

The logo consists of the text 'Fi360' in a white, sans-serif font, centered within a white square frame. The background of the entire image is a gradient from orange to red.

Fi360

A Broadridge® Company

Step 4 of the Fiduciary Process: Monitoring the Client Engagement

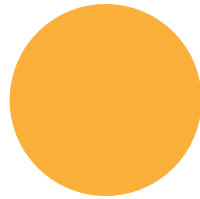
Rich Lynch, AIFA®
Fi360, Chair of COC

Bennett Aikin, AIF®
Fi360, Certification Director

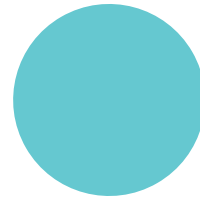
U.S. Legislation

**ERISA:**

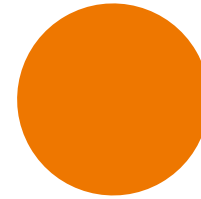
Employee Retirement
Income Security Act
(Qualified retirement
plans)

**UPIA:**

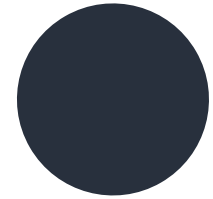
Uniform Prudent
Investor Act (Private
trusts, the default
standard if nothing else
“fits”)

**UPMIFA:**

Uniform Prudent
Management of
Institutional Funds Act
(Foundations,
endowments, and
government sponsored
charitable institutions)

**MMPERSA:**

Uniform Management
of Public Employees
Retirement Systems
Act (State, county,
and municipal
retirement plans)

**IAA:**

The Investment
Advisers Act of 1940

Global Fiduciary Precepts

- 01 Follow laws and governing documents
- 02 Diversify to manage risk and return
- 03 Prepare and follow an investment policy statement
- 04 Prudently select fiduciary and non-fiduciary service providers
- 05 Control and account for costs
- 06 Avoid or manage conflicts of interest
- 07 Monitor service providers
- 08 Monitor and assure conformity to fiduciary obligations

Job Task Analysis



Periodic Table of Fiduciary Practices





Step 4 – Monitor

- Quantitative and qualitative reviews
- Fees and expenses
- Fiduciary reviews

About the Monitoring Process

- **Most labor intensive and time-consuming step.**
- **Area where there are the many fiduciary shortfalls due to:**
 - inadequate preparation in earlier steps; and
 - failure to apply established policies and procedures.

Monitoring: Working Backwards



- **Periodic reviews compare investment performance against appropriate market and peer group benchmarks and overall portfolio objectives.**

- 4.1.1 Investment performance of the overall portfolio is compared against an appropriate benchmark and evaluated in the context of portfolio objectives.
- 4.1.2 The performance of each investment option is periodically compared against an appropriate market and peer group benchmark and any other performance-related due diligence criteria defined in the investment policy statement.
- 4.1.3 Underperforming investments are monitored and decisions to retain or replace investments are documented.
- 4.1.4 Rebalancing procedures are reasonable, documented, and consistently applied.
- 4.1.5 Investment performance is periodically reported to the client.

PRACTICE

4.1

Portfolio Monitoring

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4.1

- **Portfolio Accounting:** gather facts from custodial statements
- **Performance Measurement:** the “science” of MPT stats and attribution, etc.
- **Performance Evaluation:** the “art” or call to action

Factors that Impact Frequency

- Specified fiduciary requirements
- The size of the portfolio
- The investment strategies employed
- The sophistication of the client/steward
- The volatility of the investments selected
- The general economic and market conditions then prevailing

Portfolio Monitoring

CRITERION

4.1.1

- Compare portfolio returns to an appropriate benchmark
- In the context of the portfolio objectives and the strategy employed

Investment Performance Review

- Include comparison of each fund's or investment manager's performance against:
 - Appropriate index
 - Peer group results
 - Performance objectives stated in the IPS

