

Investment Advice & Wealth Management

Plan Sponsor Due Diligence

Designations and Certifications That Matter

As a group, Americans are a wealthy but challenged population of consumers and investors. Of some \$33 trillion of financial wealth, retirement plan assets equal almost half of that number. IRAs and defined contribution plan balances amount to over \$7 trillion and these numbers continue to grow.

These assets represent the financial future for over 45 million American workers. That future is largely in the hands of financial institutions and professionals that design, administer and invest their assets. The skills, resources and professional ethics of those institutions and professionals are the subjects addressed in this report.

In the coming months, McHenry will introduce related research reports that enhance and expand this subject. These publications will deal with revenue sharing and economics, the fall of the Merrill Rule and standards-based fiduciary investment analysis and client reporting, among other current issues.

In This Report:

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5. Best Practices: Interview with Kenneth Ingham of The Ingham Group.

This compelling topic will be covered in depth at the Center for Due Diligence 2007 Conference at the beautiful Scottsdale Princess Resort in Scottsdale, Arizona on October 1-3.

For more information, visit www.401kduediligence.com/CFDDconference2007.asp



1. ISSUE

Corporate investors, fiduciary investors and professional investors are required to invest according to certain standards defined by statute (laws and regulations), case law and professional guidelines developed and promulgated by various organizations.

These requirements and recommendations are based upon long-standing and well-recognized concepts such as the "Prudent Man" standard dating from early 19th century case law. Later legislation passed in the wake of the crash of 1929 provided a structure for regulation of investment advisors and managers. More recently scandals in corporate governance (Enron) and mutual fund business management have combined to create something of a "perfect storm" for investment and compliance professionals and solution providers.

Much effort has recently been expended by financial institutions and professionals in the development of products, services and marketing messages designed to respond to actual and perceived needs in the marketplace. The justification or rationalization for these efforts can be found in various sources such as:

1. **Prudent Investor Standards** – The "Prudent Man Rule" is based on common law stemming from the 1830 Massachusetts court decision - *Harvard College v. Armory*. The Prudent Man Rule directs trustees "to observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested".
2. **The Investment Company Act of 1940** – This legislation set separate standards by which investment companies should be regulated. The act defined and regulated investment companies, including mutual funds (which were virtually undefined prior to 1940). The act's purpose, as stated in the bill, is "to mitigate and... eliminate the conditions... which adversely affect the national public interest and the interest of investors." Specifically, the act regulated conflicts of interest in investment companies and securities exchanges. Subsequently, the impact of the Act was expanded in practice to cover investment advisors as well as investment managers. The Act represents the primary regulatory framework for oversight of fee-based professionals that provide investment advice.
3. **The Employee Retirement Income Security Act of 1974 ("ERISA") and The Pension Protection Act of 2006 ("PPA")** – ERISA is a federal statute which sets minimum standards for pension plans in private industry and provides for extensive rules on Federal income tax effects of dealings in connection with various employee benefit plans. The PPA was signed into law on August 17, 2006. This legislation addresses a broad range of topics that impact corporate retirement plans. Among other things, Title VI of the act deals with investment advice to plan participants and introduces a new term, "fiduciary adviser." The act neither defines the term in much detail, nor does it define the practices associated with the term. The act does spell out certain minimum fiduciary requirements.
4. **Uniform Prudent Investor Act ("UPIA")** – This is a national model for adoption by states. Most of the states, along with the District of Columbia and the US Virgin Islands have adopted the UPIA. The only states not to have done so are Delaware, Florida, Georgia, Kentucky, Louisiana and New York. Primary differences from The Prudent Man Rule are that under the UPIA: a) A trust account's entire investment portfolio is considered when determining the prudence of an individual investment; b) Diversification is explicitly required as a duty for prudent fiduciary investing; and c) A fiduciary is permitted to delegate investment management and other functions to third parties.
5. **The Sarbanes-Oxley Act of 2002 ("Sarbox")** – This is a federal law passed in response to a number of major corporate and accounting scandals in the late 20th century. The legislation is wide-ranging and establishes new or enhanced standards for all U.S. public company boards, management, and public accounting firms. In addition, many non-public companies seek to conform to the principles (if not the letter) of the Act, as they may either seek to become public in the future or do business with public companies. The Act provides guidance on a "governance-based approach" to fiduciary obligations (to shareholders and employees) and the management of resources. Responsibilities include the creation and maintenance of investment policies and guidelines; spending policies and asset allocation; manager selection; diversification and on-going review of results.

