

PENSION FUNDamentals®

Trustee Development Seminar II

Investment of Plan Assets

Under PA 314 of 1965, as amended

**Michigan Association of Public Employee
Retirement Systems
Fall 2014 Conference**

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Objective for Trustee Development Seminar II

To provide retirement system trustees and plan administrators a general overview regarding the investment of public pension plan assets under PA 314.

Fiduciary Responsibility Under Public Act 314 of 1965

Controlling Authority – Section 13(1)

Act 314 “... shall supercede any investment authority previously granted to a system under any other law of this state”.

Fiduciary Responsibility Under Public Act 314 of 1965 Controlling Authority – Section 13(2)

“The assets of a system may be invested, reinvested, held in nominee form, and managed by an investment fiduciary subject to the terms, conditions, and limitations provided in this act.” (Excludes DC Plans)

Fiduciary Responsibility

Public Act 314 of 1965, Sec 12c.(1)

Definition of “Investment Fiduciary”:

- a. One who exercises any discretionary authority or control in the investment of a system’s assets; and/or
- b. Renders investment advice for a system for a fee or other direct or indirect compensation.

Public Act 314 of 1965

Fiduciary Duties – Section 13(3)

An investment fiduciary shall discharge duties solely in the interest of the plan participants and beneficiaries and shall do the following:

- a. Act with the same care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a similar capacity and familiar with those matters would use in the conduct of a similar enterprise with similar aims.**
- b. Act with due regard for the management, reputation, and stability of the issuer and the character of the particular investments being considered.**

Public Act 314 of 1965

Fiduciary Duties – Section 13(3)

An investment fiduciary shall discharge duties solely in the interest of the plan participants and beneficiaries and shall do the following:

- c.** Make investments for the exclusive purposes of providing benefits and of defraying reasonable investment expenses.
- d.** Give appropriate consideration to facts and circumstances that fiduciary knows or should know are relevant to the particular investment or investment course of action incl:
 - i.** The diversification of the investments;
 - ii.** The liquidity and current return of the investments relative to cash flow needs;
 - iii.** The projected return of the investments relative to the funding objectives.

Public Act 314 of 1965

Fiduciary Duties – Section 13(3)

An investment fiduciary shall discharge duties solely in the interest of the plan participants and beneficiaries and shall do the following:

- e. Give appropriate consideration to investments that would enhance the general welfare of the state and its citizens if such investments offer the safety and return of other comparable investments permitted under the Act;
- f. Prepare and maintain written investment objectives, policies, and strategies with clearly defined accountability and responsibility for implementing and executing the system's investments;

Public Act 314 of 1965

Fiduciary Duties – Section 13(3)

An investment fiduciary shall discharge duties solely in the interest of the plan participants and beneficiaries and shall do the following:

- g. Monitor the investments with regard to the limitations of the Act and to reallocate prudently if such investments exceed the limitations allowable under the Act.**

Plan assets are valued at “market” for purposes of meeting the asset limitations under the Act (PA 314, Sec12a).

Public Act 314 of 1965

Fiduciary Duties – Section 13(3)

An investment fiduciary shall discharge duties solely in the interest of the plan participants and beneficiaries and shall do the following:

- h. Prepare and maintain written policies regarding ethics and professional training and education, including travel, which policies contain clearly defined accountability and reporting requirements.**

Public Act 314 of 1965

Fiduciary Duties – Section 13(3)

An investment fiduciary shall discharge duties solely in the interest of the plan participants and beneficiaries and shall do the following:

- i. Publish a summary annual report (“SAR”) that includes, at a minimum, all of the requirements detailed in the Act. (i.e., investment fiduciaries, assets & liabilities, funded ratio, investment performance, ALL expenditures, actuarial info, open/closed, etc.)
- j. Sec. 20h.(6) requires the SAR to be published on the System’s or sponsoring political subdivision’s website.

Delegation of Responsibility

Section 13(5) of Act 314 provides that an investment fiduciary may:

- a) use a portion of the income of the system to defray the costs of investing, managing, and protecting the assets of the system;
- b) retain investment and all other services necessary for the conduct of the affairs of the system, including consultants, advisors, custodians, accountants, actuaries, attorneys, administrators, etc; and
- c) pay reasonable compensation for those services.

Delegation of Responsibility

- Fiduciaries generally not liable for a breach of duty if such duty has been specifically allocated to another fiduciary.
- Fiduciaries must exercise reasonable prudence in delegating.
- Delegees must be qualified, competent, and capable.

Delegation of Responsibility

- It is essential that the qualification status and written acknowledgement of the fiduciary is well documented in official records.
- Prudence requires fiduciaries to actively monitor the activities of all appointed fiduciaries.

Delegation of Responsibility

Section 13(7) of Act 314 provides that:

- a) Before any investment services are provided, the provider shall provide a complete written disclosure of all fees or other associated compensation;
- b) After investment services are provided, the provider shall provide annual written disclosure ALL fees (i.e., commissions, 12b-1, 3rd party compensation, etc.).
- c) “Investment Service Provider” defined broadly.

Retention of Professionals: "The Prudent Specialists"

1. Custodial Bank
2. Investment Consultant
3. Broker
4. Investment Manager(s)
5. Legal Advisor
6. Actuary
7. Auditor / Accountant

Investment Advisers – PA 314 Sec.13

(11)

An investment adviser shall meet 1 of the following requirements:

- a) Be a registered investment adviser under the Investment Advisers Act of 1940 or the Michigan Uniform Securities Act;
- b) Be a bank as defined under Investment Advisors Act; or
- c) Be an insurance company qualified under Section 16(3).

