association of Public Pension Auditors, AICPA - Employee Benefits Section, National Association of Corporate Directors and Financial Executives International. She is a member of the 401(k) vendor RFP best practices committee for the Association of Financial Professionals. Susan can be reached at susanm@fiduciaryleadership.com or 203-261-5519.

FIDUCIARY FATIGUE

- Low equity returns (and high volatility)
- Low bond yields
- Higher inflation
- Higher life expectancy
- Cash contributions
- Increased regulation
- Higher PBGC premiums
- Accounting impact
- Enterprise riskiness
- Impact on share price
- Litigation risks
- M&A deals gone awry due to pension issues
- Debt capacity
- Liquidity constraints
- Cost of capital

MANY PLAN SPONSORS WANT
OUT
OF THE
RETIREMENT BENEFITS
BUSINESS

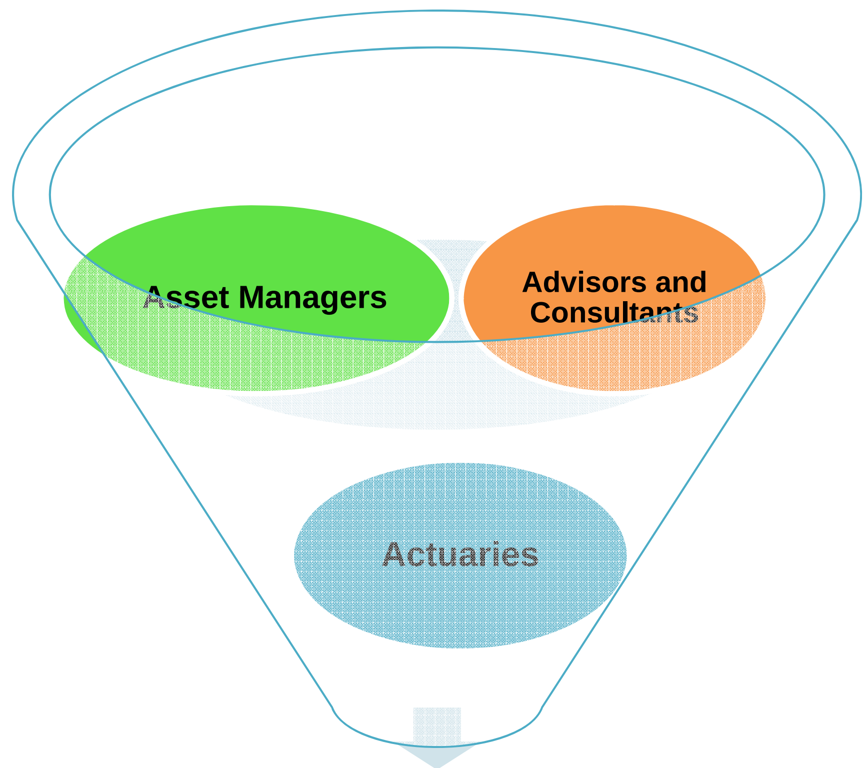
ONE SOLUTION IS TO OUTSOURCE

- Fiduciary outsourcing is on the rise
- The “F” word is here to stay – Regulators are reviewing fiduciary standard rules
- There is no free lunch where fiduciary duties disappear altogether
- Selection and overview of a fiduciary, functional or contractual, is critical
- Litigation against service providers is a real issue and not just about fees

MANY PLAN SPONSORS WANT
HELP

EXTERNAL FIDUCIARY ECOSYSTEM

- Who does what, when, for how much and on what basis?
- What are parameters for discretion and control over plan assets?
- Who can impact policies, procedures and internal and external controls?
- What is the role of the independent fiduciary, if one is used?
- Who is in charge of reviewing conflicts of interest across the fiduciary ecosystem?
- How are attorneys and auditors impacted by fiduciary outsourcing?



ERISA Fiduciary Duties

PARTIAL LIST OF
DUE DILIGENCE HOT BUTTONS

There is no shortage of issues that must be reviewed on an ONGOING basis.