U.S EQUITY - LARGE BLEND

INVESTMENT NAME	TYPE	TICKER	Fi360 SCORE	FI360 SCORE ROLLING AVERAGES				TOTAL RETURN (% Rank)			NET EXP RATIO (% Rank)
				1 YR	3 YR	5 YR	10 YR	1 YR	5 YR	10 YR	
Sample Large Blend Investment	MF		41	40	30	30	19	16.26 (69)	12.38 (64)	10.36 (34)	1.57 (57)
# OF MF/ETF PEERS			1,302	1,235	1,101	957	624	1,411	1,221	1,067	1,485
MEDIAN MUTUAL FUND/ETF								18.05	13.06	9.90	0.82
RUSSELL 1000 TR USD								19.81	14.36	10.92	-

Apply Same Criteria Used to Select Investments

4.1.3

- Change in portfolio managers
- Product's assets fall below \$75 million
- Percentage of underlying securities falls below 80%
- Style drift
- Fees increase to top 25%
- Risk-adjusted performance falls below median
- Performance falls below median

Retain or Replace Decision Making

CRITERION

4.1.3

- Meet regularly
- Evaluate evidence
- Act appropriately based upon evidence and precedent
- Document deliberations and decisions

Rebalancing Protocol

CRITERION

4.1.4

- Clearly defined in the IPS
- Aligned to current best practices
- Consistently applied

- **Periodic reviews are made of qualitative and/or organizational changes of investment managers and other service providers.**

- 4.2.1 Periodic evaluations of the qualitative factors that may impact the results or reliability of investment managers are performed.
- 4.2.2 Negative news and other material information regarding an investment managers or other service provider are considered and acted on in a timely manner.
- 4.2.3 Deliberations and decisions regarding the retention or dismissal of investment managers and other service providers are documented.
- 4.2.4 Qualitative factors that may impact service providers are considered in the contract review process.

PRACTICE

4.2

Qualitative Factors

CRITERION

4.2.1

- **Periodically review qualitative information such as:**
 - Staff turnover
 - Organizational structure
 - Level of service provided
 - Quality of reports
 - Quality of responses to requests for information
 - Investment education

Duty to Act on Adverse Information

- **Evaluate:**

- Who is implicated?
- What is the organization's response?
- If an investment manager:
 - Are there alternative investment options?
 - What are the tax implications?
 - What is the fund family fiduciary ranking?

- **Decide:**

- Make a change
- Leave things alone
- Document rational either way

Documentation and Precedent

- Qualitative information is often contextual
- Fiduciaries must feel confident that the manager can meet expectations going forward
- Documentation is important for demonstrating prudence and consistency

Contract Review Process

CRITERION

4.2.4

- Qualitative and/or organizational changes to service providers should be considered during contract review
- Recommended review frequency is approximately every three years

Resources for Qualitative Information

CRITERION

4.2.4

- Data and analysis services
- Investment and online publications
- Professional journals
- Free online services
- Contract review
- Fiduciary reviews

- **Procedures are in place to periodically review policies for trading practices and proxy voting.**
 - 4.3.1 Procedures are in place to periodically review each Investment Manager’s policies for best execution.
 - 4.3.2 Procedures are in place to periodically review each Investment Manager’s policies for special trading practices such as “soft dollars”, directed brokerage, and commission recapture.
 - 4.3.3 Procedures are in place to periodically review each Investment Manager’s policies for proxy voting.

PRACTICE

4.3

Best Execution

CRITERION
4.3.1

- **Investment managers consider:**
 - Commission cost
 - Market price
 - Trade quality
- **Justify paying up**

Directed Brokerage

CRITERION
4.3.2

- **Potential negative impacts:**
 - Institutional “block” in front of “directed trade” (disadvantaged position in the “queue list”)
 - Insufficient benefit to justify the added cost

Principal vs. Agency Trades

- Principal trades – “We make a market in this security.”
- Agency trades – sent to the floor for transaction
- Investigate further when principal trades account for more than 20% of the total trades

Proxy Voting

CRITERION
4.3.3

- Retain or delegate power to vote.
- Delegation via instructions in the investment policy statement.
- Proxies should be voted in a manner most likely to preserve or enhance the value of the subject stock.