Investment in Stocks/Equities



Definition of Equity Securities

Equity securities represent ownership shares. The owners have a residual claim (which comes after a creditor's claim) on the corporation's assets and earnings. Equity-related assets include publicly traded common stock, preferred stock, options, convertibles, mutual funds as well as ownership positions in small firms and venture capital investments. Each of these investments represents direct or indirect ownership in a profit-seeking enterprise.

Act 314 "Equity" Definitions

- "**Stock**" means capital stock, common stock, preferred stock, American depository receipts, or any evidence of residual ownership of a corporation (Sec. 12e.(4)).
- "**Equity interests**" means limited partnership interests or other interests in which the liability of the investor is limited to the amount of the investment...(Sec. 12b.(3)).

Act 314 "Equity" Definitions

- "**Global equity**" means an equity position in a company traded on an exchange outside of the US or a security that may be issued in a currency other than the US dollar or an unregistered American depository receipt (Sec. 12b.(4)).

"October. This is one of the peculiarly dangerous months to speculate in stocks. The others are July, January, September, April, November, May, March, June, December, August and February."

Mark Twain

Equities – Section 14

Sec. 14 previously only referenced domestic stock, but now includes global equities.

An investment fiduciary:

1. May not invest more than 70% of a system's assets in stock or global equity;
2. May not invest in more than 5% of the outstanding stock of any 1 corporation;
3. May not invest more than 5% of a system's assets in the stock of any 1 corporation.

Stock/Equities – Section 14

Investments in stocks or global equities shall meet 1 of the following:

1. Be registered on a national securities exchange regulated under Securities Exchange Act of 1934 or an industry recognized exchange outside of the US;
2. Be on a national association of securities dealers automated quotation system or a successor to this system; or an industry recognized exchange outside of the US;
3. Be issued pursuant to rule 144a under the Securities Act of 1933;
4. An ADR or Global Equity meeting the foregoing requirements may be qualified as either a Sec. 14 investment or a Global Security investment under Sec. 20k.

Fixed Income Investing



What Is a Bond?

- Loan to the issuer
- Referred to in Act 314 as “obligations”
- Issuer pays the investor regular interest payments
- Principal – Face Value – Par Value

Act 314, 12d.(3) - Obligations

"Obligations" means bonds, notes, collateral trust certificates, convertible bonds, debentures, equipment trust certificates, conditional sales agreements, guaranteed mortgage certificates, pass-through certificates, participation certificates, mortgages, trust deeds, general obligation bonds, revenue bonds, or other similar interest bearing instruments of debt... may be secured or unsecured, publically offered or privately placed.

Fixed Income

Act 314 - Section 17

An Investment Fiduciary may invest in:

- a) Obligations issued, assumed, or guaranteed by an entity created under US or state law.
- b) Obligations secured by security interest in real property or personal property and a lease obligation given by a solvent entity whose obligations would be otherwise qualified under the Act.
- c) Obligations issued, assumed, or guaranteed by the U.S., its agencies, or U.S. Government-sponsored enterprise.

Fixed Income – Section 17

An Investment Fiduciary may invest in:

- d) Obligations of a possession or territory of U.S. or any political subdivision.
- e) Banker's acceptances, commercial accounts, CDs, depository receipts issued by bank, trust co., S&L, or credit union.
- f) Commercial paper rated within 2 highest classifications which mature within 270 days.

Fixed Income – Section 17

An Investment Fiduciary may invest in:

- g) Repurchase agreements
- h) Reverse repurchase agreements
- i) Any investment otherwise permitted in which the interest rate varies
- j) Obligations secured by any of the obligations described in subdivisions (a) or (c).
- k) Dollar denominated obligations issued in the U.S. by foreign governments, supranationals, banks, or corporations.

Fixed Income – Section 17

An Investment Fiduciary may not:

- Invest in more than 5% of the outstanding obligations of any 1 issuer.
- Invest more than 5% of a system's assets in the obligations of any 1 issuer.

Credit Quality

Act 314 Definitions – Section 12

Investment Grade [Section 12c(3)]. Means graded in the top 4 major grades as determined by 2 national rating services.

Credit quality

Act 314 Definitions – Section 12

National rating service [Section 12d(1)] means Moody's Investor Services, Inc.; Standard & Poor's Ratings Group; Fitch Investors Services, Inc.; Duff & Phelps Credit Rating Corp.; or any other nationally recognized statistical rating service as determined by the state treasurer.

Credit Quality

Major Credit Ratings

	Standard & Poor's	Moody's	Fitch Ratings
Investment Grade	AAA	Aaa	AAA
	AA	Aa	AA
	A	A	A
	BBB	Baa	BBB
Below Investment Grade	BB	Ba	BB
	B	B	B
	CCC	Caa	CCC
	CC	Cc	CC
	C	C	C
	D		D

Misc. Act 314 Provisions
**Securities Exempt from
Income or Other Taxes –
Section 20g**

Investments in securities wholly or partially exempt from U.S. income or other taxes shall be made only at taxable-equivalent yields or returns available on comparable securities at time investment decision is made.

Global Securities



Global Securities: Act 314, Section 20k

A System with assets of <\$2B, may invest up to 20% in global equities, bonds, derivatives etc., subject to:

1. 5% limitation in outstanding securities of any 1 issuers;
2. 5% limitation of system's assets in any 1 issuer;

Investments in global securities shall only be by qualified investment fiduciaries with demonstrated expertise.

Global Securities: Act 314, Section 12b.(4)

“*Global Security*” defined as any of the following:

- A fixed income security issued by a government, a governmental agency, or a public or private company...
- An unregistered ADR or an equity position in a company...
- An equity or fixed income derivative of the above or a global security or bond index...

... that is traded on an exchange outside of the US and may be issued in a currency other than the US dollar.

