Fiduciary Breach Investigation of US Airways Pilots Pension Plan

Investigation of Conflicts of Interest, Undisclosed Fees, and Malfeasance Related to the Retirement Income Plan for Pilots of US Airways, Inc., by Benchmark Financial Services, Inc., dated May 5, 2012.

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1. Executive Summary

In September, 2011, Benchmark Financial Services, Inc., ("Benchmark") was retained by the US Airline Pilots Association ("USAPA") to investigate concerns regarding potential conflicts of interest, undisclosed fees, and malfeasance involving firms providing investment-related services to the Retirement Income Plan for Pilots of US Airways, Inc. ("the Plan"), an ERISA-governed noncontributory defined benefit plan sponsored by US Airways.

Fiduciary breach investigations require access to evidence. While the record indicates that USAPA and participants in the Plan have repeatedly over the years since the Plan was terminated in 2003 requested all the documentation and records related to the Plan from US Airways, the Pension Benefit Guaranty Corporation, Towers Perrin, State Street Bank and Trust Company, and all of the Plan's former investment managers and investment consultants, virtually none of the information requested has been provided to participants.[1] Critical documents such as contracts between the Plan, on the one hand, and, on the other, the Plan's actuary, custodian,

KEY FINDING:

Our review reveals profound omissions, errors, conflicts of interest and "red flags" regarding many of the firms that provided fundamental services to the Plan, such as audit, actuarial, custodial, investment consulting, foreign exchange, securities trading and money management.

[1] USAPA served document subpoenas on US Airways, Air Line Pilots Association, International and Integrated Management Resources Group, Inc., ("IMRG") and deposition subpoenas on IMRG, former IMRG employee Yaya Adegboyega, former US Airways executive Michelle Bryan, and former PBGC employee Richard Holbrook. USAPA also served a Freedom of Information Act request on the Department of Labor regarding its Program 53 investigation. Further, USAPA sent letters to the Plan's actuary, custodian and all of the Plan's former investment managers and pension consultants requesting any contracts, statements, reports, or other documents, related to the Plan.

investment consultant, private equity consultant, and the dozens of investment managers retained to manage Plan assets, have not been provided. The Plan's securities trading and investment performance records are lacking, as are the minutes of meetings of the Investment Committee of the Plan (if, in fact, meetings were held).

Virtually none of the information regarding the Plan requested by USAPA has been provided to participants.

In our opinion, given regulatory record-keeping requirements applicable to registered investment advisers, securities dealers and banks, as well as standard industry practices, it is inconceivable that the overwhelming majority of the records related to the Plan have simply vanished. Almost certainly, the crucial documents do still exist. The only conclusion that can be reached is that they are being withheld.

The participants in the Plan were denied access to material information related to the Plan *before* the Plan was terminated (as discussed below), and continue to be denied necessary access even today. As a result, efforts by participants and this firm to investigate potential fiduciary breaches and other forms of wrongdoing have been severely hampered. Further, any parties that may have contributed to the demise of the Plan have not, as yet, been held accountable.

The PBGC has never adequately investigated conflicts of interest, undisclosed fees and malfeasance involving investment firms providing services to the Plan.

Our review of an eight-page Fiduciary Breach Investigation of the Plan conducted by the PBGC seven years after termination of the Plan (and after inception of litigation between USAPA and PBGC) in 2010, reveals that the PBGC did not at that time, or any time prior, adequately investigate conflicts of interest, undisclosed fees and malfeasance involving investment firms providing services to the Plan. Allegations of fraud asserted by creditors in the US Airways bankruptcy proceedings that were not specifically addressed and adjudicated by the bankruptcy court and the causes of the $2.1 billion funding shortfall that precipitated the Plan's distress termination on March 31, 2003, were never investigated by PBGC. No meaningful analysis was undertaken by PBGC of certain specific investments that lost most, if not all, of their value over a very short period of time, and whether these investments were appropriate for, as well as consistent with the investment guidelines of, the Plan. Further, PBGC did not review the Plan's investments in futures and made no attempt to investigate the Plan's $188 million in futures losses in 2001. Finally, PBGC did not investigate what caused the Plan to lose $658 million dollars, or one-third of its value between December 2001 and March 2003, and did not compare performance of the Plan against any of the other US Airways pension plans for the same period.

Our review of the limited records of the Plan made available to us reveals profound omissions, errors, conflicts of interest and "red flags" regarding many of the firms that provided fundamental services to the Plan, such as audit, actuarial, custodial, investment consulting, foreign exchange, securities trading and money management.

According to the December 31, 2000 and 1999 financial statements, US Airways, the plan administrator, instructed the Plan auditor, KPMG, not to perform any auditing procedures with respect to pension plan assets certified by certain financial institutions that served as the trustees and insurance company of the Plan. The information that was not audited by KPMG related to all, or virtually all, of the Plan's assets. Because of the significance of the information that KPMG failed to audit, that firm did not express an opinion on the financial statements of the Plan.

> ***As a result of the lack of an annual audit of the Plan, participants were provided with no substantive assurance of the integrity of the assets of the Plan, and were denied useful information needed to monitor the Plan's ability to pay benefits.***

As a result, in our opinion (as well as in the opinion of the Office of the Inspector General for the U.S. Department of Labor), the participants in the Plan were provided with no substantive assurance of the integrity of the assets in the Plan, and were denied useful information needed to monitor the Plan's ability to pay benefits. Further, since a significant percentage (27%) of the Plan amounting to approximately $500 million was invested in illiquid, hard-to-value assets that require even greater scrutiny than publicly traded securities and the percentage of assets lacking readily available market values increased dramatically (23%) over the prior year, the failure to audit the Plan's assets was especially egregious.

An audit of the assets of the Plan by PBGC was not completed until more than two years after the PBGC took over the Plan. The firm that conducted the asset audit for PBGC was Integrated Management Resources Group, Inc. ("IMRG"). PBGC contracting with IMRG has been highly controversial for over a decade. Last year, on March 30, 2011, the Inspector General of the PBGC issued a report indicating that the plan asset audit for seven terminated National Steel pension plans performed by

IMRG was plagued with "serious errors and omissions." More recently, on November 30, 2011 the Inspector General of the PBGC issued a report indicating that the initial four plan asset audits intended to establish the fair market value of United Airlines plan assets at the dates of plan termination, completed by IMRG, were also seriously flawed.

The PBGC has notified USAPA that the asset audit of the Plan undertaken in 2006 was flawed. The new audit, scheduled to be completed by July 2011, is still not complete.

On April 29, 2011, the PBGC notified USAPA that the asset audit of the Plan the PBGC had hired IMRG to undertake was flawed and that the PBGC had hired a new contractor to undertake a new plan asset valuation. The new audit was scheduled to be completed July 2011, however, for reasons unknown, is still not complete. As noted by the Inspector General in connection with the re-valuation of the National Steel and UAL plans, any new asset audits, whenever completed, will not produce the same level of assurance that an audit properly performed at the time of termination would have provided. Further, as noted by the Inspector General in connection with United Airlines, any re-valuations undertaken by PBGC, or firms retained by PBGC, may themselves be significantly flawed.

Given the length of time that has elapsed since the original flawed audit of the Plan's assets, completion of an audit in accordance with applicable standards to determine the fair market value of Plan assets at the time of termination will be more challenging. On the other hand, in recent years revelations regarding widespread pension malfeasance have become more commonplace and, as a result, investigating fiduciary breaches today may be less difficult than even five years ago.

The Plan purchased a range of services from custodian banks on a "bundled" fee basis that lacked transparency and exposed the Plan to potentially excessive, or even fraudulent, expenses.

While we were not provided with any of the contractual agreements between the Plan and any of its custodian banks, it appears that the Plan purchased a range of services from these banks on a "bundled" fee basis that lacked transparency and exposed the Plan to potentially excessive, or even fraudulent, expenses.

For example, State Street Bank and Trust Company ("SSBT"), the primary custodian of the Plan, managed significant assets of the Plan. The trading records confirm that the Plan also engaged in securities trading with SSBT.

In the absence of sufficient information, we were unable to "unbundle" the fees paid to the Plan's custodians for the range of services provided so as to be able to determine potential overcharges, or malfeasance. However, in light of current nationwide litigation involving major pension custodian overcharges, we recommend that the foreign exchange, securities trading, investment management and other services provided by SSBT should be examined. SSBT is the same firm that certified information to the auditor related to virtually all of the Plan's assets—information which KPMG did not audit.

Towers Perrin, problematically served as the Plan actuary and the lead investment consultant/adviser to the Plan,[2] and may have provided other services, including securities trading to the Plan, or its investment managers, through its affiliated broker-dealer and executive compensation consulting to US Airways, or its executives. It appears that Tower Perrin may have been subject to conflicts of interest, and received direct and indirect fees, that were not adequately disclosed.

