

Presentation for

**West Virginia Police & Fire Pension Trustees**

Municipal Pensions Oversight Board

## Institutional Investment Prudence

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*“Fiduciary liability is not determined by investment performance, but rather...by whether prudent investment practices were followed.”*

# Fiduciary Precepts of the WV State Pension Code

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1. Know standards, laws, and House Bill provisions.
2. Diversify assets to specific risk/return profile and within code parameters
3. Prepare investment policy statement and update annually.
4. Use independent “prudent experts” and document due diligence.
5. Control and account for investment expenses. (quarterly)
6. Monitor the activities of “prudent experts.”
7. Avoid conflicts of interest and prohibited investments/transactions.

## Timeline of Key Legislation

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### » Prior to 1995

- Municipal Police & Fire Pension's Investments **limited to predominately Fixed Income Securities (no equities)**

### » 1995 - House Bill 2832 (Code Section 8-22-22)

- Permitted investments of **equity - up to 50% of plan assets**
  - » Investment restrictions included exposures to individual fixed income issues (10%)/company equity (5%)/**industries (15%) of total portfolio**
  - » Delegate authority to Registered Investment Managers with SEC & 40' Act with assets in excess of **\$75 million** and **expenses not exceeding 1.75% for any mutual fund**
  - » Boards of Trustees shall obtain **annual comparative independent performance evaluations**
    - Evaluations should consist of **comparisons with other like Funds**
    - Evaluation of performance results should compare **vs. appropriate market indices**
  - » Each entity conducting business for each pension fund, shall fully **disclose all fees and costs of transactions**, conducted on a **quarterly basis**

## Timeline of Key Legislation

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### » 2006 - House Bill/SB 2638

- Permitted investments of **equity - up to 60% of plan assets**

### » 2009 - SB4007

- Significant Changes to 8-22-22 and 8-22-22a of Code
- Fund Management in accordance with **Uniform Prudent Investor Act (UPIA)**
- Review **Investment Policy Statements Annually** and provided to Oversight Board
- **Annual Portfolio Rebalancing to maintain 60% equity limit or less** (at least once per year set by local Board and stated in policy)
- Provides limitations to investment in **international securities (30% of plan assets) and real estate equity investments - REITs (25% of plan assets)**
- **Outlines investment restrictions** on alternative investments including private equity and real estate, hedge funds, commodities, etc.
- Provides overview on general investment concepts including **diversification, preservation of capital, rate of return, risk tolerance, liquidity, etc.**
- **All fees (including transaction costs) must be disclosed on quarterly basis** by each entity to Local Board Trustees and Oversight Board

## Developing an Investment Policy: Core Components

### A documented Investment Policy for an Employee Benefit Plan:

- Critical step in establishing a structured process for investment decision making, while also supporting continuity as plan fiduciaries change
- Outlines Plan’s investment related goals and objectives, and provides framework for performance evaluation
- Ensures you and Committee are in compliance and protects your personal liability

<b>Investment Objectives</b>	<b>Committee Composition</b>	<b>Time Horizon</b>
<b>Spending Policy</b>	<b>Asset / Liability Considerations</b>	<b>Risk Parameters</b>
<b>Asset Allocation Guidelines</b>	<b>Diversification</b>	<b>Investment Restrictions</b>
<b>Alternative Investment Policy*</b>	<b>Socially Responsible Investing</b>	<b>Liquidity Requirements</b>
<b>Selection &amp; Retention Criteria</b>	<b>Monitoring &amp; Control Procedures</b>	<b>Rebalancing Frequency &amp; Strategy</b>
<b>Delegation &amp; Responsibilities</b>	<b>Voting of Proxies</b>	<b>Review &amp; Evaluation</b>

## Allowable Investments

***Unlike other pension plans, Municipal Pensions of Police and Fire are limited to investing in traditional asset classes only.***

### Traditional Asset Classes

Examples:

- Cash
- Bonds
- Domestic Stocks
- International Stocks

Liquid markets

Historical performance data generally available

Standardized benchmarks

Returns primarily driven by beta

Normal return distributions

### Alternative Strategies

Examples:

- Hedge Funds
- Private Equity
- Managed Futures
- Structured Credit

Potential illiquidity

Limited and/or noisy performance data

Absolute return objectives

Alpha driven

Non-normal return distributions

## Annual Returns for Major Indices (1991 - 2011)

1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
118.1 MSCI EM	64.8 MSCI EM	184.9 MSCI EM	27.7 MSCI EM	38.4 Russell 1000 Value	23.1 Russell 1000 Growth	35.2 Russell 1000 Value	38.7 Russell 1000 Growth	77.5 MSCI EM	22.8 Russell 2000 Value	14.0 Russell 2000 Value	11.5 BC Govt/Cr	47.6 Russell 2000 Growth	22.2 Russell 2000 Value	35.8 MSCI EM	28.9 MSCI EM	33.5 MSCI EM	10.4 BC Intermed Govt/Cr	62.8 MSCI EM	28.3 Russell 2000 Growth	8.6 BC Govt/Cr
49.6 Russell 2000 Growth	29.1 Russell 2000 Value	29.6 MSCI EAFE	2.6 Russell 1000 Growth	37.8 Russell 1000	23.0 S&P 500	33.4 S&P 500	28.6 S&P 500	42.5 Russell 2000 Growth	12.4 BC Govt/Cr	8.4 BC Intermed Govt/Cr	9.6 BC Intermed Govt/Cr	47.3 Russell 2000	18.3 Russell 2000	29.5 MSCI EAFE	23.5 Russell 2000 Value	11.8 Russell 1000 Growth	8.0 BC Govt/Cr	37.2 Russell 1000 Growth	26.9 Russell 2000	6.1 BC Intermed Govt/Cr
46.0 Russell 2000	18.4 Russell 2000	23.8 Russell 2000 Value	1.3 S&P 500	37.6 S&P 500	22.4 Russell 1000	32.9 Russell 1000	27.0 Russell 1000	33.8 MSCI EAFE	10.5 BC Intermed Govt/Cr	8.3 BC Govt/Cr	-7.1 MSCI EM	46.7 MSCI EM	16.5 Russell 1000 Value	7.1 Russell 1000 Value	22.2 Russell 1000 Value	8.5 BC Intermed Govt/Cr	28.9 Russell 2000 Value	33.5 Russell 2000 Growth	24.5 Russell 2000 Value	2.6 Russell 1000 Growth
41.7 Russell 2000 Value	13.6 Russell 1000 Value	18.9 Russell 2000	0.4 Russell 1000	37.2 Russell 1000 Growth	21.6 Russell 1000 Value	31.8 Russell 2000 Value	15.6 Russell 1000 Value	33.2 Russell 1000 Growth	7.0 Russell 1000 Value	7.9 MSCI EM	-11.4 Russell 2000 Value	46.0 Russell 2000 Value	16.4 MSCI EM	6.3 Russell 1000	18.4 Russell 2000	7.6 BC Govt/Cr	-33.8 Russell 2000	28.4 Russell 1000	16.7 Russell 1000 Growth	2.1 S&P 500
41.3 Russell 1000 Growth	8.9 Russell 1000	18.1 Russell 1000 Value	-1.5 Russell 2000 Value	30.1 Russell 2000 Growth	21.4 Russell 2000 Value	30.5 Russell 1000 Growth	12.6 MSCI EAFE	21.3 Russell 2000	-3.0 Russell 2000	2.5 Russell 2000	-15.5 Russell 1000 Value	30.0 Russell 1000 Value	13.8 Russell 2000 Growth	5.3 Russell 1000 Growth	16.9 MSCI EAFE	6.5 Russell 2000 Growth	-36.8 Russell 1000 Value	27.2 Russell 2000	16.1 Russell 1000	1.5 Russell 1000
