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Portfolio Evaluations, Inc. is a privately-owned institutional investment consulting firm. Founded in 1992, PEI operates in an independent, non-affiliated capacity to provide advice, guidance, direction, and education to the fiduciaries of institutional investment programs.



Trend Outlook

Key Themes for 2012 and Their Impact on Investment Strategies

In a review of economists and financial market strategists, a few themes have emerged for 2012. Global economic growth will remain subdued and below trend as tighter fiscal policy around the world continues. The European economic situation will continue to suppress global export growth from the U.S and emerging Asia, but signs of domestic improvement in these economic areas will help counter European constraints. China, in particular, is expected to continue easing monetary policy that will support improved GDP. The continuing depression of consumer and business confidence from stubborn unemployment, weak housing, and uncertain political landscape has estimates of U.S. GDP in the 2.5-3.0% range.

European fiscal and credit issues will remain at the forefront. While markets were calmed by ECB intervention in the Spanish and Italian bond markets, and discussion of a Greek debt swap, a longer-term fiscal solution has yet to be worked out. Adding to the uncertainty are mounting political pressure within individual countries, such as Germany and France, and the recent S&P downgrades of France and Austria (from AAA to AA+).

Global interest rates will remain low and may continue to decline. Rates could be forced lower by a flight to quality following additional turmoil in Europe, or additional monetary easing in the emerging markets as these countries seek to re-stimulate growth.

Overall, most forecasts agree that uncertainty and related market volatility will influence financial markets and make it more difficult for Investment Committees to find opportunities for growth and return.



Case Study

Plan Fee Benchmarking: Pricing Structure Revisited

Plan fee benchmarking studies are becoming increasingly more important for plan sponsors to fulfill their fiduciary responsibilities. Plan fees directly impact the total potential savings possible for plan participants. Plan fees vary due to the unique characteristics of each plan. For such reason, PEI recommends plan sponsors to undergo this practice every three to five years to see what the market has to offer at that given point in time. In doing so, plan fiduciaries act in the best interest of the plan participants. Additionally, plan sponsors increase their fiduciary protection by following a prudent, documented process.

As an example, PEI facilitated a plan fee benchmarking study for a \$180M DC plan with over 1,100 participants. At the start of the project the client was in a bundled pricing arrangement with their incumbent which meant the vendor was collecting all revenue from the investment. At that time the required revenue equated to 18 basis points (bps) of plan assets.

At the beginning of the project, the incumbent was already in the process of changing a majority of funds in the plan to lower-cost share classes to reduce overall plan fees; estimated fees would be reduced to 11 bps. As a result of PEI's plan fee benchmarking process, the incumbent came back to PEI with a price quote of 5.5 bps. The marketplace fee quotes provided by the vendors included in this study ranged between 5 and 10 bps.

The end result of the plan fee benchmarking analysis lead to a reduction of \$225,000 in administrative fees. Not only were plan fees significantly reduced, but the process was formally documented.



DOL Issues Final Fee Disclosure Regulations

The final fee disclosure regulations were announced this morning by the DOL. The effective date has been adjusted from April 1, 2012 to July 1, 2012. The DOL fact sheet and final ruling have been published. Additional information on this ruling can be found on the Employee Benefits Security Administration website, <http://www.dol.gov/ebsa/>.



PEI News

PEI has started its 20th year! Incorporated in 1992, Michael Sasso, Richard Torbinski, and Attila Toth began Portfolio Evaluations, Inc. in Morristown, New Jersey. PEI has more than \$26 billion in assets under advisement and over 180 clients. The PEI team would like to thank the clients that have been a part of our history and looks forward towards continued partnerships.

Partner and Co-Founder, Attila Toth, was recently named one of PLANADVISER's 2012 Top 100 Retirement Plan Advisers.

Two new team members have recently joined PEI. Dan Andriola comes to PEI as a Senior Investment Analyst. Dan has several years of experience in the investment industry. Jared Anderson is the latest to join PEI. He is a recent graduate of Sacred Heart University and joins PEI as an Investment Analyst. Welcome Dan and Jared!