Alternative Investments

An Overview of Alternative Investments under Act 314

Alternative Investments Generally

Real Estate

Private Equity

Commodities and Managed Futures

Hedge Funds

Infrastructure

Real Estate – Section 19

Subsection (1) – Indirect Real Estate

- Available to all systems regardless of size
- May invest up to 10% of a system's assets in publically or privately issues real estate investment trusts (REITS) or in real or personal property otherwise qualified under Section 15, 16 or 20c.

Real Estate – Section 19

Subsection (2) – Direct Real Estate

- Available to systems >\$100M
- In addition to the 10% of Subsection (1)
- May invest up to additional 10% in Indirect Real Estate (Subsection(1)) or Direct Real Estate under qualifications of Subsection (2)

Real Estate – Section 19(2)

Direct Real Estate - Qualifications

- a) Invest in, buy, sell, hold, improve, lease, foreclose upon, real or personal property or an interest in real or personal property
- b) Develop, maintain, operate or lease the property in (a).
- c) Form or invest in 1 or more LP's, Inc.'s, LLC's, or other entity to hold, develop, lease, etc., real or personal property.

Real Estate – Section 19(5)

Direct Real Estate – Asset Limitations

Real Estate, whether qualified elsewhere in the Act, is subject to asset limitations of Section 19. However a registered, publically traded REIT may be qualified by the system as either a stock under Section 14 (70% limitation) or Real Estate under Section 19.

Alternatives

Basket Clause - Section 20d

Investment fiduciary may invest system's assets in investments not otherwise qualified, except 19a qualified, whether similar or dissimilar ...

1. If $< \$250\text{M}$, no more than 15% in basket clause.
2. If $> \$250\text{M}$, no more than 20% in basket clause.
3. If $> \$1\text{B}$, no more than 25% in basket clause
4. If state treasurer, no more than 30% in basket clause.

Alternatives-Basket Clause

Section 20d

5. If basket clause investment subsequently determined to be permitted under another section, then no longer considered in basket clause.
6. Basket clause may not be used to exceed a percentage of total assets limitation for investment provided elsewhere in Act.

Alternatives

Investments in Private Equity: Section 19a & 20d.

- 1) >\$1B, may invest 10% in private equity + 5% in MI private equity.
- 2) >\$250M, but <\$1B, 5% in MI private equity
- 3) An investment fiduciary may otherwise invest in private equity under Section 20d. (i.e., the Basket Clause).

Alternatives-Investments in Small Business : Section 20a

An investment fiduciary of system > \$250M may invest up to 2% in small business or venture capital firm having principal office or more than 1/2 of assets within Michigan. Such investment shall be considered stock for asset limitation purposes.

Alternatives - Derivatives

Section 20j

Provides specific guidelines and limitations for investment into derivatives which are otherwise qualified elsewhere in the Act. Investment in derivatives for the purpose of leveraging a portfolio or shortening securities as a sole investment is specifically prohibited.

Indirect Investment Vehicles

Mutual Funds – Section 15

- Investment fiduciary may invest in investment companies registered under Investment Company Act of 1940.
- Management of Inv Co shall have been in operation for > 5 years.
- Investment Company shall have > \$500M under management.
- Established as Ltd. Partnership, Corp. LLC, trust or other entity under US or foreign law
- Considered investment in underlying assets

Investment in Collective Investment Fund, Common Trust or Pooled Fund – Section 20c

1. An investment fiduciary may invest in collective funds, common trusts, or pooled funds established by state chartered bank, national bank, trust company or qualified management company.
2. Any such investment shall be considered investment in underlying assets for limitations purposes.

Annuity Investment Contracts, Investment Accounts of Life Insurance Companies – Section 16(1)

1. An investment fiduciary may invest in annuity contracts or participations in separate real estate, mortgage, bond, stock or other investment accts. of a life ins. Co. authorized to do business in MI.
2. Any such investment shall be considered investment in underlying assets for limitations purposes.

Miscellaneous Provisions of Act 314



Alternative Investments

Secured Loans - Section 20

An investment fiduciary may invest in loans secured by:

- a) First liens upon improved property
- b) First mortgages or deeds of trust on leasehold estates
- c) First mortgages on unimproved real property, at least 60% of which real property is under contract of sale and such contracts are pledged as collateral.
- d) Second mortgages subject to delineated requirements.

Misc. Act 314 Provisions

Real Estate or Certain Mortgages – Section 18

An investment fiduciary may invest in real estate or mortgages on real property leased or to be leased to the United States government, or to a state, territory, agency, authority, or public instrumentality of the United States.

Misc. Act 314 Provisions
**Deposits with Political
Subdivision or State Treasurer –
Section 20b**

An investment fiduciary may make interest bearing deposits with the treasurer of the political subdivision sponsoring the system or with the state treasurer.

Misc. Act 314 Provisions

General Account of a Life Insurance Company – Section 16(2)

1. Total amount of assets of any 1 system invested in any 1 insurer shall not exceed 50% of the capital and surplus of the insurer.
2. Insurance company shall have been in operation > 5 years with assets >\$500,000,000.
3. Insurance company shall have claims paying ability rating > single A.

Reporting Requirements – Soft Dollars Section 13(10)

A system shall annually publish and make available to plan participants and beneficiaries a list of all expenses paid by soft dollars as defined in Section 12e(3).

Soft dollar [Section 12e(3)]. Means brokerage commissions that are used by the system to purchase goods or services.

Misc. Act 314 Provisions
MacBride Principles – Section
13a

Establishes limitations on
direct investments in stock of
companies doing business in
Northern Ireland.