Towers Perrin problematically served as the actuary and lead investment consultant to the Plan and may have provided other services, including securities trading to the Plan, or its investment managers, and executive compensation consulting to US Airways, or its executives.

Towers Perrin's actuarial assumptions related to the Plan appear to reflect a conflict of interest and benefitted the plan sponsor at the expense of the Plan and its participants. For example, at a time when the mandatory retirement age for commercial pilots established under federal law was age 60, Towers Perrin assumed that all pilots would work until the latest possible age, without exception, and that no pilot would retire early. It was estimated that this unreasonable retirement assumption, which was inconsistent with the actual plan experience, reduced the contribution to the Plan required of US Airways by approximately $413 million. Further, Towers Perrin's use of a 9.5% investment assumption "failed miserably" and "was largely responsible for the company's unaffordable pension costs that led to the termination on the Plan." Retirement age, along with investment assumption, payroll and employee turnover, are the primary drivers of pension plan costs.

Further, given Towers Perrin's prominent role in executive compensation consulting, the multiple relationships Towers Perrin had with US Airways, and the widely recognized dangers related to executive compensation consultants that provide other services to

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[2] This conclusion is based upon our presumption that a member of the Investment Committee (who was also a former Towers Perrin employee) testified truthfully during a deposition in U.S. Airline Pilots Association vs. Pension Benefit Guaranty Corporation. The 2000 and 2003 Forms 5500 for the US Airways, Inc., Master Trust Cash Pool, to the contrary, solely indicate that Towers Perrin was compensated for actuarial services.

companies, whether Towers Perrin provided executive compensation services to US Airways, or its executives, is a significant concern requiring further investigation.

Towers Perrin's unreasonable assumptions that no pilot would ever retire early and that the Plan's investments would earn 9.5% benefitted the sponsor and led to the termination of the Plan.

Conflicts of interest, legal and regulatory issues were identified related to three other investment consultants retained by the Plan - Wilshire Associates, Callan Associates and Rocaton Investment Advisors. The PBGC itself has been criticized regarding its relationship with two of these firms. The scope of services these firms provided to the Plan, such as investment management, securities trading, or investment consulting, should be further investigated.

While the Investment Policy of the Plan states as goals maintaining an overall portfolio structure that is as simple as possible and minimizing fees in order to maximize return, the custodial statements indicate the Plan invested in 35 high-risk, high-cost, illiquid, and opaque ("blind pool") private equity investments. No performance reports, indicating the gross and net performance of the Plan's private equity investments were provided. However, as a result of the fees related to private equity investing, in order to achieve the Plan's internal rate of return objective of 15% (net of all layers of fees), the Plan's private equity investments would have had to achieve a significantly greater gross return -- in excess of 25%. The likelihood of achieving such net investment results on a consistent basis is remote, even speculative.

According to the PBGC, the PBGC retained Pacholder Associates, Inc., to value and advise it with regard to the limited partnerships in the Plan's portfolio as of the Plan's termination; however, the Pacholder report has not been provided to participants in the Plan, or to us. Due to the unreliability of private equity valuations and related conflicts of interest, any such valuations must be viewed as suspect—especially where, as here, no annual audit, or termination asset audit, of the Plan has ever been completed.

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While the private equity policies and procedures related to the Plan make repeated reference to a private equity consultant, no records have been provided that reveal the identity of the private equity consultant who recommended, or selected, these non-traditional investments. As a result, we were precluded from investigating any of the potential conflicts of interest, or financial arrangements (which are commonplace), between the private equity consultant and the private equity managers that were retained to manage Plan assets.

Our review of one private equity fund in which the Plan invested, Alchemy Investments, revealed that the fund and the management firm lacked many of the hallmarks of a prudent pension investment, such as an established investment performance track record. Contrary to prudent practices for pensions, the Plan owned 98% of the Alchemy fund. Owning virtually 100% of a private equity fund that lacked any investment performance track record amounted to piling risk upon risk.

Owning 100% of the Alchemy private equity fund that lacked any investment performance track record amounted to piling risk upon risk.

It appears that Alchemy significantly underperformed (by 20%) its applicable benchmark on a gross basis. Since fees and transaction costs related to this investment may have been in excess of 5%, the performance on a net basis may have been far worse.

A review of a hedge fund of funds investment in which the Plan invested revealed that the multiple layers of asset management, performance, and organizational fees related to the Lighthouse V Fund, combined with trading and organizational expenses, amounted to an annual charge of approximately 8% on assets under management and 30% of any potential gains. Thus, in order to generate a net positive return an investment in the Lighthouse Fund would have to exceed 12% annually to match a risk-free return of 3%.

While the documents indicate that the Lighthouse investment was a private placement, the identity of the private placement agent involved, or the amount of any placement fee related to the Lighthouse investment, was not disclosed. A concern exists as to whether the private equity consultant who recommended, or selected, this, or any of the other private equity investments, may have received compensation from the managers involved.

Putnam's Investments' lackluster investment performance track record and history of sordid business practices prior to and during the period it managed $100 million in Plan assets both are "red flags." How the firm came to be hired initially, e.g., the independence of the investment consultant that recommended Putnam and how it performed once hired deserve additional scrutiny.

Ark Asset Management, an investment manager to the Plan that ceased operations and entered into a settlement agreement with the SEC in 2009 related to a $19 million "cherry-picking" fraudulent trade allocation scheme favoring the firm over its client accounts between August 2000 and December 2003, managed Plan assets during the period when the wrongdoing occurred. Whether the Plan was harmed as a result of the fraudulent trade allocation scheme at Ark requires further investigation.

In conclusion, Benchmark acknowledges that this fiduciary breach investigation is incomplete, thwarted by its inability to obtain the overwhelming majority of the relevant documents related to the pension. This review by Benchmark was required because the PBGC since 2003 has not adequately investigated fiduciary breaches with respect to the Plan, or, for that matter, with respect to any of the thousands of other terminated pensions under its trusteeship. In our opinion, the PBGC, as the statutory trustee to the Plan, clearly has the duty under ERISA and other federal law to investigate the earlier trustees' management of the Plan.

Perhaps most important, if undertaken routinely, *PBGC investigations of fiduciary breaches related to terminated plans can:*

- Enhance understanding of the connection between fiduciary breaches and harm to pensions;
- Quantify the damages related to fiduciary breaches; and
- Improve industry conduct by holding parties that contribute to the demise of pensions responsible.

2. Background Regarding USAPA's Demand for Fiduciary Breach Investigation

USAPA represents more than 5,000 active US Airways pilots. Before 2003, USAPA's members participated in the Plan. In 2003, a bankruptcy court found that the Plan was underfunded, terminated the Plan, and appointed the PBGC as the terminated Plan's statutory trustee. Many of USAPA's members have vested tights under the Plan and expect to receive benefits when they retire—albeit much less than if the Plan were adequately capitalized. In a letter to the PBGC dated June 18, 2009, USAPA indicated that the organization and its members suspected that, before the bankruptcy proceeding and ensuing termination, the Plan's fiduciaries breached their duties by transferring assets out of the Plan and by making improper investments. In particular, USAPA and its members indicated that they had reason to believe that the Plan's then-fiduciaries (1) pursued investments that may have involved self-dealing and conflicts of interest, and pursued questionable investment strategies for long-term pension plans;

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(2) improperly transferred assets of the Plan to other US Airways plans in order to make up for shortfalls, or losses in those other plans; and (3) failed to take steps necessary to protect the Plan even as its investments were losing value. These actions resulted in the $2 billion shortfall that precipitated the Plan's distress termination. USAPA demanded that the PBGC investigate and attempt to rectify the harms the Plan's previous fiduciaries may have caused.

In a letter dated July 9, 2009 to USAPA, Judith Starr, General Counsel of the PBGC responded that an investigation was underway but asserted that USAPA had not provided sufficient information to determine the basis for its allegations that earlier misconduct had occurred. She concluded that "vague and generic allegations of misconduct by unspecified individuals at unspecified times involving unspecified investments are not susceptible to effective investigation."

Virtually none of the information regarding the Plan requested by USAPA has been provided to participants.

