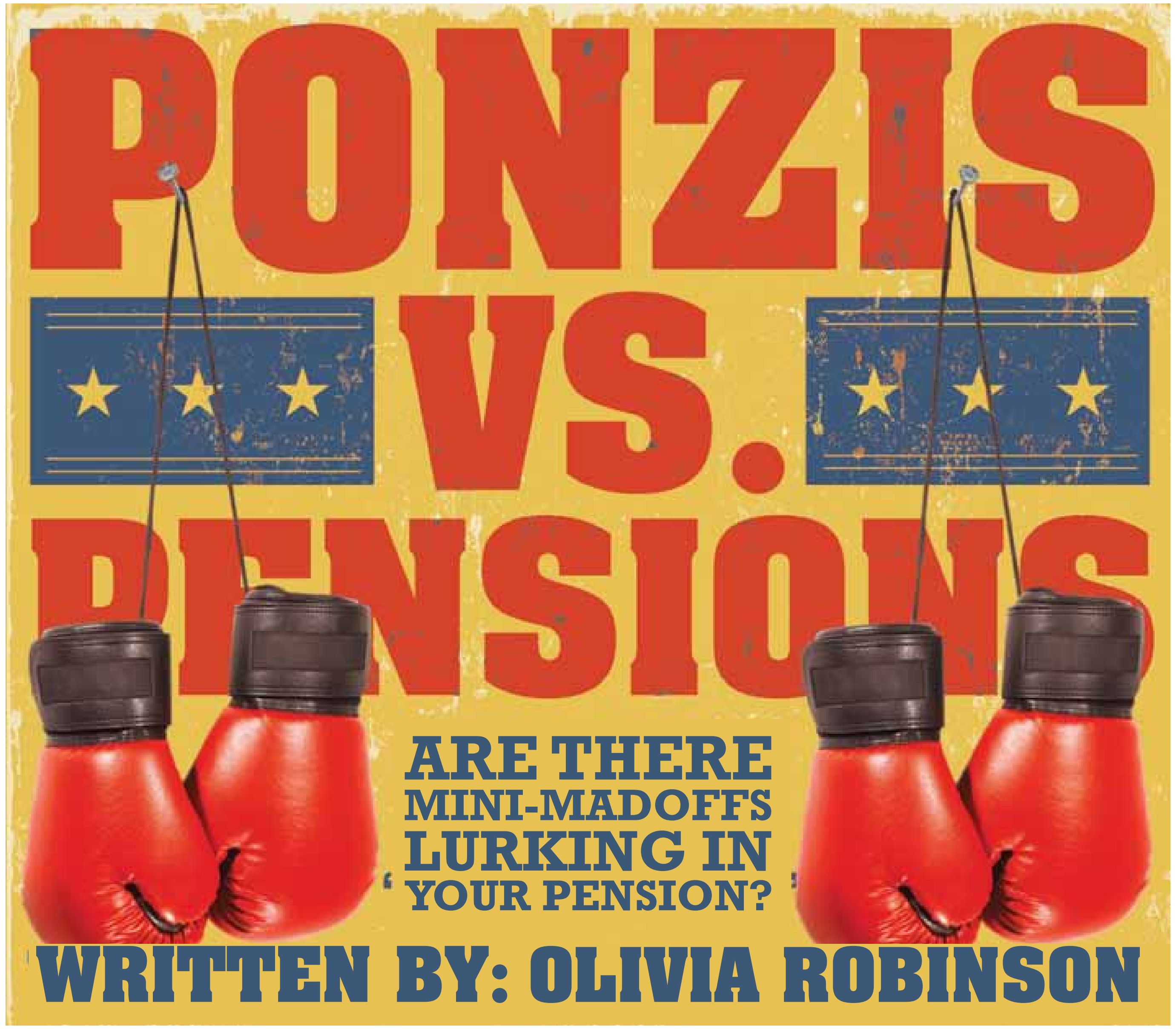


Pension funds are top news: fraud, white collar crime, indictments, and staggering financial losses. Bernie Madoff, and his skillful manipulation of investors in history's largest Ponzi scheme, has been a wake-up call for pension fund trustees and fund executives. These are the people who have a fiduciary responsibility and are personally liable for the ups and downs in pension performance, including any investment made, unknowingly, in a Madoff-style Ponzi scheme.

It's the "human factor" that has the potential to put the fund, its trustees and executives at risk of financial loss and legal challenge. Trustees need to be knowledgeable about who they are trusting to oversee fund investments: investment consultants, third-party placement agents, and alternative investment managers.

The sad truth is, whether you are a state health care employee, a county sheriff, or a federal postal worker, you are relying on others to manage how you will live out the last years of your life. That is a striking statement of fact. You have no control over the day-to-day investments being made by your pension fund on your behalf.