Misc. Act 314 Provisions

Debt Instruments Issued by Foreign Countries Engaging in Terrorism – Section 13(9)

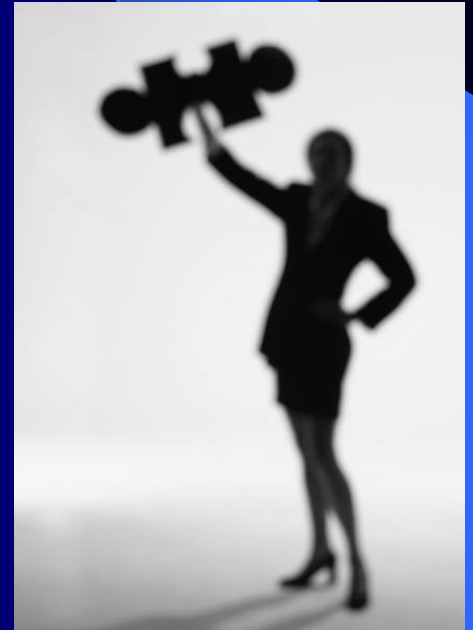
Prohibits investment into debt instruments issued by foreign countries which have been identified by the U.S. State Department as engaging in or sponsoring terrorism

FOIA Exemption – Section 20I.

Financial or proprietary information pertaining to a portfolio company in connection with real estate or alternative investments is exempt from FOIA disclosure.

Bringing It All Together

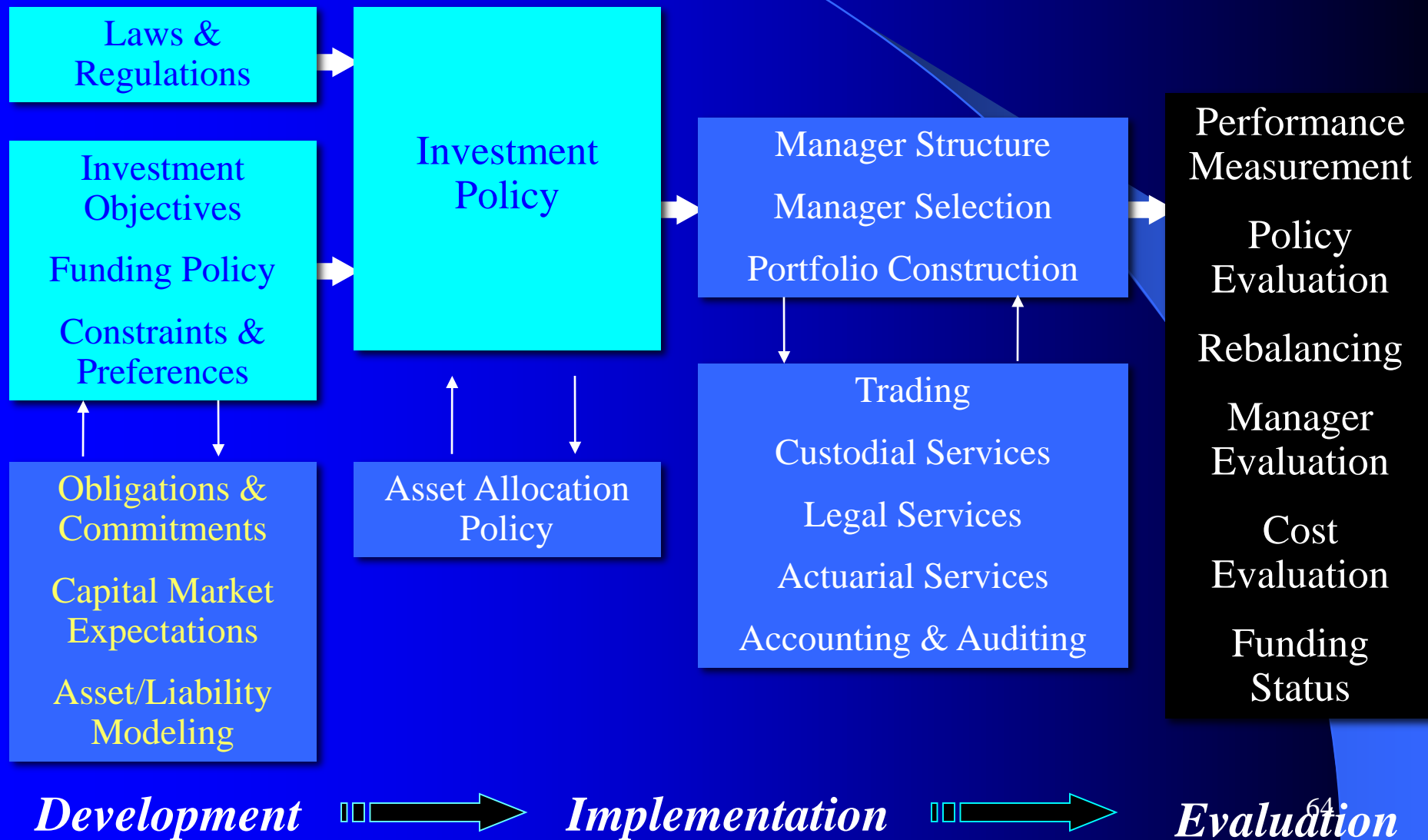
Investment Policy,
Objectives and
Guidelines



Statement of Investment Policy

- Importance of Investment Policy
- Plan Management Process
- Asset Allocation
 - Asset Liability Modeling
 - Diversification
 - Rebalancing
- Investment Manager Structure
- Administrative Issues

Plan Management Process



Importance of Investment Policy

“Before everything else, getting ready is the secret of success.”