In a letter dated July 17, 2009, USAPA responded that while Ms. Starr "appears to assume that USAPA has the duty to ferret out and identify potential wrongdoing by earlier fiduciaries, and to provide that information to PBGC, who, in turn, would decide whether such information is worth pursuing," USAPA believed that PBGC, as the statutory trustee to the Plan, had the duty under ERISA and other federal law to investigate the earlier trustees' management of the Plan. The letter went on to state that USAPA had attempted its own investigation of misconduct by earlier fiduciaries of the Plan but its efforts had been thwarted by its inability to obtain relevant documents. Notwithstanding such obstacles, USAPA's review had uncovered a number of questionable circumstances relating to activities under the watch of prior Plan fiduciaries that it believed, at a minimum, PBGC should have looked into. A list of six "suspicious occurrences, investments and transactions" was included in the letter.[3]

On September 2, 2009, USAPA filed a civil action against the PBGC in the PBGC's capacity as statutory trustee and fiduciary of the Plan alleging that although the PBGC was appointed trustee of the Plan in 2003, it had refused to perform its statutory and

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[3] The USAPA list included the following: (1) the allegations of fraud asserted by creditors in the US Airways bankruptcy proceedings that were not specifically addressed and adjudicated by the bankruptcy court; (2) the relationship between US Airways management and Tiger Management Fund; (3) the decisions of the Plan to invest in certain stocks that lost most if not all of their value over a very short period of time; (4) the investment strategies and decisions of several investment managers of the Plan—particularly those who lost significant portions of the investment dollars they were managing—to determine whether the investment strategies pursued were consistent with the investment guidelines of the Plan; (5) the decision of the Plan to invest in Alchemy Partners (Air) LLP or Alchemy Partners (Guernsey) Limited; and (6) the $2.1 billion funding shortfall that precipitated the Plan's distress termination on March 31, 2003.

fiduciary duties under ERISA and other federal law and had failed to investigate the financial affairs of the Plan and seek to remedy any breaches by the former trustees of the Plan. [4]

The PBGC never adequately investigated conflicts of interest, undisclosed fees and malfeasance involving investment firms providing services to the Plan.

In 2009 through 2010, Nicole C. Hagan, an attorney at the PBGC, conducted a Fiduciary Breach Investigation ("the Hagan investigation") to determine whether there was any evidence of a fiduciary breach related to what USAPA had described as "suspicious occurrences, investments and transactions." In her eight-page memorandum dated November 24, 2010, Hagan concluded that she did not find any such evidence and recommended that the investigation be closed.[5]

Hagan stated that her investigation "focused upon the Plan's investment policy and whether the Plan's portfolio, particularly the specific investments noted by USAPA in its letter to the PBGC dated July 17, 2009 complied with the policy." Hagan testified that her investigation was limited to allegations in USAPA's July 17, 2009 letter to PBGC[6] and that no new allegations of breaches of fiduciary duty, or potential breaches of fiduciary duty, uncovered during the course of discovery in the litigation between USAPA and PBGC were brought to her attention during the course of her investigation, or investigated by her.[7]

Most important, the Hagan investigation did not involve any review of conflicts of interest, undisclosed fees and malfeasance involving investment firms providing services to the Plan. Rather, it was a severely limited review of specific allegations made by USAPA prior to the commencement of litigation and discovery. Hagan testified that she spent a total of approximately 40-45 hours[8] on the investigation over the course of 15 months.[9]

At the outset of her report, Hagan summarily dismissed two of the areas that USAPA suggested PBGC investigate as being beyond the scope of the investigation she

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[4] US Airline Pilots Association v. Pension Benefit Guaranty Corporation, U.S.D.C. for the District of Columbia, Civil Action No. 1:09-cv-01675, September 2, 2009.

[5] Nicole C. Hagan Memorandum to Judith Starr, General Counsel, PBGC, November 24, 2010.

[6] Nicole C. Hagan deposition May 16, 2011, page 33.

[7] Id. page 33 and 34.

[8] Id. page 56.

[9] Id. page 49.

undertook: (1) allegations of fraud asserted by creditors in the US Airways bankruptcy proceedings that were not specifically addressed and adjudicated by the bankruptcy court; and (2) the causes of the $2.1 billion funding shortfall that precipitated the Plan's distress termination on March 31, 2003.

> ***Assertions of fraud by creditors of the employer are relevant in determining whether the employer lacks sufficient assets to support the plan and the plan qualifies for a distress termination.***

With respect to allegations of fraud asserted by creditors in the US Airways bankruptcy proceedings, Hagan stated that since USAPA did not suggest that there were any assertions regarding assets of the Plan, events in the bankruptcy proceeding were not relevant to her investigation.

According to the PBGC, in a distress termination, the employer must prove that it is financially unable to support the plan.[10] Any assertions of fraud by creditors of the employer are clearly relevant in determining whether the employer lacks sufficient assets to support the plan and the plan qualifies for a distress termination – regardless of whether there are any assertions of fraud regarding assets of the pension plan.

> ***While the fact that a pension is underfunded may not be indicative of a fiduciary breach, underfunding is a "red flag" that should be investigated in the context of a distress termination.***

With respect to the suggestion that the PBGC investigate the funding shortfall of the Plan, Hagan noted that the fact that a pension is underfunded may not necessarily be an indication of a fiduciary breach and that, without specific allegations, she was unable to investigate whether there was a fiduciary breach that caused the Plan to be underfunded.

Participants in pensions virtually always lack access to in-depth information regarding the causes of shortfalls, sufficient to formulate specific allegations. Further, specific allegations by participants in plans are not necessary to investigate fiduciary breaches generally, including breaches related to funding shortfalls. Fiduciary breach investigations neither necessarily depend upon, nor are guided by, allegations. Within the context of a fiduciary review of a failed plan, the causes of a shortfall can be investigated at little incremental cost and may reveal profound fiduciary lapses. In summary, while it is true, as Hagan stated, that underfunding may not be indicative of a fiduciary breach, underfunding is a "red flag" that can and should be investigated.

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[10] What is a distress termination? http://www.pbgc.gov/prac/terminations/distress-terminations.html

Hagan stated in her report that while she made a substantial effort to obtain additional documents from US Airways and made multiple requests to US Airways' counsel for information relating to the investments referenced in USAPA's letter, US Airways did not produce any information. Her report further states that she indicated to US Airways counsel that if PBGC did not receive the requested information, PBGC would issue an administrative subpoena. However, she testified at her deposition that notwithstanding the fact that she had indicated to US Airways that the documents she was seeking were important, the PBGC made the decision not to issue a subpoena.[11] Further, no subpoena was issued to State Street Bank & Trust for records related to her investigation.[12] She was unable to get minutes of meetings.[13]

PBGC made no attempt to investigate the Plan's $188 million in futures losses in 2001.

Hagan testified she relied exclusively upon John Greenburg, Chief Investment Officer of the PBGC, for analysis of specific investments cited by USAPA that lost most if not all of their value over a very short period of time, and whether these investments were appropriate for, as well as consistent with the investment guidelines of, the Plan.[14] These investments included Airgate PCS Inc., Alkermes Inc., BearingPoint Inc., Check Point Software, Elam PLC, Human Genome Sciences, Internet SEC Sys. Inc. and JDS Uniphase Corp. Hagan testified that neither she[15] nor Mr. Greenburg[16] contacted any of the Plan's investment managers during the course of her investigation to determine the analysis related to the managers' decision to purchase and continue to hold any of these specific investments.

According to her report, she neither reviewed any of the investment advisory contracts between the Plan and its external asset managers nor any of the written, specific investment mandates executed with the investment managers at the time of appointment.

As discussed further below, according to the Investment Policy of the Plan, the investment discretion granted to each of the Plan's investment managers was subject to both the provisions of the Investment Policy and the specific mandate for each manager agreed to in writing at the time of appointment.[17] Thus, in order to determine whether an investment manager's exercise of discretion, such as purchasing certain stocks "that lost

[11] Id. page 99.

[12] Id. page 125.

[13] Id. page 163.

[14] Id. page 170.

[15] Id. page 168.

[16] Id. page 167.

[17] Investment Policy for the Retirement Income Plan For Pilots of US Airways, Inc., as of December 13, 2000, page 4.

most if not all of their value over a very short period of time," was appropriate, reference to both the Investment Policy of the Plan and the written, specific investment mandate of the manager is required.

Hagan also testified that she did not review the Plan's investments in futures[18] and made no attempt to investigate the Plan's $188 million in futures losses in 2001.[19] Hagan testified she did not investigate what caused the Plan to lose $658 million, or one-third of its value between December 2001 and March 2003,[20] and did not compare performance of the Plan against any of the other US Airways pension plans for the same period. [21]

PBGC did not investigate what caused the Plan to lose $658 million, or one-third of its value between December 2001 and March 2003.

Benchmark's fiduciary breach review is limited to matters related to the Plan's investments, as revealed in documents and materials provided to us by USAPA. As indicated in this report, many of the essential documents related to the Plan have not been provided and it is difficult to determine if they exist or whether they have been destroyed or otherwise disposed of. Additional documents related to the Plan may exist at the US Airways, at the PBGC, or at the former investment services providers to the Plan (including the Plan's investment consultants, custodian banks, investment advisors, and securities dealers). Registered investment advisers, securities dealers, and custodian banks are generally required to maintain client records for regulatory purposes for a period of not less than five years.[22]

This report constitutes the firm's expert opinion of the matters reviewed. The report does not constitute legal, financial, accounting, or tax advice, and should not be relied upon as such. Where additional review has been deemed advisable, we have so noted.

