THIRTEEN QUESTIONS TRUSTEES CAN ASK ABOUT HEDGE FUNDS

These questions were developed by members of the Working Group of the Trustee Leadership Forum for Retirement Security, a project of the Initiative for Responsible Investment at the Harvard Kennedy School. The TLF is a participatory action research project on systemic thinking by labor-affiliated public and Taft-Hartley pension fund trustees about responsible investment and its relationship to long-term pension fund stability. The TLF developed in the wake of the 2008 financial crisis and ensuing political and economic fallout. This crisis crystalized the need for a forum where pension fund trustees can work on hard questions related to the challenge of retirement security in the current market environment, and build on current leadership skills to assist navigating complicated topics and situations.

1. **What are we calling hedge funds?**

2. **What purpose are hedge funds meant to serve in our plan's portfolio?**

3. **Does our plan invest in hedge funds to mitigate risks in a market downturn?**

   What scale of investment is required for this allocation to act effectively as a hedge in a market downturn?

   Is there a minimum or maximum effective range for investments with hedge fund strategies?

   What returns should be expected in non-downturn years?

4. **Does our plan invest in hedge funds in an attempt to achieve superior returns, or alpha, even in up markets?**

   How is alpha assured, net of fees?

   Will our plan only invest in the top quartile of hedge funds?

5. **Does our plan invest in hedge funds to achieve liquidity?**

   Are there less expensive ways to achieve this goal? What are they?

6. **What are the full costs to run a hedge fund investment program?**

   Determining the cost of the program should factor in consulting costs, investment manager fees, the fee structure and the mix of management fees versus performance fees, and internal staff costs (legal, compliance, risk management and operations costs).

   How will incremental returns cover costs?

7. **What are the criteria for the selection of managers?**

   Will all hedge fund managers be fiduciaries?

   Will they be regulated?

   What fee structures and liquidity terms will be required?

8. **How will hedge fund managers be held subject to claw back or other performance fee constraints?**

   Are hedge fund fees declining? What strategies do other funds use to assess and reduce fees?

   Are there hedge funds which have produced such superior returns over time that they are worth the cost, including monitoring and other transaction expenses, even if they refuse to lower fees? If yes, please tell us why.

9. **How is investing in complex and opaque investments, such as hedge funds, in compliance with my fiduciary duty, as a Trustee?**

10. **How has the experience of plans that are reducing or eliminating their exposure to hedge funds been explored?**

11. **What is the magnitude of risk associated with our plan's hedge fund allocation?**

    How is risk measured? How will the Board's appetite for risk be assessed?

12. **What is the review process for this allocation?** How will staff insure this investment is prudent and in compliance with our investment policy? How will the Board of Trustees be consulted about hedge fund allocations?

13. **How is the long-term health of the economy, including a strong tax base, considered in this investment?**

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