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global
fiduciary insights

YOUR GUIDE TO GLOBAL FIDUCIARY INSIGHTS

Fiduciary Lessons Learned from Scoundrels and Thieves

Blaine F. Aikin, CEO

&

Rich Lynch, COO

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Mission: To promote a culture of fiduciary responsibility and improve the decision-making processes of investment fiduciaries.

Topics to be covered

- Why are there so many scandals?
- Fiduciary forensics – What did fiduciaries miss or where did their processes fail?
- The highest cost of scandals – the collapse of investor trust and confidence
- How to help avoid future scandals and restore trust

Why so many scandals?

- Incredible rewards for short term success
- No perceived penalties for long term failures (moral hazard)
- Crony (false) capitalism
 - Regulatory capture
 - Lack of transparency and meaningful regulation
- Ignorance of, or inattention to, fiduciary responsibilities

Fiduciary Forensics Finding 1: The best defense is a great IPS

- We should never hear: “They had it made and then lost it all.”
 - Know when what we have is enough
 - Diversify assets unless it is clearly prudent not to do so
 - Always diversify investment managers
- The IPS is the management plan
 - Roles and responsibilities
 - Due diligence procedures
 - Risk management policies

Fiduciary Forensics Finding 2: Rely on RFPs, not references

- People still using a service provider will never say they are stupid to do so
- Scoundrels seek to penetrate particular networks such as
 - Foundations and endowments
 - Religious communities
 - Charitable and cultural circles
- Select service providers through a request for proposal process; conduct background checks; read disclosures

Fiduciary Forensics Finding 3: Self-custody is a big red flag

- Advisors should never take custody of assets
- Statements can be readily manufactured
- Checks and balances are essential
 - Administration: Custodians, TPAs, Recordkeepers
 - Managers
 - Advisors
 - Trading firms (broker-dealers)

Fiduciary Forensics Finding 4: Value isn't a matter of opinion

- Securities should be “marked to the market”
- Independent valuation of securities is essential
- Intensely question the value of any asset if there is not an active (preferably auction) market

Fiduciary Forensics Finding 5: Trade records are telling

- A great deal of money can be made from trading commissions (churning)
- Heavy trading bets with growing frequency suggest desperation
- A preponderance of principal trades suggests self-dealing
- Money never deposited never gets traded – this is where Ponzi schemes can often be detected
- Examine all custodial statements

Fiduciary Forensics Finding 6: Alternatives aren't for everyone

- Alternatives are generally not:
 - Regulated
 - Transparent
 - Easily valued
 - Liquid
- Alternatives are generally:
 - Extremely profitable for the providers
 - Difficult to understand
- Extraordinary due diligence is required

Fiduciary Forensics Finding 7: Key systems should be audited

- Financials – (AICPA recognized auditor)
- Performance (GIPS)
- Control Procedures (CEFEX*/ASPPA Recordkeeper Certification; SAS 70)
- Investment Fiduciary Practices (CEFEX* Certifications of Stewards, Advisors, and Managers)
- Fiduciary Adviser (DOL requirements)

* Disclosure: fi360 is a founding member of, and has an ownership interest in, CEFEX

Fiduciary Forensics Finding 8: Heuristics can help

- “Too good to be true” often is
- Where there is smoke, there often is fire
- Don’t put all your eggs in one basket
- Act like you are from Missouri, say “Show me!”
- Money is a better servant than a master

Trusted professionals?

- Financial scandals, on top of market meltdowns, have destroyed trust
- Financial service representatives are not held in high regard
- Investment fiduciaries – Stewards, Advisors, and Managers – are in the best position to restore trust by exposing scoundrels and thieves and preventing future scandals

Legislative & Regulatory Trends

- More transparency and exemption-oriented rules
 - PPA statutory fiduciary advisor exemption
 - Class exemption for conflicted advisers
 - 408(b)(2)
- Rules-based regulations can be effective but are inefficient (*Fiduciary Lite*)
- Principles-based (Fiduciary) approach is both more effective and efficient (NASAA initiative)

Bottom line: The rules-based approach is, at best, a transitory phenomenon.

Call to action

1. Raise your fiduciary IQ and polish your professional reputation
2. Counter market and economic uncertainty with trustworthy fiduciary processes.
3. Seek simplicity: business models, fees, affiliations, disclosures, communications, etc.
4. Play great defense: market, litigation, regulatory and business risks are at all-time highs.
5. Hold legislators, regulators, professional associations, and service providers accountable
6. Go to fi360.com for more information and to the fi360 Blog (blog.fi360.com) to continue this discussion.