3. Pervasive Industry Conflicts of Interest, Excessive/Hidden Fees and Malfeasance Harm Pensions

In recent years the U.S. Department of Labor ("DOL"),[23] the Securities and Exchange Commission ("SEC"),[24] and the General Accountability Office ("GAO")[25] have each

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[18] Id. page 154.

[19] Id. page 156.

[20] Id. page 175.

[21] Id. page 134.

[22] See Investment Advisers Act of 1940, Rule 204-2—Books and Records to Be Maintained by Investment Advisers.

[23] Selecting and Monitoring Pension Consultants, Tips for Plan Fiduciaries, U.S. Department of Labor, May 2005.

publicly acknowledged that conflicts of interest related to firms that provide investment services to pensions are widespread, and that these conflicts have resulted in reduced returns and higher fees for retirement investors.

In 2010, the DOL Office of Inspector General - Office of Audit issued a report entitled "EBSA Needs To Do More To Protect Retirement Plan Assets From Conflicts Of Interest," which explained that conflicts of interest in the retirement plan industry are commonplace, and may result in harm to pensions and pose an enforcement challenge for the Employee Benefits Security Administration ("EBSA").[26] In his report the Inspector General made reference to comparable earlier findings by the SEC and the GAO.

> *"To administer an employee benefit plan, plan fiduciaries often contract with service providers to provide professional services, such as assisting in determining the plans investment objectives and restrictions, allocating plan assets, selecting money managers, choosing mutual fund options, tracking investment performance, and selecting other service providers. Conflicts of interest affecting the plan arise when a service provider has competing professional or personal interests. Such competing interests can hinder the service provider's and the plan fiduciary's ability to fulfill duties impartially and act solely in the interest of plan participants or beneficiaries.*
>
> *Conflicts of interest are of concern in most ERISA covered pension plans. In 2005, the Securities and Exchange Commission (SEC) examined 24 service providers who were registered investment advisers; and therefore, fiduciaries under SEC rules. The SEC found inadequate disclosure of continuing conflicts of interest in 13 of the 24 service providers (54 percent). These 13 service providers, as investment advisers, had more than $4.5 trillion in assets under advisement. Furthermore, these service providers had contracted with defined benefit plans that had total assets of $183.5 billion and average assets of $155.3 million per plan.*

Breaches of fiduciary duty by financial advisers and vendors to pension plans result in substantial, quantifiable harm.

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[24] Staff Report Concerning Examinations Of Select Pension Consultants May 16, 2005, The Office of Compliance Inspections and Examinations, U.S. Securities and Exchange Commission.

[25] Defined Benefit Pensions: Conflicts of Interest Involving High Risk or Terminated Plans Pose Enforcement Challenges, GAO, June 28, 2007.

[26] EBSA Needs To Do More To Protect Retirement Plan Assets From Conflicts Of Interest, DOL Office of Inspector General- Office of Audit, Report No. 09-10-001-12-121, September 30, 2010.

Furthermore, in 2007, the Government Accountability Office (GAO) also issued a report stating that conflicts of interest involving high-risk or terminated plans posed enforcement challenges to EBSA."

The Inspector General concluded that "EBSA needs to develop additional regulations relating to conflicts of interest and incorporate these regulations into its enforcement program to better protect plan participants and beneficiaries."[27]

Industry malfeasance is not the sole reason pensions fail, but is a significant factor contributing to the demise of pensions.

More recently, Phyllis C. Borzi, Assistant Secretary of Labor of EBSA, sent an email to the Wall Street Journal citing widespread conflicts of interest in the marketplace for retirement advisory services. She went on to state that there is a good deal of evidence that these conflicts have resulted in reduced returns and higher fees for retirement investors, as reflected in the DOL's own investigations and cases, the SEC and the GAO reports, published securities cases, academic literature, and other sources.[28]

Benchmark has pioneered the emerging field of forensic investigations of money management and has conducted investigations worldwide involving in excess of $1 trillion in assets under management. Benchmark has worked extensively with the SEC, the DOL and the GAO since 2003 related to their investigations of conflicts of interest and malfeasance in the pension industry.

Our investigations have consistently revealed that breaches of fiduciary duty by financial advisers and vendors to pension plans result in substantial, quantifiable harm. That is, conflicts of interest, unethical business practices, and undisclosed compensation agreements that are pervasive in pension investment management undermine the integrity of pension investment processes and detrimentally impact performance.

Further, such industry abuses may contribute to the demise of pension plans. Indeed, the 2007 study by the GAO referred to above revealed that one form of industry abuse alone affecting pensions with over $4.5 trillion in assets – pension consultant conflicts of interest – can undermine a pension plan's investment performance by 1.3% annually.[29] Many other breaches of duty, such as those related to securities trading, money managers, and

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[27] Id. page 4.

[28] The Borzi Savings Bomb, Wall Street Journal, August 12, 2011.

[29] Conflicts of Interest Involving High Risk or Terminated Plans Pose Enforcement Challenges, GAO-07-703, June 2007.

custodians (which the GAO did not examine), we have found to also be harmful to pensions.

While we do not know the total cost of industry skimming from the nation's pension plans, our investigations frequently uncover damages in excess of 10% of the assets of a plan over time. Industry malfeasance is not the sole reason pensions fail, but it is a significant factor contributing to the demise of pensions. After all, even the 1.3% annual performance drain identified by the GAO can, over time, sink a plan.

The likelihood of malfeasance in connection with the management of a pension increases as termination of the plan becomes foreseeable.

Finally, of particular relevance here, we have observed that the likelihood of malfeasance in connection with the management of a pension increases as termination of the plan (and loss of the pension plan as a client) becomes foreseeable. Under such circumstances, client satisfaction and competitive investment performance may cease to be of concern to pension advisers, and maximizing fees prior to termination may become the main objective of advisers.

Since 2005 Benchmark has urged the PBGC to conduct investigations of fiduciary breaches related to terminated plans focused upon conflicts of interest, hidden financial arrangements and wrongdoing. It is our understanding from discussions with senior staff at the PBGC that the PBGC does not presently undertake any fiduciary breach reviews in its capacity as successor trustee to terminated plans.

4. KPMG "Limited Scope Audit" Provided No Substantive Assurance of Integrity of Plan Assets and No Basis for Participants to Judge Plan Vulnerability to Mismanagement, Fraud or Abuse

According to the December 31, 2000 and 1999 financial statements, the auditor for the Plan is KPMG.

However, the KPMG Report indicates that "as permitted by CFR 2520.103-8 of the Department of Labor's Rules and Regulations …, the plan administrator instructed us not to perform … any auditing procedures with respect to the information identified in the statements as being certified by Wachovia Bank, N.A., State Street Bank and Trust Company, Bankers Trust Company, Inc., and John Hancock Mutual Life Insurance Company, the trustees and insurance company of the Plan, respectively, except for comparing such information with the related information included in the financial statements and supplemental schedule. We have been informed by the plan administrator that the trustees and insurance company hold the Plan's assets and execute investment transactions. The plan administrator has obtained certifications from the trustees and insurance company as of and for the years ended December 31, 2000 and 1999, that the information provided to the plan administrator by the trustees and insurance company is complete and accurate. Because of the significance of the information that we did not audit, we are unable to, and do not, express an opinion on the accompanying financial statements and schedule *taken as a whole* (emphasis added)."

As a result of the lack of an annual audit of the Plan, participants were provided with no substantive assurance of the integrity of the assets of the Plan, and were denied useful information needed to monitor the Plan's ability to pay benefits.

ERISA section 103(a)(3)(c) allows a plan administrator to instruct the auditor not to perform any auditing procedures with respect to investment information prepared and certified by a bank or similar institution or by an insurance carrier that is regulated, supervised, and subject to periodic examination by a state or federal agency who acts as trustee or custodian. The election is available, however, only if the trustee or custodian certifies both the accuracy and the completeness of the information submitted. The limited-scope audit exemption is implemented by 29 CFR 2520.103-8 of the DOL's Rules and Regulations for Reporting and Disclosure under ERISA. The limited-scope exemption does not exempt the plan from the requirement to have an audit.

> ***While limited scope audits of pensions are commonplace, the dangers related to such "no opinion" audits have been widely recognized for decades.***

While limited-scope audits of pensions are commonplace,[30] the dangers related to such audit opinions have been widely recognized for decades.