33.0 Russell 1000	7.6 S&P 500	12.5 Russell 2000 Growth	-1.7 BC Intermed Govt/Cr	28.5 Russell 2000	16.5 Russell 2000	22.4 Russell 2000	9.7 BC Govt/Cr	21.0 S&P 500	-7.1 MSCI EAFE	-5.6 Russell 1000 Value	-20.5 Russell 2000	29.9 Russell 1000	13.1 MSCI EAFE	4.9 S&P 500	15.8 S&P 500	5.8 Russell 1000	-37.0 S&P 500	26.5 S&P 500	15.5 Russell 1000 Value	0.4 Russell 1000 Value
30.5 S&P 500	7.5 BC Govt/Cr	10.9 BC Govt/Cr	-1.8 MSCI EAFE	25.7 Russell 2000 Value	13.5 MSCI EM	13.8 MSCI EAFE	8.5 BC Intermed Govt/Cr	20.9 Russell 1000	-7.8 Russell 1000	-9.6 Russell 2000 Growth	-21.7 Russell 1000	29.7 Russell 1000 Growth	11.4 Russell 1000	4.7 Russell 2000 Value	15.5 Russell 1000	5.5 S&P 500	-37.6 Russell 1000	25.4 MSCI EAFE	15.1 S&P 500	-3.5 Russell 2000 Growth
24.6 Russell 1000 Value	6.9 BC Intermed Govt/Cr	10.2 Russell 1000	-1.8 Russell 2000	19.0 BC Govt/Cr	11.6 MSCI EAFE	12.5 Russell 2000 Growth	0.8 Russell 2000 Growth	7.3 Russell 1000 Value	-9.1 S&P 500	-11.9 S&P 500	-22.1 S&P 500	28.7 S&P 500	10.9 S&P 500	4.6 Russell 2000	12.8 Russell 2000 Growth	4.0 MSCI EAFE	-38.4 Russell 1000 Growth	20.6 Russell 2000 Value	14.4 MSCI EM	-4.2 Russell 2000
15.9 BC Govt/Cr	6.8 Russell 2000 Growth	10.1 S&P 500	-2.0 Russell 1000 Value	14.4 BC Intermed Govt/Cr	10.7 Russell 2000 Growth	9.7 BC Govt/Cr	-2.5 Russell 2000	0.5 BC Intermed Govt/Cr	-22.4 Russell 1000 Growth	-12.4 Russell 1000	-25.8 MSCI EAFE	20.8 MSCI EAFE	6.3 Russell 1000 Growth	3.6 Russell 2000 Growth	9.1 Russell 1000	-0.2 Russell 1000 Value	-39.0 Russell 2000 Growth	19.7 Russell 1000 Value	6.1 BC Govt/Cr	-5.5 Russell 2000 Value
14.1 BC Intermed Govt/Cr	5.0 Russell 1000 Growth	8.2 BC Intermed Govt/Cr	-3.1 Russell 2000 Growth	9.8 MSCI EAFE	4.1 BC Intermed Govt/Cr	7.7 BC Intermed Govt/Cr	-6.5 Russell 2000 Value	-1.5 Russell 2000 Value	-22.7 Russell 2000 Growth	-16.0 MSCI EAFE	-27.9 Russell 1000 Growth	3.4 BC Govt/Cr	3.8 BC Govt/Cr	2.6 BC Govt/Cr	3.8 BC Intermed Govt/Cr	-1.6 Russell 2000	-39.9 MSCI EAFE	1.6 BC Govt/Cr	5.3 MSCI EAFE	-11.7 MSCI EAFE
9.1 MSCI EAFE	-5.8 MSCI EAFE	2.9 Russell 1000 Growth	-3.5 BC Govt/Cr	0.8 MSCI EM	2.8 BC Govt/Cr	4.8 MSCI EM	-19.6 MSCI EM	-2.3 BC Govt/Cr	-25.3 MSCI EM	-20.4 Russell 1000 Growth	-30.7 Russell 2000 Growth	2.3 BC Intermed Govt/Cr	2.3 BC Intermed Govt/Cr	1.7 BC Intermed Govt/Cr	3.7 BC Govt/Cr	-9.8 Russell 2000 Value	-45.7 MSCI EM	-0.3 BC Intermed Govt/Cr	5.0 BC Intermed Govt/Cr	-12.5 MSCI EM