CONFLICTS OF INTEREST

- Is an asset manager owned by the recommending consultant or financial advisor?
- How is the consultant or advisor being compensated?
- What is the experience of the consultant or financial advisor and representation of that experience to the ERISA plan?
- “Under the Investment Advisers Act of 1940 (Advisers Act), an investment advisor providing consulting services has a fiduciary duty to provide disinterested advice and disclose any material conflicts of interest to their clients. In this context, SEC staff examined the practices of advisers that provide pension consulting services to plan sponsors and trustees. These consulting services included assisting in determining the plan’s investment objectives and restrictions, allocating plan assets, selecting money managers, choosing mutual fund options, tracking investment performance, and selecting other service providers. Many of the consultants also offered, directly or through an affiliate or subsidiary, products and services to money managers. Additionally, many of the consultants also offered, directly or through an affiliate or subsidiary, brokerage and money management services, often marketed to plans as a package of “bundled” services. The SEC examination staff concluded in its report that the business alliances among pension consultants and money managers can give rise to serious potential conflicts of interest under the Advisers Act that need to be monitored and disclosed to plan fiduciaries.” (Source: U.S. Securities and Exchange Commission)

DERIVATIVES AND RISK MANAGEMENT

- “If the plan is investing in a pooled fund which is managed by a party other than the plan fiduciary who has chosen the fund, then that plan fiduciary should obtain, among other things, sufficient information to determine the pooled fund's strategy with respect to use of derivatives in its portfolio, the extent of investment by the fund in derivatives, and such other information as would be appropriate under the circumstances.” (Source: U.S. Department of Labor)

- “Plan fiduciaries have a duty to determine the appropriate methodology used to evaluate market risk and the information which must be collected to do so. Among other things, this would include, where appropriate, stress simulation models showing the projected performance of the derivatives and of the plan's portfolio under various market conditions. Stress simulations are particularly important because assumptions which may be valid for normal markets may not be valid in abnormal markets, resulting in significant losses. To the extent that there may be little pricing information available with respect to some derivatives, reliable price comparisons may be necessary. After entering into an investment, a plan fiduciary should be able to obtain timely information from the derivatives dealer regarding the plan's credit exposure and the current market value of its derivatives positions, and, where appropriate, should obtain such information from third parties to determine the current market value of the plan's derivatives positions, with a frequency that is appropriate to the nature and extent of these positions.” (Source: U.S. Department of Labor)

- With Dodd-Frank and swaps clearing rules, there is further need for clarity as to how derivatives are being use.

INVESTMENT PERFORMANCE

- How are asset classes categorized?
- Is there sufficient diversification?
- Is the fiduciary benefitting from helping to craft an Investment Policy Statement that lays out permitted strategies and allocations to certain types of asset managers?
- Who is kicking the tires on reported investment metrics?
- How much is being paid in fees to outsiders?
- Who is monitoring style drift?

LIQUIDITY

- How is liquidity being measured and by whom?
- Who is overseeing a plan’s restrictions on transferability?
- What are the economic rights of a pension plan limited partner?
- Promise to Adhere to Specified Concentration and Type of Investments
- Are there lock-ups?
- Are there side pockets?
- Can an asset manager suspend the right to redemptions?

VALUATION

- "Understand how a fund's assets are valued. Funds of hedge funds and hedge funds may invest in highly illiquid securities that may be difficult to value. Moreover, many hedge funds give themselves significant discretion in valuing securities. You should understand a fund's valuation process and know the extent to which a fund's securities are valued by independent sources." (Source: U.S. Securities and Exchange Commission)

- Bad valuation numbers drive bad performance data which in turn dictates the level of fees that are paid by an ERISA plan sponsor.

- Who is assessing the valuation models?

- Are assets and liabilities being priced to market or model?

- Bad inputs generate bad output. Who is vetting the integrity of data being used for pricing purposes?