Henry Ford

- Dynamic blueprint for investment success.
- Crucial today considering:
 - Pension and healthcare costs on the rise
 - Modest market returns and future assumptions
 - Number of active participants to number of retirees ratio falling
- Critical part of the Plan Management Process.
 - Clearly defined responsibility and accountability for implementing, executing and monitoring the system's IP and Act 314 compliance

Investment Policy, Guidelines, Objectives

- Evaluate Current Financial Position
- Setting Investment Objectives
 - ✓ Liquidity
 - ✓ Income Requirements
 - ✓ Growth / Preservation of Principal
 - ✓ Risk: Inflation, Interest Rate, Recession, Market
 - ✓ Return
 - ✓ Time Horizon
 - ✓ Benchmark / Indices
 - ✓ Policy Restrictions

Asset Allocation

- An asset allocation process may begin by documenting an investor's profile. This incorporates:
 - ❖ Objectives - Risk Tolerance - Time Horizon - Constraints
- The asset classes for consideration are then selected by the investor.
- Once the asset classes are selected, they are combined through a portfolio optimization process to determine the efficient frontier that represents the optimal asset mixes.

Asset Allocation

- The portfolio further analyzed to examine the potential for loss over different time periods prior to selection of the appropriate long-term strategic asset allocation.
- The ongoing monitoring and review of the portfolio mix is critical to long-term success. This incorporates rebalancing and reallocating decisions based on changes in the portfolio, capital market assumptions and/or IP modifications.

Asset Allocation

*“Failure to
prepare is
preparing to
fail.”*

John Wooden

- Ties the actuarial and investment issues together by establishing a roadmap for the Plan to meet its objectives.
- Is usually strategic or tactical and developed through the use of an optimization program.
- Most important decision Boards make, and also contributes the most to long-term returns.

Asset Allocation

- Asset Classes

- Equity

- Fixed Income

- Other Asset Classes

- ❖ Real Estate – Direct / Indirect Investments

- ❖ Global: Equity (ADRs), Bonds, etc.