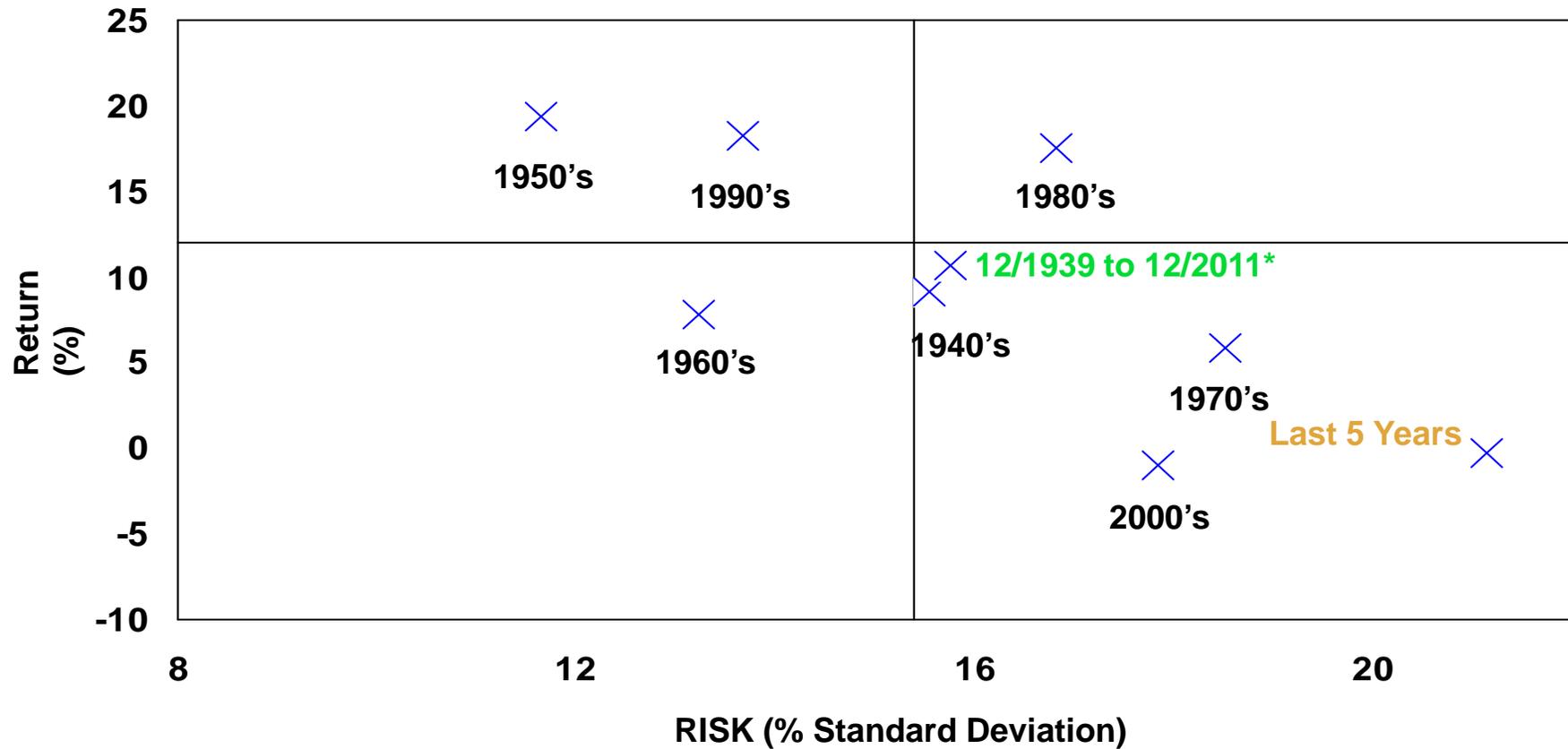
Source: MSCI, Standard & Poor's, Russell Investments, FactSet, Bloomberg. Data as of January 2012. Past performance is no guarantee of future results. Estimates of future performance are based on assumptions that may not be realized. This material is not a solicitation of any offer to buy or sell any security or other financial instrument or to participate in any trading strategy.