Summary

Virtually any corporate investor or retirement plan sponsor is subject to one or more of these defining elements. Faced with these requirements, many (if not most) corporate investors utilize the services of experienced, prudent experts – whether employees within the organization, or retained professionals as consultants, advisors or managers. **Part 2** of this paper deals with the need for due diligence in selecting and retaining such third-party experts, be it an individuals or institution.



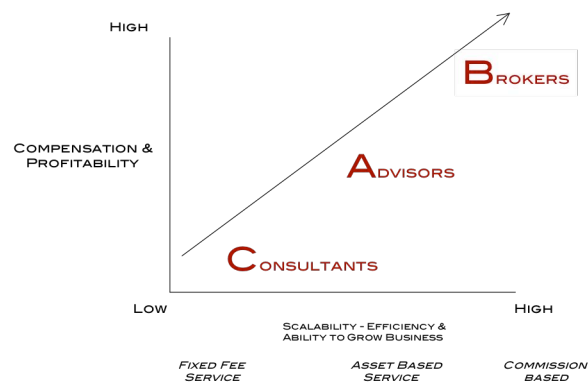
2. NEED

Objective Professionals?

Two important variables in the selection of an investment "advisor" is the question of how the professional views his/her role and the basis upon which compensation is paid. Years ago, the scenario was much simpler. There were consultants, paid by the hour for professional services, and then there were brokers, paid by commission, often fixed-price commissions before deregulation and elimination of fixed-pricing in transaction fees.

Prior to May 1, 1975, high commissions and lack of disclosure and meaningful regulation meant that brokers were able to generate high levels of revenue with low levels of disclosure and documentation, typically through "soft-dollar" schemes that resulted in revenue transfers and relatively high costs to investors. In recent years, many consultants and brokers have moved toward the advisor business and service model. In this way, they have been able to shift to more profitable and scalable business models. Many brokers continue to collect commissions, however, even when providing services that otherwise look, smell and taste like professional consulting and advisory services.

Several of the most visible national investment consulting firms have been challenged by regulatory and prosecutorial actions. The Department of Labor (DOL), the Securities and Exchange Commission (SEC) and the Government Accountability Office (GAO) have all expended great effort in analyzing issues related to advice and the economics of fiduciary investing and retirement plans. Congress has also taken a greater and greater interest in these issues. In fact, as this report goes to press, Representative George Miller (D-Calif.) is planning congressional hearings to examine whether pension consultant conflicts of interest are hurting 401(k) plan participants.



Access to Competent Counsel

In retaining professional counsel to support corporate or fiduciary investment operations, a prudent practice includes a thorough due-diligence analysis of the professional, his or her organization and the policies, processes, procedures and practices that support and enable their delivery of services to the client investor. A range of objective and subjective input variables may be part of the final analysis, but it should be noted that just hiring a well-known, national firm is not necessarily the most prudent approach – certainly not without some sense of why the firm was selected.

The hiring of an investment advisor (regardless of compensation method or amount) requires that corporate and fiduciary investors engage in a thorough analysis of the advisor's services, underlying methodologies and potential conflicts of interest. Staff skills and capabilities, educational backgrounds, business history and even criminal records should be considered – especially prior litigation and regulatory actions against the firm and its individual staff members. Publicly available information from various agencies help any informed buyer to do their homework. **BrokerCheck** is a service of National Association of Securities Dealers (NASD), a major self-regulating organization ("SRO"), which provides easy access to the professional histories of registered representatives affiliated with securities firms. To research the background of an affiliate of a registered investment advisory firm, go to the web site of the US Securities and Exchange Commission (www.sec.gov) and search the site for "**Investment Advisor Public Disclosure**" to use the SEC's tool to review complaints and actions against registered investment advisors and their registered affiliates.