- **Periodic reviews are conducted to ensure that investment-related fees, compensation and expenses are fair and reasonable for the services provided.**

- 4.4.1 A summary of all parties being compensated from client portfolios or from plan or trust assets, and the amount of compensation, has been documented.
- 4.4.2 Fees, compensation, and expenses paid from client portfolios or from plan or trust assets are periodically reviewed to ensure consistency with all applicable laws, regulations, policies and procedures, and service agreements.
- 4.4.3 Procedures are in place to avoid or identify and appropriately address unreasonable fees.

PRACTICE

4.4

Why So Much Attention on Fees?

CRITERION
4.4.1

- Area most abused
- Easily detected
- Easily argued
- Quickly remedied

Guidance, Rules on Revenue-Sharing

CRITERION

4.4.1

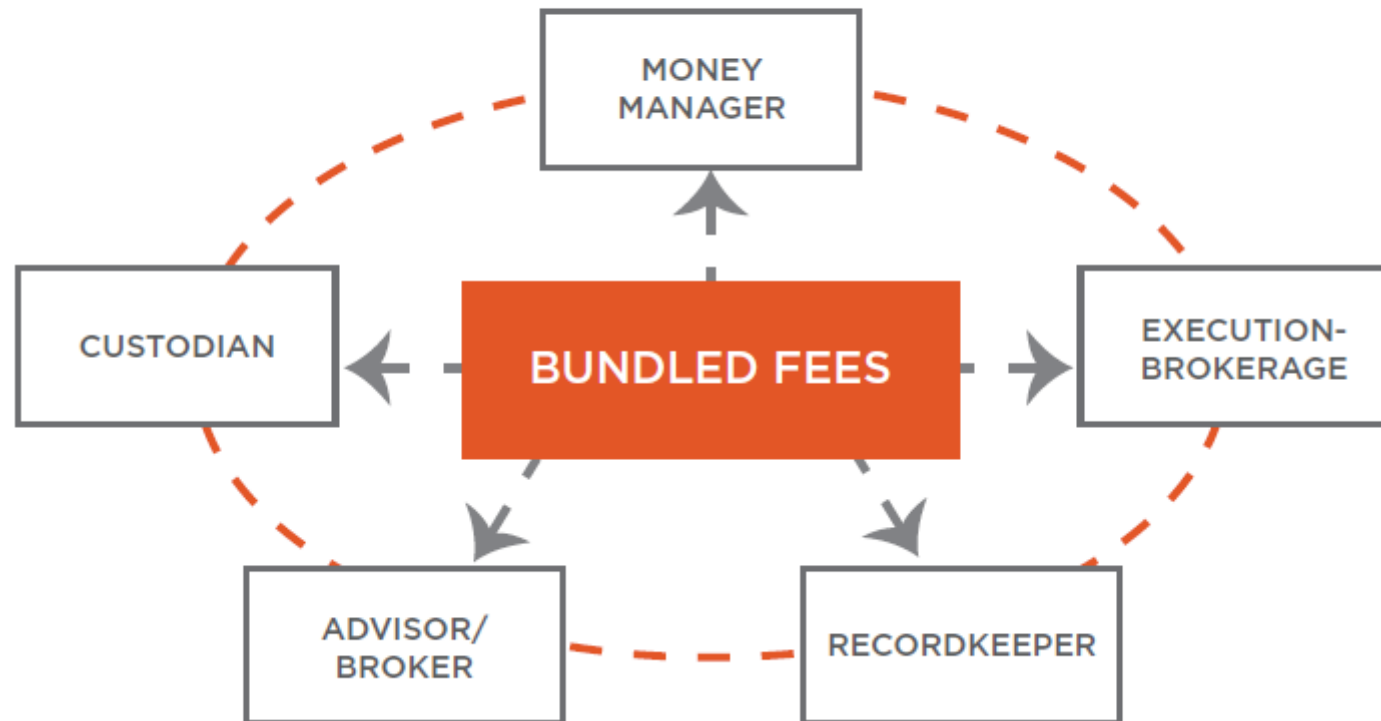
- **DOL Opinion Letters:**
 - DOL Advisory Opinion 97-15A: The Frost Letter
 - DOL Advisory Opinion 97-16A: The Aetna Letter
 - DOL Advisory Opinion 2003-09A: The ABN AMRO Letter
- **Recent DOL Disclosure Rules:**
 - “Service Provider Disclosure Rule” under ERISA Section 408(b)(2)
 - “Participant Disclosure Rule” under ERISA Section 404(a)(5)
- **Form 5500:**
 - Repository for plan information

Who is Being Paid?