- ❖ Alternatives –Private Equity, Hedge Funds, Real Assets, Options/Futures

- Asset Styles

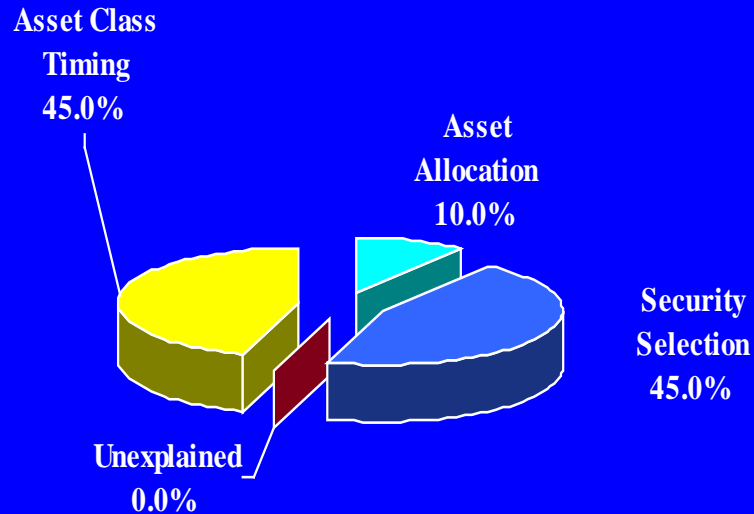
- Correlation

- Risk Management

*“If you don’t know
where you’re going,
you’ll never get there.”*

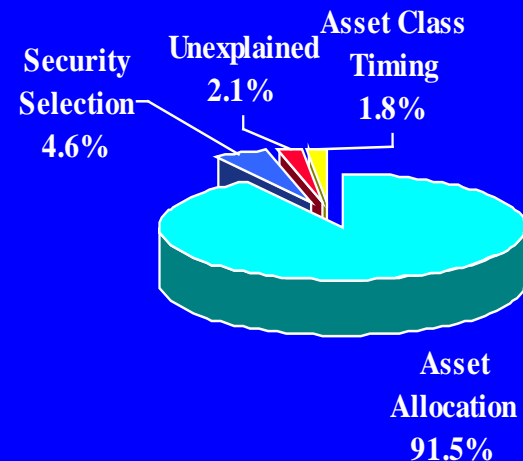
Anonymous

Components of Return Variability: *The Fallacy*

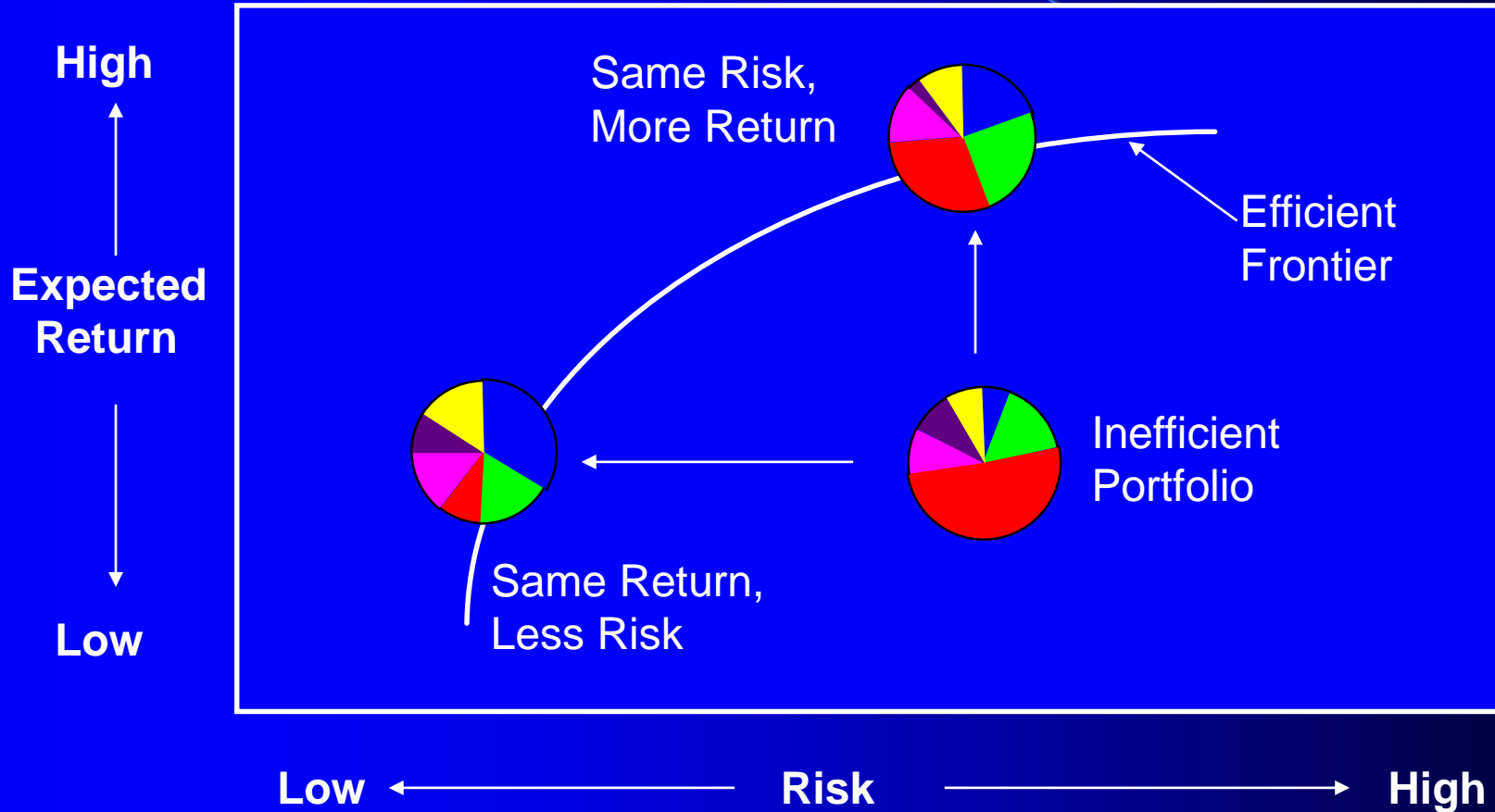


Asset Allocation

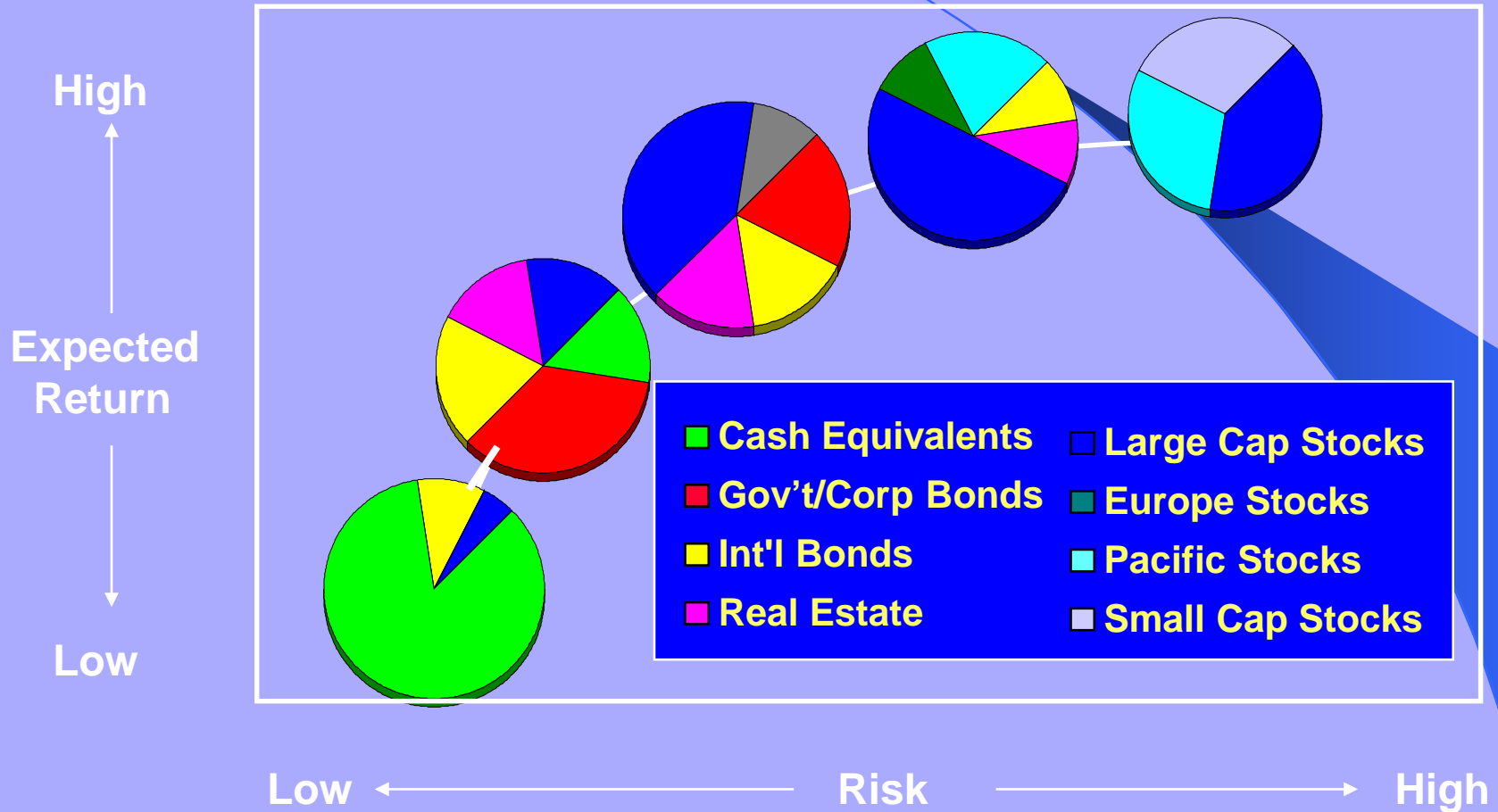
Components of Return Variability: *The Fact*



