Taft-Hartley Funds

Taft-Hartley plan trustees are bound by fiduciary responsibilities that require them to act with care, skill, prudence and diligence. These high standards were established by three landmark laws passed nearly 60 years apart. Throughout this time, history—and the legal and regulatory environments—suggest that trustee responsibilities have increased in both magnitude and complexity.

The first of these laws, the Taft-Hartley Act of 1947, established the structural framework for managing multi-employer benefit plans negotiated in collective bargaining. The Act’s scope has broadened over the years, now enabling the creation of plans to fund many employee benefits, such as unemployment payments; education scholarships; life, disability and accident insurance; legal services; and child care assistance.

The second law was the Employee Retirement Income Security Act of 1974. ERISA, as amended, codified the prudent standards that trustees are expected to follow in managing the investments of employee benefit plans. Yet, while ERISA added another blanket of rules to Taft-Hartley plans, it recognized that trustee responsibilities differed between multi-employer and single-employer plans.
Morgan Stanley Smith Barney’s approach is a six-stage process that helps Taft-Hartley fiduciaries develop and document a prudent strategy.

The third law affecting Taft-Hartley funds is the Pension Protection Act of 2006 (PPA), which was prompted in large part by the existence of many large underfunded defined benefit plans. PPA includes new regulations targeting Taft-Hartley plans, including the requirement to perform certain funded status tests known as solvency tests. Failure to meet these tests results in constraints that can include the development of a Funding Improvement Plan, for plans whose funding status is considered “endangered,” to a Rehabilitation Plan, for plans whose funding status is considered “critical.”

1. CONDUCTING A NEEDS ANALYSIS

One of the most important components of prudent fiduciary stewardship for Taft-Hartley plans is a documented investment policy. But before that policy can be developed, plan trustees, and other advisors, should carefully review the plan’s needs. The result of this analysis is a written investment policy statement—an important blueprint that helps guide all investment activities under the plan.

Conducting needs analysis includes a review of these and other important considerations in the table below.

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2. ESTABLISHING INVESTMENT POLICY
Fiduciaries are required to act in strict accordance with the plan’s investment policy guidelines at all times.

Once the plan’s investment objectives have been identified and an appropriate strategy formulated, Consulting Group helps Taft-Hartley plans prepare a written investment policy and legal counsel statement that establishes guidelines for the plan’s portfolio. This investment policy statement defines the duties of all parties’ involvement with the plan’s investment process. It also details the plan’s risk and return targets, describes portfolio constraints, and outlines the selection and termination criteria used for investment managers. Under ERISA these documents become part of the plan’s documentation, and should be carefully reviewed from both an investment and a legal perspective.

ASSET/LIABILITY MODELING CAPABILITIES
Helping Funds Assess the Probability of Funding Future Liabilities

We believe that liability modeling is the domain of professional actuaries. While we do not serve in an actuarial capacity, we can work in conjunction with specific actuarial assumptions to develop asset/liability studies. These studies, based on relevant historical data and projected actuarial assumptions for benefits, can assess the probability of funding the future liabilities by employing different investment strategies.

Our asset liability model is an interactive, stochastically-based asset liability optimizer tool that provides asset and liability analysis of defined benefit pension plans for single employer, multi-employer and public funds. For each asset allocation chosen for testing, we perform stochastic forecasts for a time horizon of up to 20 years, storing the results (the true risk measures) from each forecast in a database.

The output from the model is presented in a report, which contains the following sections:

• Deterministic Projections—Shows trends in the plan assuming a constant rate of return (no investment return volatility) and provides a reference for the later projections.

• Stochastic Projections—A range of results is shown for each true risk measure, showing results for each tested portfolio ranging from worst result to best result through quarterlies. Typically, all portfolios are shown at five-year intervals through the projection period.

• Detailed Stochastic Projections—The most likely candidates for the best portfolio are compared at each year of the projection.

• Summary and Recommendation—This section summarizes the test and recommends a portfolio citing reasons for the recommendation.