Summary

A written interrogatory of candidate investment advisors is a valuable tool in conducting due-diligence investigations about investment advisors. Several related topics for discussion in such a request for information are the **designations** and **certifications** in place at your candidate firms as covered in **Part 3** of this paper.



3. SOLUTION

Designations

Buyer choice – buyer beware. Driven by market demand and entrepreneurial opportunities, a number of organizations have introduced a plethora of professional designations which are designed to meet the needs of corporate and fiduciary investors. They come in a wide range of configurations with varying emphases based upon the needs addressed and the interests of the designation holder and the issuing organization.

Retirement / investment specialists. While it would be nice to provide a single resource that compares and analyzes all of the currently available or popular designations, there is no such “one stop shop” or buyers’ guide. There is one source that addresses most of the more popular and recognized retirement-specific designations. It is authored by Sharon Pivrotto, PPC™, AIF® of Financial Service Standards, LLC.

The comparison chart profiles twelve of the designations most often seen in the retirement marketplace and can be found at <http://financialservicestandards.com/survey.htm>.

Some of the most often seen designations:

Accredited Investment Fiduciary (AIF™)

Offered by the Center for Fiduciary Studies, this designation is the first and foremost designation to address knowledge, skill development and competency in the area of fiduciary responsibility. www.fi360.com

Accredited Investment Fiduciary Analyst (AIFA™)

A related designation to the AIF, the AIFA designation not only signifies the same thorough knowledge of the prudent process for investment fiduciaries that the AIF designation represents, but also the ability to perform assessments of that process. AIFA designees are trained in the Global Fiduciary Standard of Excellence, as defined by the Foundation for Fiduciary Studies, as well as the assessment procedures (analogous to the ISO 9000 Quality Management System standard) defined by the Center for Fiduciary Studies. Their primary function is to perform, or assist in, assessments of an Investment Steward’s, Advisor’s, or Manager’s conformance to a Global Fiduciary Standard of Excellence.

Qualified Plan Financial Consultant (QPFC)

Offered by the American Society of Pension Professionals & Actuaries, with a focus upon development of retirement sales, investment and service professionals. www.asppa.org

Investment generalists. The most valuable and most often seen designations of this type are:

Chartered Financial Analyst (CFA®)

Offered by the CFA Institute (formerly the Association for Investment Management and Research [AIMR]). Candidates must complete three increasingly difficult exams and have at least three years of qualifying work experience, among other requirements. Through these exams, candidates demonstrate their competence, integrity and extensive knowledge in accounting, ethical and professional standards, economics, portfolio management and security analysis. www.cfainstitute.com

Certified Investment Management Analyst (CIMA)

Offered by the Investment Management Consultants Association, this designation focuses on asset allocation, ethics, due diligence, risk measurement, investment policy and performance measurement. Only individuals who are investment consultants with at least three years of professional experience are eligible to obtain this certification, which signifies a high level of consulting expertise. www.cimaglobal.com

Chartered Investment Counselor (CIC)

Offered by the Investment Counsel Association of America (ICCA) Candidates must first obtain a CFA designation, be employed by a member of the ICAA (Investment Counsel Association of America) and have five cumulative years of related work experience. www.icaa.org

Summary

A designation alone will not ensure excellence in execution or a positive client experience, but the holder of one of the designations above can at least show a willingness and commitment to improve their skills and to grow as professionals. Understanding these designations and their value in application is a part of any fiduciary selection process.



Certifications

Process driven. Any well-run business must be able to stand the light of a third-party review or audit. Just as public companies must provide audited financial statements to regulators and investors, so must retirement and investment providers stand ready to document their processes in support of client needs.