In November 1989, the Office of the Inspector General for the U.S. Department of Labor issued a report titled "Changes Are Needed in the ERISA Audit Process to Increase Protections for Employee Benefit Plan Participants." According to the Inspector General, the most critical recommendation made in that report was to amend ERISA to require full scope audits. In September 1996, the Inspector General issued a report entitled "Full Scope Audits of Employee Benefit Plans Still Needed" which stated that "the need for full scope audits of employee benefit plans is as important today as it was 7 years ago." This review confirmed that, at that time, almost half of the plans reviewed received limited scope audits and disclaimers of opinions. The Office of the Chief Auditor "concluded that this is a disservice to plan participants in terms of protection and in terms of useful information the participants need to monitor their plans' ability to pay benefits."[31]

> ***"We believe this is an important issue. A lot of pension dollars have not been properly audited."***
>
> *--Howard Shapiro, Counsel to the Inspector General of the Department of Labor*

According to Howard Shapiro, Counsel to the Inspector General of the DOL, every year since the original audit study related to the issue over twenty years ago in 1989, the Inspector General has recommended to Congress that the limited-scope audit exemption be eliminated. Shapiro states "we believe this is an important issue. A lot of pension dollars have not been properly audited."[32]

[30] According to Michael Auerbach, Office of Chief Accountant, DOL approximately 60% of pension audits today are limited in scope. Conversation with Auerbach, September 16, 2011.

[31] Full Scope Audits of Employee Benefit Plans Still Needed, Letter Report No. 09-96-005-12-121, September 30, 1996.

[32] Conversation with Howard Shapiro, Office of Inspector General, DOL September 21, 2011.

In 1990, 1992 and 1998,[33] the GAO recommended that the limited scope audit exemption should be repealed. According to the GAO:

> *"Under this limited scope audit, the auditor is required to obtain financial statements from the company holding the investments and a certification from that company that the statements are accurate and are a part of the company's annual report. However, the auditor would not perform the normal procedures designed to provide certain basic assurances about the existence, ownership, and value of a plan's assets held in trust. The resulting lack of audit work can result in an auditor disclaiming an opinion on the financial statements.*
>
> *The disclaimer can cause two problems. First, it can diminish the value of an audit by leaving a significant gap in the information intended to help participants evaluate their plan. For example, plan participants would have no basis for judging whether excluded investments are vulnerable to mismanagement, fraud, or abuse. Second, the disclaimer language could confuse the participant. It says that the auditor does not express an opinion on the financial statements and supplemental schedules, but that the auditor does provide some assurance that the form and content of information included in statements and schedules comply with the Department of Labor rules and regulations. As a result of this potentially confusing wording, users of limited scope audit reports could be uncertain about what, if any, assurance these reports provide."*[34]

As pensions have increased their holdings of assets whose values are far less certain and far more difficult for a financial institution to certify, the dangers related to limited scope audits have grown significantly.

More recently, the Inspector General in his Semiannual Report to Congress for the period ending March 31, 2011 recommended repeal of ERISA's limited-scope audit exemption. According to the Inspector General, "This provision excludes pension plan assets invested in financial institutions such as banks and savings and loans from audits of employee benefit plans. The limited audit scope prevents independent public accountants who are auditing pension plans from rendering an opinion on the plans' financial statements in accordance with professional auditing standards. *These "no opinion" audits*

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[33] See Audits of Employee Benefit Plans Need to Be Strengthened (GAO/T-AFMD-90-25, July 24, 1990); Employee Benefits: Improved Plan Reporting and CPA Audits Can Increase Protection Under ERISA (GAO/AFMD-92-14, April 9, 1992); and Limited Scope Audit Exemption Should Be Repealed (GAO/T-AIMD-98-75, February 12, 1998).

[34] Limited Scope Audit Exemption Should Be Repealed (GAO/T-AIMD-98-75, February 12, 1998).

provide no substantive assurance of asset integrity to plan participants or the Department (emphasis added)."[35]

In conclusion, since the Company as plan administrator instructed the auditor of the Plan, KPMG, not to perform any auditing procedures with respect to information provided in the statements certified by three financial institutions, the financial statements as a whole utterly lacked integrity. Indeed, the unaudited information related to all or virtually all of the Plan's assets.

At a minimum, in the words of the Inspector General, the limited scope audit denied the participants useful information they needed to monitor the Plan's ability to pay benefits.

Over time, as pension funds have increased their holdings of assets whose values are far less certain and far more difficult for a financial institution to certify, the dangers related to limited scope audits have grown significantly. In the six years through 2008 alone, the average S&P 500 corporate pension fund with alternative investments increased its share from 7% to 17% of its portfolio holdings, according to the Center for Retirement Research at Boston College.[36]

Banks have moved to distance themselves from the reliability of the hard-to-value asset values they certify to pension auditors.

According to accounting experts, in a limited scope audit, the custodial bank certifying the value of hard-to-value assets generally does not independently verify the asset values. “"The bank puts that [valuation] information into the trust record without independently verifying it," says Ian MacKay, director of Federal Affairs for the American Institute of Certified Public Accountants."They're just passing along what they're told" by outside money managers."[37]

Further, as hard-to-value assets have grown as a percentage of pension assets in recent years, the major banks appear to have moved to distance themselves from the reliability of the asset values they certify by modifying the wording of their certifications to explicitly deny liability for false valuations. “"We typically only have one source [of valuation information], and that is the [asset] manager or fund's periodic statement,"

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[35] Semiannual Report to Congress, Office of Inspector General for the U.S. Department of Labor, Volume 65, October 1, 2010-March 31, 2011.

[36] Id.

[37] Superficial Pension Audits a Risk to Trust Banks and Others, American Banker, November 1, 2011.

BNY Mellon managing director Kerry White told a Department of Labor committee last year. "We do not have a systemic way to verify the veracity of those prices ourselves.""[38]

Since a significant percentage of the Plan, amounting to approximately $500 million, was invested in illiquid, hard-to-value assets that require even greater scrutiny than publicly traded securities, the failure to audit the Plan's assets is especially egregious. According to the December 31, 2000 financial statements, 27% of the Plan's assets lacked quoted market prices and the fair value of these assets was estimated by unidentified third parties.[39] For unknown reasons, the percentage of assets lacking readily available market values increased dramatically (23%) over the prior year.

Since a significant percentage of the Plan, approximately $500 million, was invested in illiquid, hard-to-value assets, the failure to audit the Plan's assets is especially egregious.

Our review of the KPMG Independent Auditors' Reports which we have been provided related to the defined contribution plan offered by the Company, the 401(k) Savings Plan, reveals for periods ended December 31, 2002 and 2001, the auditor's opinion was unqualified. That is, the Company engaged KPMG to perform a full scope audit of the defined contribution plan at the same time as the Company engaged KPMG to perform a limited scope audit of the (defined benefit) Plan.

The following two years, for periods ended December 31, 2004 and 2003, a limited scope audit of the defined contribution was performed by KPMG. Throughout the period 2001-2003, Fidelity Investments and related entities served as record-keeper, plan trustee and investment services provider for the defined contribution plan. It is unknown who made the decision to limit the audit of the defined contribution plan.

Since the overwhelming majority of the assets in the 401(k) plan were invested in registered investment companies managed by Fidelity, certification by Fidelity of the fair value of such publicly traded securities in connection with a limited scope audit would arguably pose less of a risk than a limited scope audit of the Plan where substantial assets were held in illiquid, hard-to-value securities. The reasons the Company chose a limited scope audit of the defined benefit plan and a full audit of the defined contribution plan should be further examined.

Finally, since it is our understanding that KPMG provides termination audit and other services to the PBGC, we believe any investigation into KPMG's potential liability

[38] Id.

[39] See Note 2 (f) to December 31, 2000 financial statements.

related to limited scope audits of plans trusteed by the PBGC, such as the Plan, may be problematic.

5. "Serious Errors" and "Shoddy Contract Work" Uncovered By PBGC Inspector General Force Re-do of Plan Asset Audit that Remains Undone

An audit of the assets of the Plan, dated January 11, 2006, was completed more than two years after the PBGC took over the Plan. The asset audit verified the fair market value of the Plan as of March 31, 2003.

As noted by the Office of the Inspector General of the PBGC:

> *"When PBGC becomes the trustee of a terminated pension plan, it must determine the value of the plan's assets. This is necessary to determine if the plan's assets are sufficient to provide plan participants more than their guaranteed benefit. In some cases, the value of plan assets may exceed the amount needed for guaranteed benefits, allowing plan participants to receive a higher benefit amount. In other cases, the value of the plan assets may be less than the value of guaranteed benefits; in these cases, PBGC pays the guaranteed amount to plan participants. PBGC's process for identifying and determining the value of a pension plan's assets is called a plan asset audit.*

The PBGC has notified USAPA that the asset audit of the Plan undertaken in 2006 was flawed. The new audit, scheduled to be completed by July 2011, is still not complete.