Identifying Efficient Portfolios



Selecting a Suitable Portfolio



Diversification

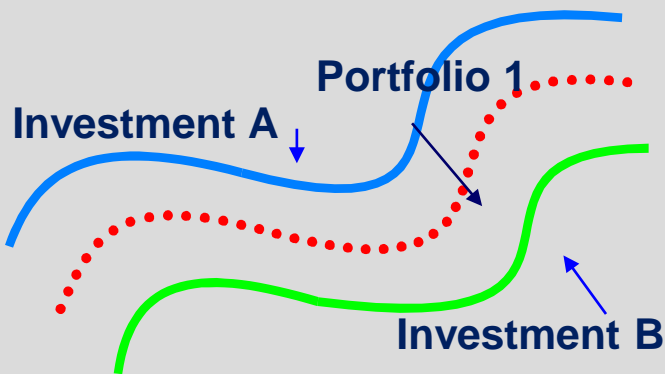
- Allocation among numerous asset classes to enhance performance while reducing volatility.
- Most asset classes do not move in tandem with each other.
- Low correlation is key to diversification.

“If everyone is thinking alike then somebody isn’t thinking.”

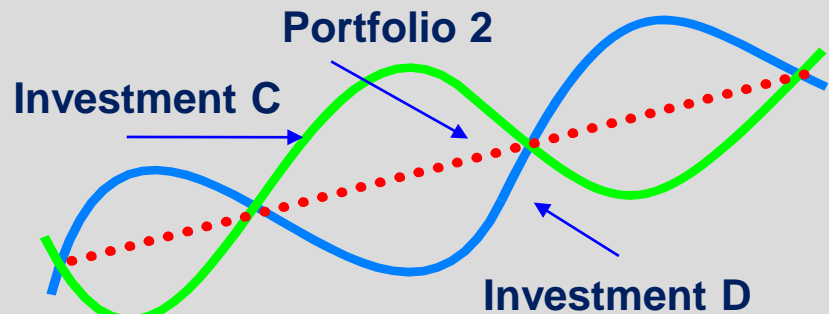
George S. Patton, Jr.

Diversification from Combining Asset Classes

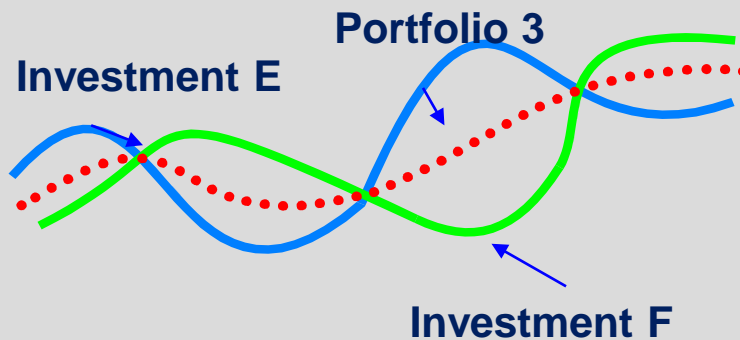
No Diversification



Complete Diversification



Some Diversification



Diversification

- “Prudent Expert Standard” points us towards viewing the total portfolio as a whole, not separate pieces; opening the door to several new asset classes.
- Non-traditional asset classes have been the key to above average results since 2000.
- Strong arguments for certain asset classes should at least be heard by Boards.
- Diversification within asset class.

Rebalancing

- Boards are frequently faced with an emotionally difficult choice, especially during volatile markets.
- A simple mechanism to help keep returns around target return.
- Reduces the likelihood of very negative outcomes.

“Even if you’re on the right track, you’ll get run over if you just stand there.”

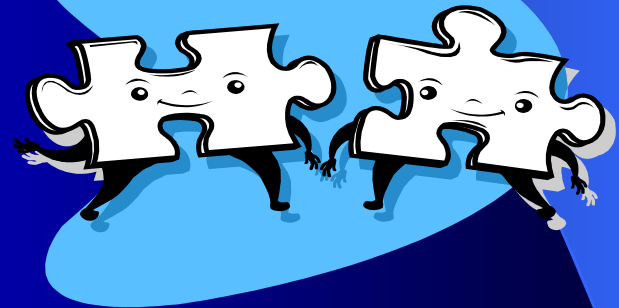
Will Rogers

Rebalancing

Important considerations when rebalancing:

- Set bands around target allocations.
- All asset classes do not behave the same.
- Cost/benefit analysis should determine trigger point and how far to rebalance.
- Policy should specify who, under what circumstances and when rebalancing occurs.

Due Diligence Process



Due Diligence Process

- Frank Russell
- Vestec
- PSN
- Performance Analytics

*Evaluate managers based on
QUALITATIVE and QUANTITATIVE factors*

- Onsite Due Diligence
- Review Trading Activity
- Ongoing Monitoring

Quantitative Analysis

Quartile Ranking

Capture Ratio

Risk Reward

Growth of Assets

Performance

Develop a short list of
125-150 managers

**Investment
Manager**

Qualitative Analysis

Creditable Organization

Consistent Performance

Continuity in Management Staff

Coherent Investment Process

Due Diligence Committee

Annual On Site Visit

Quantitative Manager Analysis

- Begin with a database of managers who have passed a rigorous due diligence process. Managers are then examined based on **risk to reward ratios, quartile ranking in peer group universe, capture ratio trends, growth of assets and performance criteria.**
- Based on the recommended asset class weightings provided by the allocation modeling process, the committee/Board begins a search for independent firms to manage portfolios within the various asset classes.
- Finally, recommend investment managers that meet the investor's selection criteria. Finalists will make presentations to the appropriate committee/Board.