CEFOX Fiduciary Assessment & Certification

An independent risk-based assessment of an organization's ability to meet investor's expectations which leads to an independent certification as recognition of a fiduciary's conformity to all Fiduciary Practices and criteria. It implies that a fiduciary can demonstrate adherence to the industry's best practices, and is positioned to earn the public's trust. It is not a measurement of the degree to which a firm has implemented the best practices. The CEFEX Fiduciary Assessment is based on the Fiduciary Practice standard. The Fiduciary Certification is performed by a qualified CEFEX Analyst, and reviewed by the CEFEX Registration Committee to ensure complete impartiality. www.fi360.com/main/certification.jsp



Statement of Auditing Standards

SAS 70

An acronym for Statement on Auditing Standard 70, developed and maintained by the American Institute of Certified Public Accountants ("AICPA"). SAS 70 defines standards to be followed when an independent auditor conducts an investigation of the development status and effectiveness of a corporate management system policies and procedures, and then issues a report to the corporation on the investigation results. A report issued by the independent auditor to the corporation based on SAS70 is commonly known as a SAS70 Audit Report.

In today's market, SAS 70 is a helpful and substantial audit that provides transparency to the businesses with which a service organization works. It also shows the service organization's prospective clients that the service organization has satisfactory controls and safeguards in place. This is particularly important when hosting information or processing such information such as data belonging to customers and clients.

SAS 70 has grown increasingly popular with the implementation of Sarbanes-Oxley, a trend that adds importance in implementing SAS 70 as a valuable resource to show the effectiveness of a service organization's internal controls and data security safeguards.



ISO 9000

A family of standards for quality management systems. ISO 9000 is maintained by the International Organization for Standardization ("ISO") and is administered by accreditation and certification bodies

A company or organization that has been independently audited and certified to be in conformance with ISO 9001 (part of the 9000 family) may publicly state that it is "ISO 9001 certified" or "ISO 9001 registered." Certification to an ISO 9000 standard does not guarantee the compliance (and therefore the quality) of end products and services; rather, it certifies that consistent business processes are being applied.

Although the standards originated in manufacturing, they are now employed across a wide range of other types of organizations, including colleges and universities.

Summary

A candidate advisor or retirement provider may not be large enough to justify ISO 9000 series certification, but any firm under consideration should at least be able to discuss all of these certifications and their relative merits.



4. CONCLUSIONS

What to Look for in an Advisor

Three key attributes. Through thirty years of experience in the advice and retirement segments of the financial services industry, McHenry has found that consumers of financial advice are much like any other buyers of professional services. There are three key attributes that can be reduced to questions to ask one's self about the candidate individual:

1. **"Is he/she honest?"** – Not just ethically, but also with themselves as to his/her ability to execute and deliver. Often professionals are challenged when dealing with their own limitations, including scheduling, resource allocation and management.
2. **"Is he/she competent?"** – With the skills necessary to meet the client's needs, without undue risk of execution. Also, is the business successful, profitable and growing? Will your advisor be around with the budget necessary to invest in systems and professional development resources to continue to meet your needs over time?
3. **"Can we communicate effectively?"** – With all the best intentions, skills and experience, all will be for naught if the professional cannot understand the client's needs and communicate to the client information important to their shared efforts – setting goals, assessing risks and making decisions.

Three key deliverables. Assuming the attributes above are in place through a professional service relationship, clients generally look for

- **Performance** – Investment returns that meet your needs – risk adjusted, net of expenses, tied to an appropriate benchmark and peer group.
- **Value** – Service and management fees that represent fair pricing and a good return on your investment of time, effort and expense.
- **Service** – How hard is it to get what you need, want and deserve from a professional service provider? Think of the best service experience you have ever experienced (Lexus auto dealer, Apple store, Nordstrom store) and then think about how it stacks up against your advisor or plan service provider.

Hard work is usually good work. We all feel better after we put in a full day of productive and valuable effort on behalf of a project. Look for professionals that appear to enjoy or at least tolerate hard work.

Disclosure. Don't be shy if your questions are not answered – speak up and keep asking until you get the answers you deserve. Better yet, seek out service providers that answer your questions before you have a chance to ask them. Example topics to prioritize in your research:

- **Conflicts of Interest** – How aligned are your needs and theirs? How will those conflicts be managed?
- **Commitments** – What promises will they make and how will they keep them?
- **Compensation** – How much and in what form, for what services?