> *The purpose of a plan asset audit is to determine the fair market value of the plan's net assets as of the date of the plan termination. To accomplish this task, the audit team should ensure that all plan assets and liabilities have been identified and valued as of the date of plan termination, and take steps to ensure that significant instances of fraud, fiduciary breach, and party-in-interest transactions have been considered. An accurate assessment of the plan's net assets is critical to determining the amount of benefits that can be paid to plan participants.*

> *Accurately valuing a terminated pension plan's assets is one of the most important and fundamental aspects of PBGC's post-trusteeship process and carelessness in this area exposes PBGC to a variety of risks, including, but not limited to: incorrect value of plan assets; failure to identify all plan assets; incorrect value of plan liabilities; insufficient documentation to support*

valuation; incorrect benefit payments; increased exposure to PBGC's insurance program; increased benefit processing time; and litigation against PBGC.

Additional plan assets, if any, that exist but are not identified as part of the plan asset audit, are not available to PBGC to pay future benefits and unnecessarily increase PBGC's deficit position."[40]

As mentioned above, plan asset audits determine the fair market value of net pension plan assets *as of the date of plan termination*. The two year passage of time between the date of Plan termination and completion of the plan asset audit, alone, may be a cause for concern. The reason for the delay has never been explained to participants; further, with the passage of time, the risk that the identification and valuation of the Plan's assets and liabilities may be inaccurate as of the date of the plan termination and instances of fraud, fiduciary breach and party-in-interest transactions go undetected, may increase.

PBGC contracting with Integrated Management Resources Group has been highly controversial for over a decade.

The firm that conducted the asset audit was Integrated Management Resources Group, Inc. ("IMRG"). PBGC contracting with IMRG has been highly controversial for over a decade.

In 2000, in connection with an investigation into alleged contracting irregularities at PBGC that the GAO had been asked to undertake on behalf of the Special Committee on Aging and the Committee on Small Business, United States Senate,[41] the GAO investigated the award of contracts to IMRG worth approximately $40 million. The GAO concluded that the PBGC's Director of the Insurance Operations Department had demonstrated a lack of impartiality with respect to IMRG and referred the matter to PBGC and the Justice Department to determine what, if any additional action might be appropriate.[42]

At that time, IMRG's contract included administration of the Pan American World Airways pension plans and the Association of Former Pan Am Employees was involved in litigation with the PBGC.

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[40] PBGC's Plan Asset Audit of National Steel Pension Plans Was Seriously Flawed, PBGC Office of Inspector General Evaluation Report, March 30, 2011, OIG Eval-2011-10/PA-09-66-1, page 7.

[41] See Pension Benefit Guaranty Corporation: Contracting Management Needs Improvement (GAO/THEHS-00-199, Sept. 21, 2000).

[42] See Pension Benefit Guaranty Corporation: Appearance of Improper Influence in Certain Contract Awards (GAO/T-OSI-00-17).

An attorney representing the former Pan Am employees alleged they had been harmed as a result of the relationship with IMRG, "since money that could have provided retirement benefits was squandered through favoritism." A former IMRG employee testified before the Senate Special Committee on Aging and the Senate Committee on Small Business as to mismanagement at IMRG related to administration of the Pan Am plans. She concluded, "In my opinion pensioners of bankrupt companies should not be caught between an inefficient, incompetent bureaucracy and an inferior, covetous contractor!"[43]

> ***"In my opinion pensioners of bankrupt companies should not be caught between an inefficient, incompetent bureaucracy and an inferior, covetous contractor."***
>
> *--Testimony of Bonnie Ann McHenry, former IMRG employee*

PBGC's then general counsel was quoted as saying the GAO report was incomplete and that "PBGC is confident that, after the Department of Justice has reviewed the matter completely, it will find that there is no conflict of interest or appearance of a conflict under the government's ethics rules."[44]

According to reputable sources both within and outside the PBGC, around this same time, a "qui tam" lawsuit was filed under seal against IMRG by a private individual alleging fraud committed against the federal government (PBGC).

In 2007, the Office of the Inspector General of the PBGC issued two audit reports addressing concerns with IMRG, including deficiencies related to education and experience of employees provided by IMRG and PBGC oversight of the contractor. That same year, a PBGC commissioned assessment of its trusteeship of large defined benefit plans completed by Hewitt Associates concluded, in part, that auditors employed by the PBGC and contract employees lacked the audit skills necessary to adequately perform their roles.[45]

Last year, on March 30, 2011, the Inspector General of the PBGC issued a report indicating that the plan asset audit for seven terminated National Steel pension plans performed by IMRG was plagued with "serious errors and omissions." [46] This occurred,

[43] Testimony of Bonne Ann McHenry, September 21, 2000.

[44] UpFront: Too Close For Comfort, Plansponsor.com December 2000.

[45] PBGC Office of Inspector General Evaluation Report, PBGC Processing of Terminated United Airlines Pension Plans Was Seriously Deficient, November 30, 2011, EVAL-2012-05/PA-10-72, page 20.

according to the Inspector General, "because PBGC and its contractor did not exercise due professional care in the conduct of the audit. Further, PBGC did not provide effective oversight for the contractor and accepted and paid for sub-standard and obviously flawed audit work. As a result, neither PBGC nor the plan beneficiaries has reasonable assurance that plan assets have been identified, correctly valued, and allocated to the individual National Steel pension plans." [47]

In the National Steel report, the Inspector General of the PBGC noted that examples of required audit procedures that were not performed included (1) independent validation of the custodian's valuation for "hard to value" and "non-traditional assets;" (2) verification of transfers and unusual transactions; and (3) procedures to identify missing assets. [48]

The Inspector General also noted that the "Audit work papers contained no evidence that PBGC or its contract auditors had performed any of the required procedures intended to identify potential conflicts of interest, fiduciary breaches or fraud. For example, PBGC policy required the auditors to determine whether people other than the named fiduciaries had handled plan investment and whether transactions appeared to be "arms length." Nevertheless, we found no evidence of completion of the required steps to assess risk and identify potential fraud. As a result, PBGC and the National Steel beneficiaries have a reduced level of assurance with regard to the risk of fraud relating to plan assets and liabilities."[49]

The Inspector General warned that while the PBGC's subsequent decision to contract with a CPA firm to re-evaluate the value of the National Steel plan assets previously determined by IMRG was a positive one, given that the original report was accepted by PBGC in 2004, the work the PBGC was currently doing would not provide the same level of assurance that a properly performed audit would have provided. *"The passage of time will prevent PBGC and its new contract auditor from being able to complete many of the audit tests related to the detection of fraud, waste, or abuse. Further, in some instances, outside parties may not have maintained the corroborating records that could be used to assist in the valuation of plan assets.*"[50]

Most recently, on November 30, 2011 the Inspector General of the PBGC issued a report indicating that the initial four plan asset audits intended to establish the fair market value of United Airlines plan assets at the dates of plan termination, completed by IMRG, were seriously flawed. According to the Inspector General, "each of the four plan asset audits failed to meet applicable professional standards, containing myriad obvious errors and

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[46] PBGC's Plan Asset Audit of National Steel Pension Plans Was Seriously Flawed, PBGC Office of Inspector General Evaluation Report, March 30, 2011, OIG Eval-2011-10/PA-09-66-1, page7.

[47] Id.

[48] Id. page 13.

[49] Id. page 14.

[50] Id. page 3.

omissions, as well as a number of critical unsupported conclusions."[51] The Inspector General noted that the PBGC's efforts to date to correct the audits have not yet been effective in providing a reasonable level of assurance about the value of plan assets[52] and that, due to the length of time that has elapsed since the original UAL plan asset audits, it is now unlikely that any firm could complete an audit in accordance with applicable standards to determine the fair market value of plan assets.[53]

It is likely that any valuation of the Plan's hard-to-value assets was based upon custodial statements, as opposed to fair market value, as required by PBGC regulations.

The Inspector General's report indicated that when the errors and omissions in the IMRG audits of United Airlines plans were originally brought to the attention of the PBGC, the PBGC contracted with a CPA firm to perform a re-valuation of UAL plan assets. However, the PBGC did not provide adequate oversight and review for the re-valuation work. As a result, the four reports that were intended to replace the seriously flawed plan asset audits performed by IMRG were also themselves significantly flawed.[54]

For example, PBGC regulations call for plan assets to be valued "at their fair market value, *based on the method of valuation that most accurately reflects such fair market value* (emphasis added)." However, the agreement between PBGC and the CPA firm called for the firm to determine "the fair market value of plan assets as of the date of plan termination, *using custodian statements as of the dates of plan termination and any monthly statements for the preceding year* (emphasis added)."

The difference between the two approaches is important, noted the Inspector General, since the CPA firm's methodology led to tremendous reliance on the values reported by the custodian/trustee. That is, instead of using the method that most accurately reflects fair market value, as required by Federal regulation, the CPA firm's valuation were based on a far more limited approach and, in some cases, did not make use of credible, reliable information, even when such information was readily available. The Inspector General concluded that PBGC officials were apparently unaware of the regulatory requirement to value plan assets in the manner that most accurately reflects fair market value.[55]

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[51] PBGC Office of Inspector General Evaluation Report, PBGC Processing of Terminated United Airlines Pension Plans Was Seriously Deficient, November 30, 2011, EVAL-2012-05/PA-10-72, page 1.