How to Monitor an Outsourced CIO

Whether one is a part of a small or large organization, the decision to implement an outsourced Chief Investment Officer (CIO) solution is likely based on a variety of factors. A common challenge faced by organizations is the development and maintenance of internal staffs with the appropriate level of investment and fiduciary expertise. In addition, software tools and databases for portfolio oversight, manager due diligence, and reporting must be in place to run and monitor complex portfolios. Finally, organizations may be looking to take more frequent tactical decisions, which can be difficult with the traditional internal investment committee structure.

For organizations that do not want these responsibilities, an outsourcing solution can make a lot of sense. Organizations may think their responsibilities end with the selection and turning over the reins to an outsourced CIO, but best practices dictate that the outsourced CIO is subject to formal monitoring. So the practical question is; how should one monitor an outsourced CIO?

As the party conducting manager due diligence and portfolio construction, the outsourced CIO's investment performance should be measured against appropriate benchmarks and peer groups. These performance thresholds should be stated in the portfolio's Investment Policy Statement (IPS) and investment reports should properly reflect these hurdles. The key question for an organization is; can one rely on a CIO to impartially report and compare its performance? This is where an outside party such as an investment consultant can be helpful which typically has the databases and expertise to make appropriate comparisons.

One of the primary resources for turning to an outsourced CIO is the expertise of the people to conduct due diligence and carry out the performance and

risk objectives of the portfolio. As such, it is important for an organization that hires an outsourced CIO that the personnel maintain the high standards held in the selection process. Thus, on a periodic basis, it is important to make an assessment on those within the outsourced CIO firm to make certain that there have not been any significant losses of talent and that the individual or primary team members remain suitable.

An inspection of the processes employed by the CIO to conduct manager due diligence, and portfolio construction is fitting on a periodic basis. The processes employed should be transparent enough for an organization to make an informed judgment. These include examining a CIO's systems, reports, and internal decision making mechanisms.

Finally, with any selection of a CIO, the cost that is associated with it needs to be reasonable. At the time of the decision to outsource, presumably the organization examined multiple qualified parties and their costs to make an informed decision. But as time passes, it is important for the organization to benchmark those fees periodically to ensure that they remain competitive.

Whether subject to ERISA or UPMIFA, these are elements of an appropriate governance strategy, helping to insulate those within an organization of their decision to outsource and the health of the overall investment portfolio. These elements can be accomplished within the organization, or if the organization does not have the expertise or time, it can turn to outside impartial experts. As is always the case, documentation of all the above can serve as the proof points for executing a prudent process.



Case Study

Asset/Liability Modeling

Within the U.S. corporate defined benefit space, an ever increasing number of plan sponsors are beginning to turn away from the long run practice of evaluating the assets and liabilities of their defined benefit plans as separate and distinct entities. They are beginning to understand that to effectively manage the risks that the DB plan poses on the plan sponsor, they have to evaluate both the assets and liabilities in conjunction with each other. As part of our service offering, PEI has conducted asset/liability studies for various clients in order for them to better understand how their investment decisions will impact various aspects of their plan as a whole. We do this through sophisticated asset/liability modeling that includes forecasts and stress tests. This allows plan sponsors to fully ascertain the various economic impacts of their decisions, and to help guide them towards investment structures that would be expected to lower the overall risk of the plan.

As an example, PEI recently completed an asset/liability study for a \$120M DB plan which was considering the possibility of pursuing a pension de-risking strategy, whereby the goal of minimizing funding volatility takes precedence over the goal of minimizing investment volatility. Currently the client is investing in an asset mix that includes approximately 60% stocks and 40% bonds. Like many plan sponsors, the economic events of 2008 had severely impacted the plan's funding levels. As a result, they were looking at options that included minimizing the economic impacts of future market events.

PEI views all asset/liability work as a collaborative effort between PEI and the plan actuary. This case was no different and we spent a great deal of time requesting and analyzing actuarial data and conducting phone conferences with this client's actuary. From there we built our actuarial model and ran various simulations that projected plan assets and liabilities into the future.