Documentation. Get it in writing or get it from a different provider.

Risk and Return

The challenges of corporate and fiduciary investing are very different from self-determinant investing for one's own account. If you want to make intemperate or unreasoned decisions with your own money, it is unlikely you will be called to task by a third party. Such is not the case for corporate and fiduciary investors charged with caring for the assets of their shareholders and retirement plan participants.

Chose your providers well and document your efforts – and you will probably do just fine.

Thank you for your interest in our work and the topic of the report. For additional information on this subject, please feel free to call the principal author, Ward Harris, at 617-959-1886, or ward.harris@mchenrygroup.com



5. BEST PRACTICES: Interview with Ken Ingham, Ingham Group

*Ken Ingham, AIFA®, Enrolled Actuary
President and CEO
(305) 671-2200
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Background

Ingham Group combines the unique professional and business capabilities of three affiliated organizations. Together, they deliver an integrated solution in the strategy, tactics and operational success of investment-based retirement plans and the needs of plan participants as well as of high net worth investors.

- **Ingham & Company** – One of the Southeast's largest SAS 70 audited Third Party Administration (TPA), tier one record keeping and actuarial consulting firms.
- **Ingham/Russell Investment Advisors, Inc.** - A CEFEX certified Investment and Fiduciary Advisory firm providing an organized, formalized, process of implementation and monitoring to retirement plan committees, participants and high net worth investors.
- **Ingham Financial Corporation** - Specialists in comprehensive individual retirement planning, serving high net worth investors and plan participants who seek professional guidance in analyzing their current retirement readiness.

Since its beginning, Ingham has developed a national reputation as a forward-thinking retirement plan provider.

Over the last 33 years, Ingham Group has provided design, installation, administration and/or termination services to over 7,000 benefit plans in 40 states. To best serve these clients, Ingham employs a highly qualified multidisciplinary team of accounting, legal, investment and actuarial professionals and analysts.

In 1991, Ingham had a clear vision of the coming trend toward fee-based investment services and established a Registered Investment Advisor (RIA) to better serve its corporate and fiduciary investing clients. As a commitment to excellence, operating solely in the best interest of their clients, Ingham assumes a co-fiduciary role by contract and established a brokerage affiliation in order to collect, disclose and share securities revenues with its clients.

Today

Ingham Group serves approximately 200 daily valuation defined contribution plans, 280 balance-forward defined contribution plans and 70 defined benefit plans. The firm has over \$1 billion in assets under administration, with over 30,000 participants.

Client plan administration is performed on a daily-valuation technology platform, together with a proprietary website which supports plan sponsor and participant needs.

Before accepting a new client, the firm's professionals underwrite each case which, when accepted, is subject to detailed client agreements that specify exactly what Ingham will and will not do and how it will be compensated.

Working with its clients, the firm discloses all revenue and in this way, maximizes the value to clients and eliminates conflicts of interest. Firm management is now working on the "next generation of disclosure" of service revenues, designing enhanced information for delivery to plan participants.

Continued...