[52] Id. page 1.

[53] Id. page 4, footnote 2.

[54] Id. page 4

[55] Id. page 25

As mentioned earlier, a significant percentage of the Plan, amounting to approximately 27% of Plan assets or $500 million, was invested in hard-to-value assets that lacked quoted market prices and the fair value of these assets was estimated by unidentified third parties.[56] Based upon the PBGC Inspector General's findings in the National Steel and United Airlines reports, it is likely that any valuation of the Plan's hard-to-value assets by PBGC staff, or IMRG was, at best, based upon custodian statements as of the dates of plan termination and any monthly statements for the preceding year, as opposed to the fair market value of plan assets as of the date of plan termination, as required by PBGC regulations. That is, it is unlikely that any independent validation of the custodian's valuation for hard to value and non-traditional assets was undertaken by PBGC's staff or IMRG.[57]

The PBGC has used IMRG to perform hundreds of plan asset and participant data audits during the last decade. Remarkably, the PBGC does not have a definitive listing of the specific plan terminations for which IMRG provided audit services. The Inspector General's review of available evidence showed that IMRG had worked on at least eight of the ten largest pension plan terminations in PBGC"s history.[58]

On April 29, 2011, the PBGC notified USAPA that the plan asset audit it had hired IMRG to undertake was flawed and that PBGC had hired a new contractor, Crowe Horwath LLC, to undertake a new plan asset valuation for the US Airways pension plans. The new audit was scheduled to be completed July 2011, however, for unknown reasons, is still not complete.

Completion of an audit of the assets of the Plan will be more challenging today. On the other hand, investigating fiduciary breaches may be less difficult than even five years ago.

As noted by the Inspector General in connection with the re-valuation of the National Steel and UAL plans, any such new asset audits, whenever completed, will not produce the same level of assurance that an audit properly performed at the time of termination would have provided. Further, as noted by the Inspector General in connection with United Airlines, any re-valuations undertaken by PBGC or CPA firms retained by PBGC may themselves be significantly flawed.

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[56] See Note 2 (f) to December 31, 2000 financial statements.

[57] Again, in connection with the limited scope audits of the Plan, the auditors did not independently value these no-public assets.

[58] Id. page

Given the length of time that has elapsed since the original flawed audit of the Plan's assets, completion of an audit in accordance with applicable standards to determine the fair market value of Plan assets at the time of termination will be more challenging. On the other hand, in recent years revelations regarding widespread pension malfeasance have become more commonplace and, as a result, investigating fiduciary breaches today may be less difficult than even five years ago.

6. "Bundled" Custody Arrangement Created Risk of Significant Overcharges, or Even Fraud, By Custodians of Plan Assets

According to the financial statements of the Plan prepared by KPMG, from the period prior to November 30, 1999, Wachovia Bank, N.A., was the trustee of the Plan. On December 1, 1999, State Street Bank and Trust Company ("SSBT") became the trustee of the Plan. Bankers Trust Company, Inc. was also trustee of certain assets related to the former Shuttle Plan until the assets were transferred to SSBT in 2000.[59]

Virtually all of the larger pension plans throughout the nation have entered into contracts with global custodian banks to purchase a range of services, including custody, on what is commonly referred to in the industry as a "bundled" fee basis. In a bundled fee arrangement, the global custodian safekeeping pension investments also may provide investment management (including cash management), securities lending and trading, foreign exchange, and other services. Bundled fees lack transparency and obscure the prices pensions pay for any given service included in the bundle. As a result, pensions are exposed to potentially excessive, or even fraudulent, expenses. Therefore, in reviewing a pension's relationship with its custodian, bundled fees must be unbundled to determine the prices paid for services provided and any potential overcharges.

The Plan purchased a range of services from custodian banks on a "bundled" fee basis that lacked transparency and exposed the Plan to potentially excessive, or even fraudulent, expenses.

We have not been provided with any of the agreements between the Plan and any of its custodian banks. However, we have reviewed the SSBT form of Master Trust Agreement for numerous other plans.[60] These agreements typically include provisions related to, for

[59] Financial Statements of the Plan as of December 31, 2000 and 1999, note 2(f).

[60] We have also investigated Wachovia custody arrangements and the issues are similar. See Pension Consultant Conflicts of Interest Review, Delray Beach Police and Firefighters Retirement Systems, Benchmark Financial Services, Inc., February 4, 2005.

example, the trustee's right to conclusively rely upon valuations certified by an investment manager of securities and other property held in an account managed by the manager; the trustee's right to purchase and sell foreign exchange and contracts for foreign exchange, including transactions entered into with SSBT; the trustee's right to invest at any bank, including SSBT, in any type of interest bearing investments; and the trustee's right to invest in units of group or collective trust funds, including those maintained at SSBT. An examination of these and other provisions of the Master Trust Agreement related to the Plan is required to determine possible overcharges or other claims the Plan may have against its custodian.

Provisions in the Master Trust Agreement related to foreign exchange, securities lending, securities trading and investment management services provided by the custodian must be examined, as well as the documents related to these services, such as trade confirmations.

The custodian's duties regarding valuations may be of particular concern since the Plan received only a limited scope audit and held significant hard-to-value assets. For example, if the Master Trust Agreement states that the trustee has a right to conclusively rely upon valuations certified by an investment manager of assets held in an account managed by the manager, then any certification by the trustee, in turn, to the auditor in connection with a limited scope audit would rely exclusively upon the potentially conflicted and unverified valuation of the investment manager responsible for managing those assets.[61]

We have not been provided with any Custody Fee Schedule related to any Master Trust Agreement with any custodian. A Custody Fee Schedule may state prices for the wide range of services provided by the custodian pursuant to the Master Trust Agreement. For example, SSBT Schedules often provide that when foreign exchange transactions are executed through SSBT there is no charge; however when undertaken elsewhere, there is a charge. While the Schedule may provide there is no fee for foreign exchange trades executed at SSBT, SSBT profits on the funds' foreign exchange transactions and these profits may not be properly disclosed to clients. SSBT can profit on foreign exchange by earning the bid-ask spread in this OTC market or by positioning currencies (proprietary trading). Further, the explicit charge for transactions executed elsewhere serves to discourage clients from using other firms for foreign exchange since the SSBT services appear to be "for free." The client may have no idea how much SSBT earns on these transactions, or whether using other firms for foreign exchange might improve investment performance.[62]

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[61] An investment manager is conflicted when valuing portfolios it manages since the manager receives an investment advisory fee that is based upon the value of the assets managed. Thus, the greater the value of the assets under management, the greater the investment advisory fee the manager receives.

[62] See: Probes Nip Banks' Profits, Wall Street Journal April 19, 2012. "Custodial banks are being pressured by investors and others to be clearer about foreign currency pricing. BNY Mellon this year agreed to stop describing its

As mentioned earlier, the Independent Auditors' Report prepared by KPMG dated September 7, 2001 states that "the trustees and insurance company hold the Plan's investments *and execute investment transactions (emphasis added)*." The limited trading records provided indicate that the Plan did engage in securities trading with SSBT. The extent and competitiveness of the trading services provided by SSBT is unknown.

Further, the trading records indicate that the Plan did engage in purchases and sales of foreign equities and related currency transactions. However, the identity of the brokerages handling the Plan's foreign currency transactions is not clear. Whether SSBT executed foreign currency transactions on behalf of the Plan requires further investigation.

According to published reports and SSBT regulatory filings, SSBT is currently being investigated by the SEC over its pricing of some foreign exchange services provided to pension custody clients—an issue which has resulted in legal actions from whistleblowers and state Attorneys Generals.[63]

The State of California has alleged fraud on currency trades handled by State Street, the custodian of the two largest state pensions, and is seeking $200 million in damages.

In October 2009, the State of California, on behalf of the two largest state pensions, CalPERS and CalSTRS, alleged fraud on currency trades handled by SSBT, their custodian bank. California is seeking $200 million in damages. California alleges that SSBT charged more than agreed on with respect to the transactions and concealed the overcharges by entering false exchange rates into its own databases and documents. In October 2010, the Washington State Investment Board reached a settlement with SSBT for $11.7 million to settle a pricing dispute over foreign exchange transactions. BNY Mellon, State Street's largest rival, faces similar claims from Virginia, Florida, and a public pension fund in Pennsylvania.[64]

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currency-trading service as "free," as part of a settlement of some of the charges in a civil lawsuit filed last year by the Manhattan U.S. attorney's office."

[63] Bloomberg News, SEC Investigates State Street Over Foreign-Exchange Pricing After Lawsuits, May 12, 2011.