The end result was that PEI was able to construct a timeline with which the client could begin to phase in a de-risking strategy, whereby the assets would move from their current allocation of 60% stock and 40% fixed income to a dynamically allocated asset mix which is designed to mimic the economic exposure of the liability. The ultimate goal is to have the liability completely hedged as the plan crosses the targeted funding threshold.



PEI Calendar

February 28, 2012

Online

David Hudak, Senior Consultant, will be a part of HR.com's Benefits: Cost Containment, Audits and Legal Risks Virtual Workshop. Dave will present on the topic, Plan Fee Disclosure: Are You Ready? To register for this event, visit porteval.com or HR.com.

March 12, 2012

Miami, FL

Jean Martone, Director of PEI's Retirement Plans Group, will moderate at the P&I Annual East Coast Conference in Miami. Jean will moderate the important topic of, "Battling Participant Inertia".

April 12, 2012

Online

PEI will co-host a webinar on the upcoming plan fee disclosure regulations. Attendees will learn the requirements of these regulations, what responsibilities plan sponsors hold, and best practices for compliance. Please contact PEI to register for this webinar.



Asset Class Insider

Revisiting Stable Value Investments

An article written by Marcia Peters appeared in the January/February edition of the Plan Sponsor Council of America (PSCA) publication, *Defined Contribution Insights*. This article is a summary of this paper and addresses issues that plan sponsors should consider when evaluating stable value funds in addition to new developments in this asset class.

Clients that have stable value funds in their investment line-up have witnessed a number of changes in the last three years. Issues in the credit markets and the related tightening of portfolio constraints related to liquidity, stability of income, transparency and, most importantly, security of principal, have presented many challenges for plan sponsors as they select and monitor a stable value fund. To guide plan sponsors, PEI reviewed the following key parameters as part of our quarterly assessment of stable value funds:

- Liquidity structure of the portfolio
- Credit quality
- Diversification of holdings
- Monitoring performance and market-value to book-value
- Risk management capabilities
- “Exit” liquidity for withdrawals for both participants and the plan
- Wrap structure
- Fees

Understanding the nuances of each of the parameters will result in the proper assessment of the fund and its fit within a plan sponsor’s portfolio.

Recent constraints revolving around the principal protection wrap contract has led to a number of stable value fund terminations or freezes. However, those wrap contract providers and the fund managers that are remaining in the industry are finding creative solutions to ensure the longevity of stable value funds, and ensuring they are meeting their objectives out into the future.

If you would like a reprint of the full article, please contact PEI.

For further information on how PEI can help you achieve your investment goals, contact our corporate headquarters at 973-538-4347.



PEI Published

Marcia Peters, CIO, published an article titled “Revisiting Stable Value Investments” in the PSCA’s Jan/Feb edition of *Defined Contribution Insights*. The article contains a detailed view of stable value investments. A copy of this paper can be found at porteval.com.

David Hudak, Senior Consultant, was published in the latest issue of *Plan Consultant* magazine, formerly known as *The ASPPA Journal*. The article, “Investment Policy Statements and the Fiduciary”, features the importance of an investment policy statement and its use as a part of a prudent fiduciary process.

PEI’s Gregory McCarthy, Principal, Scott Rubin, Director of Research, an Julie Yusko, Senior Consultant, published an article in the latest issue of the *Journal of Pension Benefits*. The team wrote on the details of a three-tier lineup investment strategy.

This newsletter has been prepared exclusively for informational purposes. Every effort has been made to provide accurate and authoritative information in regards to the subject matter in this newsletter; however, accuracy and completeness cannot be guaranteed and is not warranted as such. Numerous sources were used in compiling the data for this newsletter. PEI does not assume responsibility for the accuracy or completeness of such information. The information contained in this newsletter is provided with the understanding that PEI is not engaged in rendering legal, accounting, or actuarial advice. If such advice is required, the services of a competent professional of this kind should be sought. The information contained in this newsletter does not constitute the recommendation of any advisement advisor or their services nor does PEI assume responsibility for the conduct of any investment manager.