• Appendix—Describes the capital market assumptions and methods used in the study.
3. CREATING ASSET ALLOCATION OBJECTIVES
Consulting Group begins every relationship with an objective assessment of each plan’s current investment needs and future goals. This analysis leads to detailed asset allocation recommendations for each plan that seek to improve returns, reduce risks and eliminate unnecessary expenses.

Some of the critical factors examined include:

- The rates of return the plan expects to achieve (both in absolute terms and relative to appropriate benchmarks)
- The amount of risk each plan is willing to assume in pursuit of the plan’s investment objectives
- The specific asset allocation strategy adopted and the amount allocated to stocks, bonds and cash
- The amount of allocation to alternative investments, including funds-of-hedge-funds and real estate, among other options
- The plan’s prior investment strategies and limitations

Fiduciaries are generally required to diversify plan investments to help reduce the risk of large losses in any one asset class, investment style or security. Helping plan fiduciaries ensure diversification among different asset classes is one of the core services provided by Consulting Group. Based on your objectives and guidelines, we will assist with the allocation of plan assets among a mix of investments designed to help maximize returns at the level of risk most appropriate for the plan.

4. MANAGER EVALUATION AND SELECTION
To help investors make these important decisions, the Investment Advisor Research team at Morgan Stanley Smith Barney has developed a disciplined process for evaluating investment managers. Through this process, we deliver a wealth of detailed information about the investment products available through our investment advisory programs to our Financial Advisors and clients.

Our analysts examine a range of criteria they believe are indicative of potential investment manager quality—such as investment philosophy, buy and sell discipline, research capabilities, business operations and the qualifications of key personnel.

One of Taft-Hartley plan fiduciaries’ most important responsibilities is the ongoing monitoring of each investment manager’s performance.

Morgan Stanley Smith Barney’s Consulting Group does not charge investment managers for its evaluation and our manager research reports are generally not provided to anyone other than our investors.
ALTERNATIVE INVESTMENTS*

Recognized for Portfolio Diversification Capabilities, Historically Low Correlation to Public Markets and Attractive Risk-Adjusted Returns

Many institutional investors seek attractive return potential that many alternative investment strategies may offer. By design, these types of investments have a generally low correlation with traditional asset classes and can provide enhanced risk-adjusted return potential.

Morgan Stanley Smith Barney’s Consulting Group offers a fund-of-hedge-funds platform consisting of multiple fund managers, with a number of investment vehicles and multiple strategies.

The funds-of-hedge-funds structure helps simplify the manager selection and allocation process and provides access to such diversification at reduced minimum investments. For more information on alternative investment strategies, including fund-of-hedge-fund platforms, talk to your Institutional Consulting Director.

5. MONITORING PORTFOLIO PERFORMANCE

One of Taft-Hartley plan fiduciaries’ most important responsibilities is the ongoing monitoring of each investment manager’s performance. Morgan Stanley Smith Barney’s Consulting Group helps you meet this requirement by periodically reviewing each investment manager’s investment results and activities. This includes an evaluation of the manager’s performance, the performance relative to appropriate benchmarks and, most importantly, relative to the objectives and guidelines you have established for your plan.¹

All plan fiduciaries also receive quarterly performance reports summarizing investment performance and portfolio activity, including all transactions and changes in asset mix. In addition, we will arrange meetings with your investment managers and plan trustees as often as needed.

¹ To help Taft-Hartley plans evaluate their performance versus their industry peers, Morgan Stanley Smith Barney provides access to the Wilshire Taft-Hartley Peer Universe.

*Alternative Investments are not suitable for all investors.
6. PERIODIC REBALANCING STRATEGIES

In today’s complex market environment, maintaining a sound, well-diversified investment portfolio is a complex process. Over time, changing market conditions can lead your plan’s portfolio to stray from its original asset allocation strategy, leaving your portfolio exposed to more risk than planned.