While the major pension funds have tremendous resources at their disposal for planning, investment and oversight, smaller pension fund managers do not. Often, they must rely on trusted consultants and outside professionals to guide them. The recent Madoff scandal has highlighted the importance of doing due diligence on all individuals involved in an investment.

In recent years, pension funds have been under extraordinary pressure to increase earnings, and have steered some of their asset allocation away from the typical mix of stocks and bonds. As a result, some have invested in "alternative investments" (e.g. hedge funds, private equity funds, real estate) in order to take advantage of the higher returns from these less traditional sources. It is estimated that up to 20 percent of a pension fund's portfolio may be invested in these alternative investments.

This approach to investing can backfire on the pensions. Smith Breeden was fired after it was discovered that they'd lost $50 million of pensioners' money in a bait-and-switch scheme, reversing the practice of investing 93 percent in government bonds in favor of putting 93 percent into commercial mortgage-backed securities and the like. They were supposed to follow the Lehman Cap benchmark. Instead they flipped it, and lost everything. The New Mexico PARA Council didn't catch it until one quarterly report showed the loss.

"This was a grey area whether the Council itself was legally culpable," said Scott Adams, American Federation of State, County and Municipal Employees, AFL-CIO, Coordinator for the Western Region Pension Program. "But there was a clear lack of due diligence and fiduciary oversight. They need to do due diligence on money managers and their investment history. They also need to be active in examining the current investment strategy to make sure that it's being implemented".

"Some of those most easily conned from fraud cases are wealthy professionals and investors, whose egos won't permit them to think that they can be fooled", said John Bagnall, detective in charge of the Fraud Section of the LAPD. "And, that's the reason that con men get away with the scam. A lot of victims in these cases deny that they've been conned. They don't want people to know. They know that they're not going to get their money back and they'd rather take their losses". Trustees of pension plans have a fiduciary responsibility and can't just walk away or pretend that the loss didn't happen.

How can pension funds protect themselves?

A quick and easy way to prevent fraud is to know who you're dealing with ahead of time through a relatively simple background check.

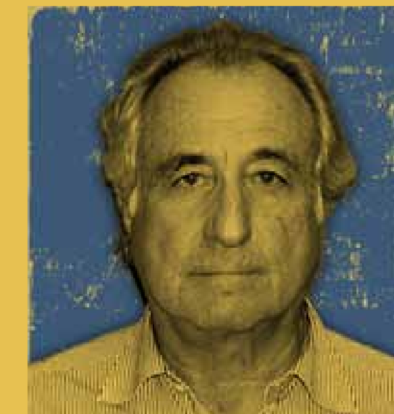
Steve Vale of Los Angeles-based Risk Solutions & Investigations, Inc. suggests the following: require that the fund and its principals complete a specific application form and then cross-check responses through active interviews, and a search of online and public records, for consistency, accuracy and completeness. Above all, don't rush. Take your time to properly assess and understand the situation. Investments are very rarely, maybe never, extremely time sensitive.

Mark Mermelstein, of Counsel, Orrick, Herrington & Sutcliffe, says pension funds should establish standardized due diligence procedures to understand the investment. The basics include: (1) setting up an Investment Committee to review and approve all investments; and (2) developing a due-diligence checklist to vet all investment opportunities and the people behind them. "In the event that the investment has already been made, the pension fund will want to know from an attorney what their exposure is," says Mermelstein.

Olivia Robinson is President of Background Intelligence Inc.

THEN VS. NOW

Name: Charles Ponzi
Born: 1882
Sentence: 14 Years
Arrested: August, 1910
How He Was Caught:
Turned himself in
Size of Fraud:
Around $10 million
(approx. $225 million in
2008 valuation)
Company:
Securities Exchange Company



Name: Bernard Madoff
Born: 1938
Sentence: 150 Years
Arrested: December, 2008
How He Was Caught:
Sons turned him over
Size of Fraud:
$50 billion or more
(alleged by Madoff)
Company:
Bernard L. Madoff -
Investment Securities, LLC.

STEPS TO MADOFF-PROOF YOUR PENSION:

There is possible legal exposure for Pension Funds and their executives who may not have had any idea that they were putting money into risky investments. The following steps can help Pension Funds protect themselves in case they come in contact with a "mini-Madoff"

- Under attorney guidance (attorney-client privilege), it is critical to document what the Pension Fund knew at the time they made the investment.
- There are risks to the Fund that has invested in a Ponzi scheme if some of the executives knew it was a Ponzi scheme. Exposure includes: (1) criminal exposure for the executives who acted recklessly; and (2) liability for the Fund itself, and (3) liability to the pension holders.
- The Fund will have to write off the investment and the pension holders will suffer the consequences.
- The Fund and its executives may be charged with negligence and failure to do due diligence.
- Conceptually, the Pension Fund is still responsible and potentially liable if they hire an outside consultant to perform investment advisory services.