Interview

- McHenry:** Thanks for your time today, Ken. Let's start by asking about how you find yourself leading one of the most recognized plan administration and advice firms in the Southeastern United States.
- Ken Ingham:** Back in 1966, I had an accounting class with Professor Steinhoff at the University of Miami. His words of wisdom – "If you lose money on every transaction, volume only drives you deeper into the hole." I knew right then that I wanted to run a successful business that delivered good value to clients at a profit.
- McHenry:** Sounds like a great recipe and it's obviously working for you. What is the rest of your secret besides good business management?
- Ken Ingham:** We are objective and obsessed. Objective in that we don't have any investment bias. We live and breathe open architecture and as a result are not in a position of having to promote or defend any particular investment. Obsessed in that client service is the most important aspect of our relationships – with both plan sponsors and plan participants. When service questions arise, "if it's not right, we'll fix it."
- McHenry:** You have the CEFEX certification. Why the effort and expense for something that some professionals would see as "nice to have" rather than "got to have?"
- Ken Ingham:** We may be a little early in that we were one of the first investment managers to get certified in September of 2006 – but believe that it is a critical differentiator when we are competing for corporate relationships. When I sit in a room with the client committee and ask "Who is the fiduciary?" they all point to me. You are either in the game or you are on the sidelines. Clients should be able to rely on certain standards of fiduciary excellence and CEFEX is a supporter of ISO and the organization certifies to the ISO 19011 standard.
- McHenry:** You really seem to go out of your way to disclose and offset your firm's revenue sharing receipts. Why go the extra distance on this subject?
- Ken Ingham:** It is really all about what clients need and deserve. As a fiduciary we are required to offset all revenue-sharing income against the firm's service fees. Our position is that the plan sponsor and committee are also plan fiduciaries responsible for knowing what plan participants are paying and also making sure that the amount is reasonable. If we don't give them the information, where are they going to get it from?
- McHenry:** What about investment operations? For example, do you encourage clients to have written investment policy statements?
- Ken Ingham:** Yes, I believe that the most important fiduciary practice is to have a written investment policy statement (IPS). Some clients feel that the absence of an IPS is better; they feel that they won't set themselves up with procedures that they may fail to follow. I try to educate plan sponsors that, while they have the ultimate responsibility, they are hiring our firm as co-fiduciaries to shoulder much of that burden. Then it becomes a matter of whether the company really wants to establish the infrastructure and have a committee to oversee the process.
- McHenry:** What about the impact of the Pension Protection Act (PPA) and all these new provisions under the law?
- Ken Ingham:** Ironically, the PPA legally holds us to a standard that we had set for ourselves long ago. The PPA established a "Fiduciary Advisor" and we're already set up to do what is required, including standing up to a third-party audit. Ultimately, there will also be a "second audit" required to see if the plan sponsor is following the appropriate process. The result will be that the plan sponsor / investment committee will be more informed when evaluating the advisor's processes in oversight of plan investments.

Continued...



McHenry: What is the hardest part of your work with retirement plans?

Ken Ingham: We try to educate the plan sponsor / investment committee on how revenue sharing works and it can get complicated in a hurry. Every fund has a different way of paying a different amount to the record keeper, and the information is not always clearly disclosed. People are looking at what they are being billed, not at what costs may be imbedded in the investment products, and there is a difference! In most cases, the plan sponsor does not have the time, skills, data, tools or access to information necessary to find out what the plan is really costing the participants.

McHenry: You certainly have some energy on this point, Ken.

Ken Ingham: Non-disclosure is stealing! I don't care what everyone else is doing, we are going to do it right. Service providers (especially plan record keepers) can't wash their hands and say it's not their responsibility. If we do not help them find out the cost where are they going to get it from? Ultimately, excess fees may prevent participants from reaching their retirement goals, or they'll have to work longer to meet these needs.

McHenry: One might conclude that you are kind of a missionary on this topic, Ken.

Ken Ingham: No, we are business managers, not missionaries. There is a tendency by some service providers to confuse full disclosure and the right to make a profit. These are not mutually exclusive concepts. We are entitled to make a fair profit.

McHenry: So any words of wisdom for corporate or fiduciary investors?

Ken Ingham: Historically, most providers take in a new client and then try to figure out how to make it profitable. Some sell cases as a 'loss leader' and then try to sell other business. That's not the right way to manage a professional relationship and do the right thing. I would encourage corporate and fiduciary investors to do business with someone who is a good professional and a good businessperson.

McHenry: So what are you working on now?

Ken Ingham: We are currently working on a Task Force with American Society of Pension Professionals and Actuaries (ASPPA) and the Center for Fiduciary Excellence (CEFEX) to develop a certification program for record keepers. This certification will signify that they comply with a certain standard of administrative excellence and transparency so that plan sponsors, investment committees, and participants can rely on these record keepers to give them the information they need.

McHenry: And any final thoughts?

Ken Ingham: There is a difference between disclosure and education. We work hard to deliver education and answer an important question: "How do clients know what's reasonable?" If we can accomplish this for the plan sponsor with transparency and integrity, and still make a profit, then I see it as a winning situation for everyone.

McHenry: Thanks for your time, Ken.

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