## Last 10 years – Top 3/Bottom 3

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Top 3 performing indices	11.5 BC Govt/Cr	47.6 Russell 2000 Growth	22.2 Russell 2000 Value	35.8 MSCI EM	28.9 MSCI EM	33.5 MSCI EM	10.4 BC Intermed Govt/Cr	62.8 MSCI EM	28.3 Russell 2000 Growth	8.6 BC Govt/Cr
	9.6 BC Intermed Govt/Cr	47.3 Russell 2000	18.3 Russell 2000	29.5 MSCI EAFE	23.5 Russell 2000 Value	11.8 Russell 1000 Growth	8.0 BC Govt/Cr	37.2 Russell 1000 Growth	26.9 Russell 2000	6.1 BC Intermed Govt/Cr
	-7.1 MSCI EM	46.7 MSCI EM	16.5 Russell 1000 Value	7.1 Russell 1000 Value	22.2 Russell 1000 Value	8.5 BC Intermed Govt/Cr	-28.9 Russell 2000 Value	33.5 Russell 2000 Growth	24.5 Russell 2000 Value	2.6 Russell 1000 Growth
Bottom 3 performing indices	-25.8 MSCI EAFE	20.8 MSCI EAFE	6.3 Russell 1000 Growth	3.6 Russell 2000 Growth	9.1 Russell 1000 Growth	-0.2 Russell 1000 Value	-39.0 Russell 2000 Growth	19.7 Russell 1000 Value	6.1 BC Govt/Cr	-5.5 Russell 2000 Value
	-27.9 Russell 1000 Growth	3.4 BC Govt/Cr	3.8 BC Govt/Cr	2.6 BC Govt/Cr	3.8 BC Intermed Govt/Cr	-1.6 Russell 2000	-39.9 MSCI EAFE	1.6 BC Govt/Cr	5.3 MSCI EAFE	-11.7 MSCI EAFE
	-30.7 Russell 2000 Growth	2.3 BC Intermed Govt/Cr	2.3 BC Intermed Govt/Cr	1.7 BC Intermed Govt/Cr	3.7 BC Govt/Cr	-9.8 Russell 2000 Value	-45.7 MSCI EM	-0.3 BC Intermed Govt/Cr	5.0 BC Intermed Govt/Cr	-12.5 MSCI EM

Source: MSCI, Standard & Poor's, Russell Investments, FactSet, Bloomberg. Data as of January 2012. Past performance is no guarantee of future results. Estimates of future performance are based on assumptions that may not be realized. This material is not a solicitation of any offer to buy or sell any security or other financial instrument or to participate in any trading strategy.