CRITERION

4.4.1

UNBUNDLING FEES AND EXPENSES



Mutual Fund Expense Structure

- **Regulatory expense ratio (RER):**
 - Management fees
 - Rule 12b-1 fees
 - “Other” expenses
- **Additional expenses not reported:**
 - Brokerage commissions (avg. approx. 40 bps)
 - Implicit trading costs (avg. approx. 50 bps)

Revenue Sharing

CRITERION

4.4.1

- 12b-1 Fees
- Sub-Transfer Agency Fees
- Shareholder Servicing Fees
- Finder's Fees

Addressing Fees

- Which services are necessary?
- Can the fees be paid from portfolio or plan assets?
- Are the fees reasonable in light of the services to be provided?
 - Compare multiple suitable alternatives
 - Compare fees to benchmarks

- **There is a process to periodically review the organization's effectiveness in meeting its fiduciary responsibilities.**

- 4.5.1 Fiduciary assessments are conducted at planned intervals to determine whether appropriate policies and procedures are in place to address all fiduciary obligations and that such policies and procedures are effectively implemented and maintained.
- 4.5.2 The investment policy statement is reviewed at least annually to ensure it is aligned with current facts and circumstances.

PRACTICE

4.5

The Meaning of Assessment

CRITERION
4.5.1

- **Assessment is:**
 - systematic, independent, and documented process
 - used for obtaining assessment evidence and evaluating it objectively
 - to determine the extent to which assessment criteria are fulfilled

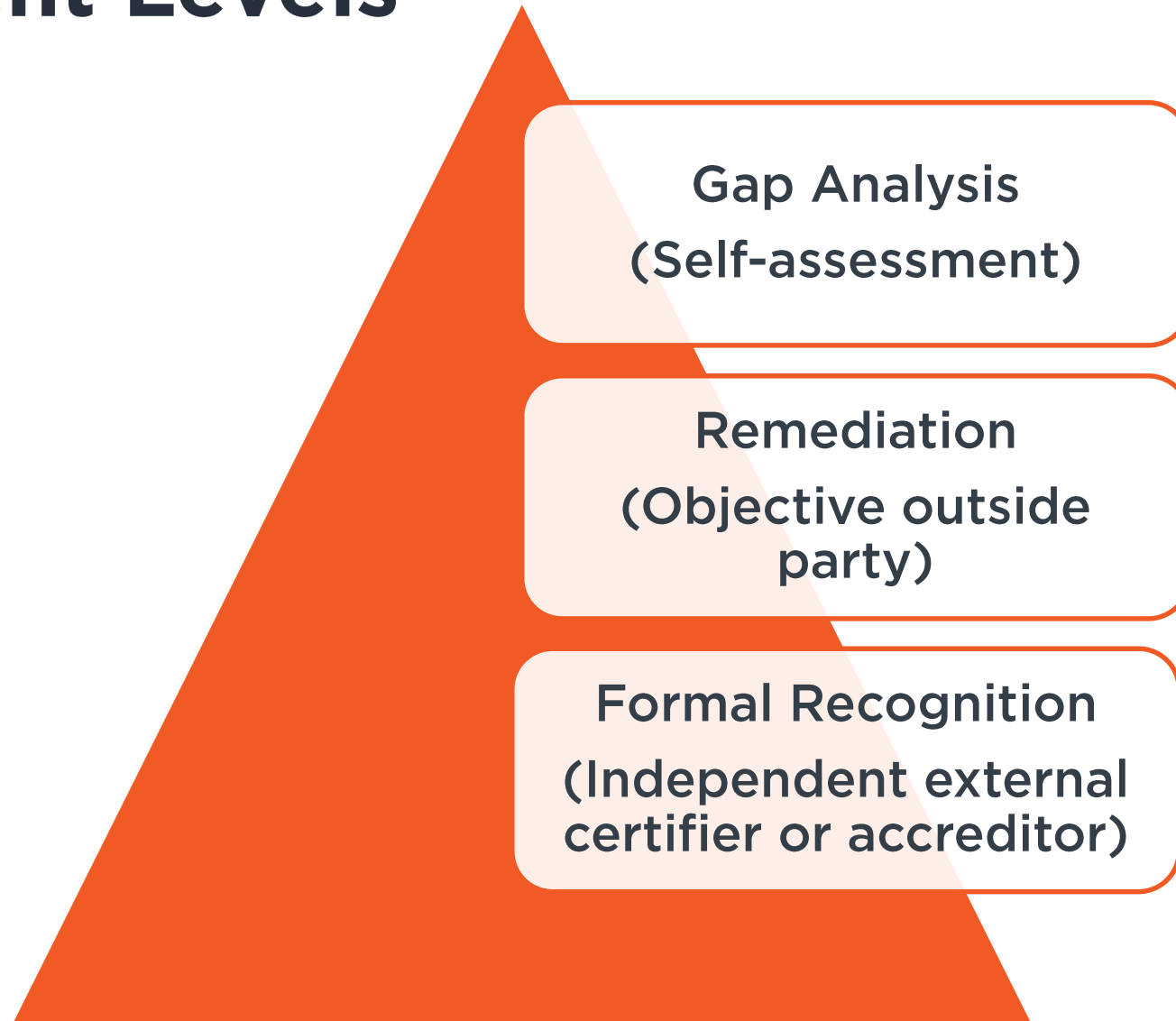
Why Conduct Assessments?