Careful analysis and periodic course corrections can help reduce such risks. This process is known as portfolio rebalancing. Consulting Group can help you evaluate key rebalancing strategies, which include periodic, threshold, range, volatility-based and active rebalancing, among others, to carefully select the appropriate option that best suits the needs of your plan and its participants. For more information on rebalancing, ask your Institutional Consulting Director for a copy of our white paper, *The Art of Rebalancing.*

RESPONSIBILITIES EXTEND TO ALL PLAN-RELATED MATTERS

In today’s complex regulatory and investment environment, satisfying fiduciary requirements is more difficult than ever before. The nation’s laws and regulations stipulate that a trustee’s responsibilities extend to all plan-related matters. Four major areas of a plan’s operation may require a particularly prudent approach:

- **Recordkeeping.** Detailed plan records must be maintained to account for plan assets and liabilities, as well as payments to and from the plan.
- **Collections.** Plan fiduciaries must ensure that participating employers properly pay contributions.
- **Benefits.** Funding the program and paying benefits are among the most technical of a plan’s operations.
- **Investments.** Trustees must ensure that plan assets are invested prudently and productively, balancing the management of risk with the needs of plan participants and their beneficiaries now and in the future.
Of the four critical areas previously listed, the first three can be delegated to accounting firms, actuarial firms or other third-party professionals with the expertise to ensure compliance with regulatory and reporting requirements. These firms must be carefully monitored by plan fiduciaries to ensure that high standards of diligence and professionalism are maintained.

Satisfying fiduciary responsibilities in investments, however, is not so easily accomplished. Although the Acts allow for the delegation of responsibility to qualified investment managers meeting ERISA’s definition, trustees remain fully responsible for prudently selecting and overseeing managers on an ongoing basis.

Morgan Stanley Smith Barney specializes in assisting Taft-Hartley plan trustees and other fiduciaries with monitoring and managing their responsibilities through a disciplined six-stage process.

THE POWER OF AN INDUSTRY LEADER; THE BENEFIT OF PERSONALIZED ADVICE

Morgan Stanley Smith Barney’s Consulting Group, an industry leader in investment consulting, can help Taft-Hartley fiduciaries satisfy their ongoing investment and trustee responsibilities and, as a result, help reduce the personal risks associated with this complicated area of plan management.

Your plan will receive the benefits of an industry leader and the expansive services available through Morgan Stanley Smith Barney, in which, Consulting Group is a division. Those expansive services are coupled with the benefits of personalized advice provided by your Morgan Stanley Smith Barney Institutional Consulting Director.

Working together, we focus on:

• Analyzing plan objectives and creating written investment policy statements
• Developing appropriate asset allocation strategies customized for the needs of your plan

• Monitoring relationships between Taft-Hartley plan fiduciaries and third-party investment management firms, including the evaluation and selection of those firms

• Providing specialized performance reporting and monitoring systems that help maintain active and efficient communication between plan trustees and investment firms

• Developing periodic review procedures and customized rebalancing strategies

• Delivering high-quality advisory services investment advice and investor materials to help plan trustees maintain a high-quality knowledge of the capital markets and economic environment

For more information on Consulting Group and its services for institutional investors, or to review some of our specialized reports and white papers, please speak with your Institutional Consulting Director.
Diversification does not assure a profit or protect against loss.

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Investing in alternative investments is speculative, not suitable for all clients, and intended for experienced and sophisticated investors who are willing to bear the high economic risks of the investment, which can include:

- loss of all or a substantial portion of the investment due to leveraging, short-selling or other speculative investment practices;
- lack of liquidity in that there may be no secondary market for the fund and none expected to develop; and
- volatility of returns.
- may employ aggressive tax strategies that may ultimately pose tax risks for investors;
- typically have higher fees and expenses than other investment vehicles, and such fees and expenses will lower the returns achieved by investors;
- funds of hedge funds often have a higher fee structure than single manager funds as a result of the additional layer of fees.

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