## S&P 500's Risk/Return by Decade

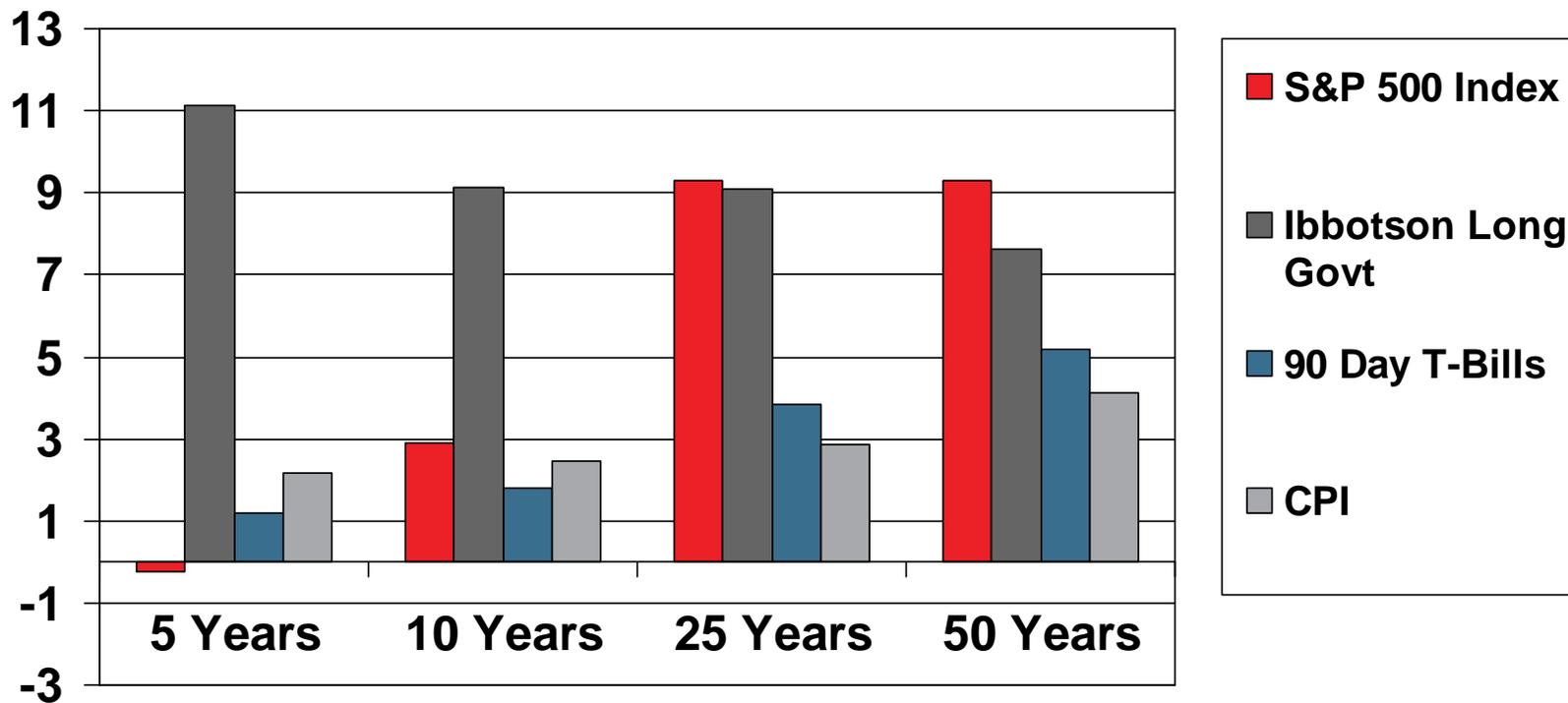


•Annualized for the 68 years ended 12/31/2011

Past performance does not guarantee future results

Indices are unmanaged and investors cannot invest directly in an index. The performance of unmanaged indices reflect no deductions for fees, expenses or taxes which would affect performance of actively managed assets

## 50-Year Illustration of Capital Markets and Inflation



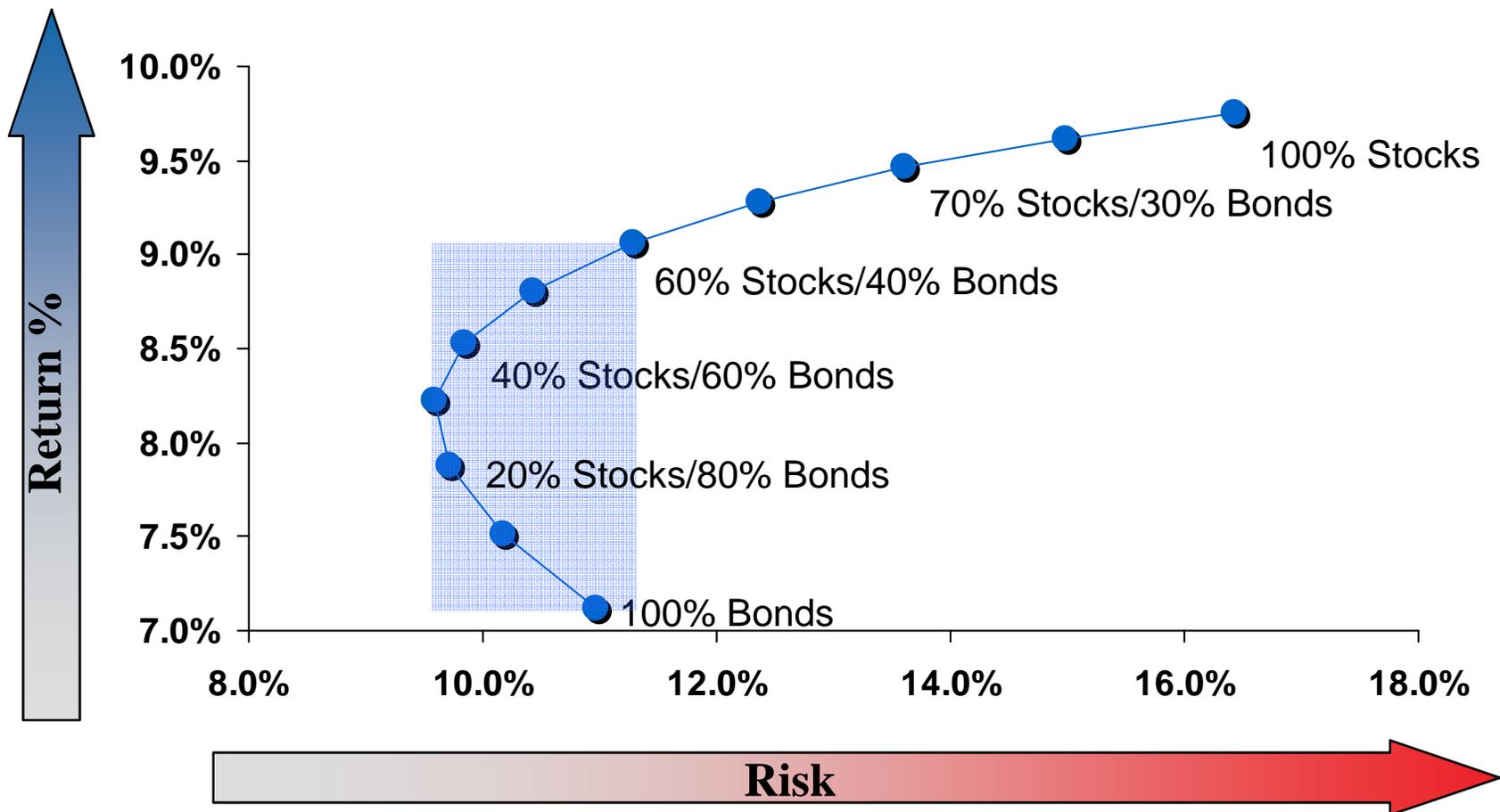
Note: All returns are annualized for the period ending 12/31/2011.