Qualitative Manager Analysis

Creditable Organization

- ✓ An upstanding reputation in the financial services industry.
- ✓ A proven track record of at least five years.
- ✓ Min. \$100M in assets under management. (Reflects financial stability, business commitment and ability to accept additional monies.)
- ✓ A minimum number of accounts managed. (A reasonable # of accounts given dollar amount and type of assets managed)
- ✓ Proven administrative capabilities. (Trading, client communication, and reporting.)
- ✓ SEC and State registration compliance.

Qualitative Manager Analysis

Continuity in Management Staff

- ✓ A highly-qualified management team.
Sufficient experience and time with the firm.
- ✓ Present employment of those involved in creating the firm's track record.
- ✓ Low turnover rate among the management team.

Qualitative Manager Analysis

Coherent Investment Process

- ✓ Definable investment philosophy.
- ✓ Effective investment process given an organization's structure.
- ✓ Consistent investment strategy relative to manager's stated investment style and performance.

Investment Manager Selection

- Identify Asset Class via Asset Allocation Process
- Implement Allocation via retention of Investment Manager
 - Manager Search Process
 - Interviews or Recommendation from Consultant?
 - Act 314 Qualification Opinion
 - Contract Negotiation
 - Fee Negotiation
- Implementation of Portfolio
 - Best practices
 - Utilize transition manager?

Performance Monitoring



Performance Evaluation

Why Do We Evaluate Plan and Investment Manager Performance?

To Monitor:

- Progress towards meeting the goals of the Total Fund;
- Compliance with the Investment Policy Statement and Public Act 314;
- Total Fund Asset Allocation;
- Investment Manager style purity; and
- Investment Manager risk and return.

Performance Evaluation

Total Fund Index Comparisons

- **Policy Index** – an index created to represent the long-term target asset allocation of the Total Fund
 - e.g., 40% S&P 500, 10% Russell 2000, 10% MSCI EAFE, 40% Barclays Gov/Credit
 - Policy Index will help you evaluate progress of Plan Assets towards long term goals
- **Active Allocation Index** – an index created to represent actual asset allocation within each quarter
 - Active index will help you monitor Tactical Asset Allocation decisions

Performance Evaluation

Investment Manager Performance Monitoring

- Index Comparisons
 - Select appropriate style specific benchmark for each investment manager
 - Keep in mind three to five year time frame for appropriate evaluation
- Peer Group Comparisons
 - Another tool for comparisons
 - Keep in mind three to five year time frame for appropriate evaluation

Performance Evaluation

Investment Manager Watch List Provisions

A. Qualitative Issues Arise

- Investment team/professional leaves firm
- Ownership structure change

B. Quantitative Issues Arise

- Significant underperformance vs benchmark and peer group
- Manager breaches investment policy constraints

C. Watch List should be at least 2 qtrs of monitoring of progress toward specific goals

- Manager must supply monthly written reports of quantitative and qualitative issues/progress
- Set date in writing

Performance Evaluation

Termination of an Investment Manager

- Portfolio consistently outside of IPS or stated investment philosophy
- Manager shows consistent style drift
- Performance does not show improvement during Watch-List status
- Investment Manager is not forthright about material changes within firm

Performance Evaluation

The Quarterly Performance Reports include:

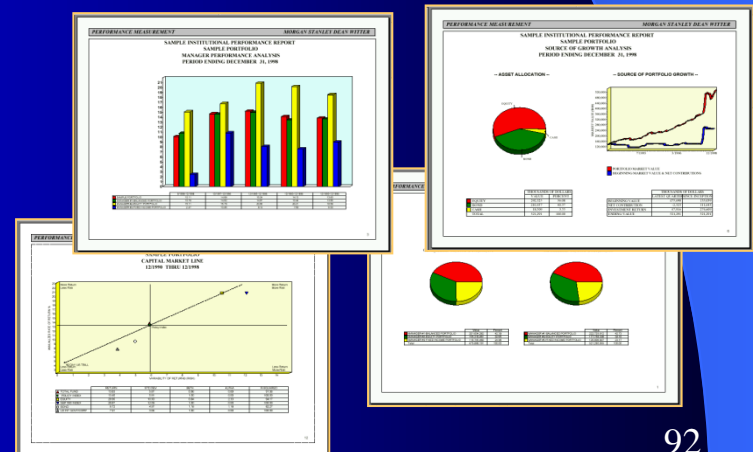
REPORTS

MONITOR RETURN

MEASURE VOLATILITY

EVALUATE MANAGER

- ❑ Quarterly, Year-to-Date and Since Inception Performance Results
- ❑ Performance Results Compared to Stated Market Indices and Appropriate Benchmarks
- ❑ Performance Results Related to a Universe of Managers with Similar Investment Styles
- ❑ Accrual Method of Accounting
- ❑ Trade Date Analysis
- ❑ Gross/Net of Management Fees
- ❑ Time Weighted Rate of Return
- ❑ Risk Return Analysis



Investment Consulting

Fees and Costs

- Directed Broker vs. Manager Selection
- “Soft Dollar” vs. Hard Dollar Consulting
- Commission Rate Negotiations
- Basis Points
- Commission Recapture
- Wrap Fees
- Trading Effectiveness: Ongoing Measurement

Administrative Issues

- Act 314 Required Disclosures
- Disclosure by all Plan vendors and/or fiduciaries of any potential or actual conflicts of interest.
- Disclosure by all Plan vendors and/or fiduciaries of their fee/compensation from the Plan including amount and type of arrangement.

Question / Comments



Michael VanOverbeke

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313 / 578-1000

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Endnotes

This information is for illustrative purposes only and is not intended to represent the recommendation or performance of any specific investment or investment course of action.