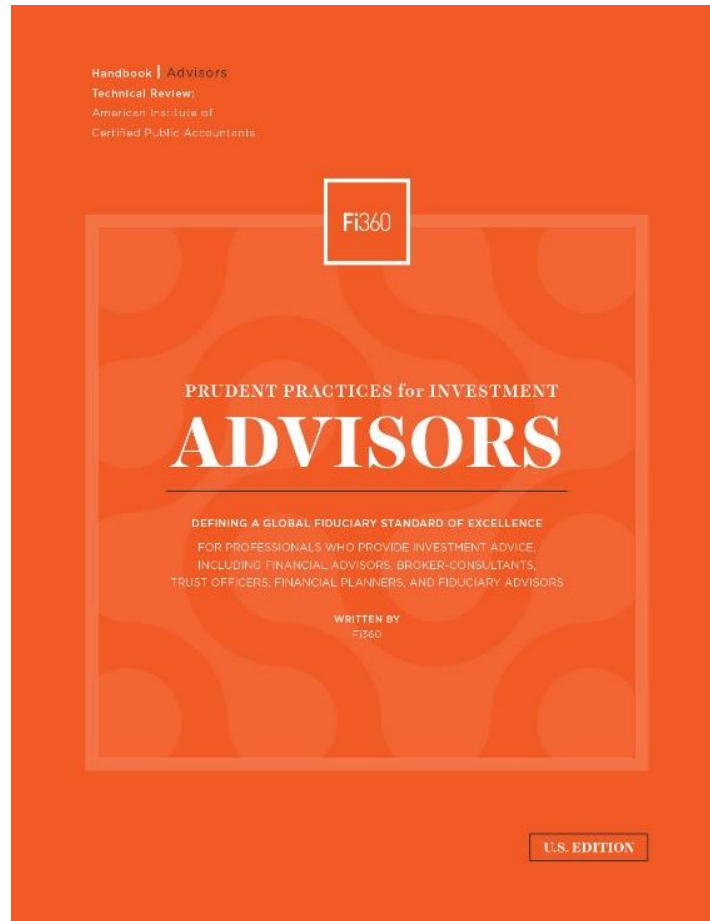
- **To establish a framework that ensures fiduciary Practices are addressed on an ongoing basis:**
 - The SEC requires CCOs to perform this function for RIA firms
- **They are well-recognized tools to:**
 - evaluate risks
 - ensure effectiveness of policies and procedures

Assessment Levels

CRITERION

4.5.1





www.fi360.com/AdvisorsHandbook

Q & A

Please submit any questions using the GoToWebinar interface

Additional questions can also be sent to support@fi360.com

THANK
YOU