Past performance does not guarantee future results.

Generally, investing in equities entails greater volatility than investing in bonds.

Indices are unmanaged and investors cannot invest directly in an index. The performance of unmanaged indices reflects no deductions for fees, expenses or taxes which would affect performance of actively managed assets

## Risk/Return Tradeoff: Annualized for 50 Years Ending 12/31/10



Past performance is no guarantee of future results. Diversification does not ensure against market loss.

## Investment Vehicles: Managed Accounts vs. Mutual Funds

	Managed Accounts	Mutual Funds
<b>Investment Portfolio</b>	Tailored to investor's unique needs	Structured to meet fund objective
<b>Establishing Goals</b>	Consultant assists	Governed by fund prospectus
<b>Compliance with IPS</b>	Able to comply and easily monitored	Governed by fund prospectus
<b>Manager Evaluation</b>	Managers screened and evaluated by consultant	Funds screened and evaluated by consultant
<b>Performance Monitoring</b>	Consultant monitors daily on investor's behalf	Consultant monitors daily on investor's behalf
<b>Fee Ranges (fixed &amp; equity)</b>	0.25% - 0.75%	0.50% - 2.40+%

For Illustration Purposes Only

## Costs Components of Investment Management

<b>Custody fees</b>	A fee a brokerage or other financial institution charges for safekeeping services.
<b>Trading fees</b>	A fee that the broker-dealer assesses on a client for the service of filling an order.
<b>Trust administration fees</b>	A fee assessed by the custodian if the custodian provides trust accounting services.
<b>Consulting/ advisory fee</b>	A fee assessed by the investment consultant for advice on investment decisions.
<b>Investment management fee</b>	A fee an investment manager charges for managing a client's assets.
<b>Other fees</b>	Other fees assessed. Include settlement fees, travel expenses, sub accounting fees, bundled fees, etc.

## Hypothetical Cost Comparison

	<b>Pension A</b> utilizing mutual funds	<b>Pension B</b> utilizing separately managed accounts
<b>Custody fees</b>	<b>0.05%</b>	<b>0.00%</b>
<b>Trading fees (estimated as a percentage)</b>	<b>0.70%</b>	<b>0.00%</b>
<b>Trust administration fees</b>	<b>0.05%</b>	<b>0.00%</b>
<b>Consulting / advisory fee</b>	<b>0.20%</b>	<b>0.70%</b>
<b>Investment management fee</b>	<b>1.25%</b>	<b>0.40%</b>
<b>Other fees</b>	<b>0.05%</b>	<b>0.00%</b>
<b>Total fees to the plan</b>	<b>2.30%</b>	<b>1.10%</b>

For illustration purposes only