[64] Id.

"*If you discovered that your banks made $4 million as a result of your currency activities last year and that $4 million turned out to have been exchanged at a cost of 15 basis points on average worse than the prevailing interbank rates on a forward-adjusted basis, you might have a very interesting discussion with your bank," said John Galanek, CTP, chief operating officer with FX Transparency.*

"This is not a tempest in a teacup. State Street Bank and BNY Mellon service roughly $45 trillion in assets, including ERISA pensions. This is an industry-wide issue…Banks act as principal; they do not act as your company's agent," he said. "They take the other side of your company's trades and have economic incentive to give you the worst possible rate that you will accept. These lawsuits should provide a catalyst for treasurers to measure a cost most of them have yet to quantify."[65]

For decades industry insiders, such as international equity investment managers, have complained regarding pension custodian foreign exchange overcharges. In our opinion this is a longstanding, systemic problem affecting virtually all pensions executing foreign exchange transactions with their custodians and should be investigated in connection with any pension fiduciary breach inquiry. On a transaction-by-transaction basis, foreign exchange overcharges are relatively small when compared with the size of a pension and the amounts of monies being converted, but become material in the aggregate. Fiduciary breach investigations need to be vigilant when reviewing foreign exchange and other custodial charges precisely because these individual overcharges can falsely appear to be insignificant.[66]

As mentioned earlier, in a bundled fee arrangement the global custodian safekeeping pension investments also may provide investment management, including cash management services. The Custody Fee Schedule may provide an administrative/management fee is taken out of the yield of any SSB Short Term Investment Fund, or money market fund, in addition to any asset management fee related to these funds. The true cost of cash management may be obscured and uncompetitive. Our investigations reveal that pensions may pay 30-50% more for cash management that they pay bond managers—an anomaly that can only be explained by the fact that the cash management fees have been obscured by the bundled custodial fee.

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[65] State Pension Funds Sue Banks for Fraudulent FX Pricing Practices, Association for Financial Professionals, February 2, 2011.

[66] Based upon our meetings with DOL, we believe that cross-trading and other activities engaged in by custodian banks on behalf of ERISA plan clients should be examined for compliance with any applicable “prohibited transaction exemptions.” It is our understanding that DOL is not monitoring such PTE compliance.

Various reports prepared by SSBT indicate that the Plan invested its cash in a Short Term Investment Fund managed by State Street Bank and a money market fund managed by State Street Global Advisers fund.[67] Due to the custody industry practice of bundling fees, the performance and fees related to these investment funds, as well as any other investment funds managed by SSBT should be scrutinized for any excessive or undisclosed fees paid to SSBT.

We have observed that pensions frequently have uncompetitive securities lending arrangements with lending agents affiliated with their custodians.[68] Since the Investment Policy of the Plan dated December 13, 2000 indicates that securities lending is prohibited and we have no evidence that lending occurred, this does not appear to be an issue for the Plan.

7. "Multiple Roles" of Towers Perrin Created Uniquely Complex Conflicts of Interest that Benefitted US Airways and Endangered Plan

Towers Perrin served as the Plan actuary, as well as an investment adviser to the Plan, and may have provided other services, including securities trading to the Plan, or its investment managers, and executive compensation consulting to the Company, or its executives.

Towers Perrin was a privately held firm that merged with Watson Wyatt, a public company, on January 1, 2010 to form Towers Watson, “the world’s biggest pay, benefits and investment benefits consultancy.”[69] According to one industry insider, “clearly, this is a union necessitated by today's dire economic conditions."[70]

Towers Perrin problematically served as the actuary and lead investment consultant to the Plan and may have provided other services, including securities trading to the Plan, or its investment managers, and executive compensation consulting to US Airways, or its executives.

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[67] For example, the Cash Reserve Account Position Appraisal dated February 28, 2003 prepared by SSBT, indicates the Plan invested approximately $242 million in a SSBT short term investment fund.

[68] See Securities Lending By Pensions: An Emerging Duty of Best Execution in Securities Lending? Edward Siedle, Forbes.com July 2008.

[69] Towers Watson merger reflects pressure on consultants, The Times, June 29, 2009.

[70] Mixed Reviews Given to Merger, Human Resource Executive Online, July 1, 2009.

Towers Perrin has been harshly criticized in recent years for the services it provides. In her book, Retirement Heist: How Companies Plunder and Profit from the Nest Eggs of American Workers Ellen Schultz, an award-winning reporter for The Wall Street Journal specializing in pensions wrote, "Now called Towers Watson, the global consulting firm continues to help the largest companies in the Unites States, Canada, the United Kingdom, the Netherlands, and Germany shrink retiree benefits and boost executive pay and pensions."[71]

"Occupy Towers Watson" was suggested in a Washington Post opinion column listing discussing six firms responsible for economic injustice and inequality in America.[72] Our preliminary research indicates that the firm has been named as a defendant in 89 federal court cases, the majority of which were filed post-2000.[73]

According to the 2000 and 2003 Form 5500 Schedule C for the Master Trust Cash Pool and various other documents, Towers Perrin served as the actuary to the Plan. We have not been provided with any contract for actuarial services between the Plan and Towers Perrin.

When valuing the Plan's reserves, Towers Perrin as actuary is required by ERISA to act on behalf of the Plan participants. However, pension actuaries are often subject to conflicts of interest in formulating their projections. As bluntly noted by an industry expert, "There is an inherent conflict of interest at the heart of the actuarial profession. Actuaries advise pension fund trustees as well as the sponsoring company. Actuaries will say often these two groups want the same thing—a healthy pension fund. But that view is rather out of date."[74]

Towers Perrin's actuarial assumptions related to the Plan appear to reflect a conflict of interest and benefitted the plan sponsor at the expense of the Plan and its participants. For example, at a time when the mandatory retirement age for commercial pilots established under federal law was age 60, Towers Perrin utilized an age 60 retirement assumption for the Plan.[75] Assuming that all pilots would work until the latest possible age, without

[71] Retirement Heist: How Companies Plunder and Profit from the Nest Eggs of American Workers, Ellen E. Schultz, 2011.

[72] Occupy this: Six culprits for economic injustice and inequality in America, Alec MacGillis, Washington Post, November 3, 2011.

[73]A significant amount of county-level civil litigation was also found.

[74] Sir Derek Morris, Morris Review of the Actuarial Profession, Final Report, 2005. See also, "Independence, Conflict of Interest and the Actuarial Profession, Gunz, McCutcheon and Reynolds, Journal of Business Ethics 2009.
[75] See 2000 and 2001 Forms 5500 filed on behalf of the Plan.

exception, and that no pilot would retire early, was unreasonable, as well as inconsistent with the actual plan experience. Data from Towers Perrin showed that over half of the retirees retired before age 60, with an average retirement age of 56.[76] It is estimated that the unrealistic retirement assumption reduced the contribution to the Plan required of US Airways by approximately $413 million.[77]

Further, Towers Perrin's use of a 9.5% investment assumption "failed miserably" and "was largely responsible for the company's unaffordable pension costs that led to the termination on the Plan."[78] Retirement age, along with investment assumption, payroll and employee turnover, are the primary drivers of pension plan costs.

Even though actuaries are required to act on behalf of the participants when valuing plan reserves, the courts have recognized that actuaries who provide traditional professional services to qualified plans are not fiduciaries under ERISA. The actuary only becomes a fiduciary by undertaking responsibilities that transcend traditional actuarial practice, such as assuming discretionary responsibility over the administration or management of the plan, or its assets. The question of whether an actuary has assumed such responsibilities is a factual one, depending on the circumstances of each particular situation. State common law may also create due care or fiduciary responsibilities for a pension actuary.

Towers Perrin's unreasonable assumption that the Plan's investments would earn 9.5% "led to the termination of the Plan."

--Testimony of Neil Cohen

According to a deposition of a former member of the Investment Committee, Towers Perrin also was retained to provide investment advisory services to the Plan at some point in time subsequent to serving as the actuary.[79] This individual testified that retaining Towers Perrin to serve as both the actuary and investment consultant to the Plan was beneficial because Towers "could more easily marry the valuation data with the asset allocation and funding policies."[80] Later in the deposition, the individual stated that in the individual's judgment, and that of the investment committee, there were no potential risks related to having Towers Perrin serve as both the investment adviser and actuary to the

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[76] See 2002 Actuarial Report of Towers Perrin.

[77] See Declaration and Statement of Mark Dungan in Support of Debtors' Motion Seeking (1) A Determination that Debtors' Meet the Financial Requirements for a Distress Termination of the Plan and Approval of such Pension Plan's Termination and (2) Approval of a New Defined Contribution Plan for Pilots.

[78] Testimony of Neal Cohen, Distress Termination Hearing Transcript at pg. 201 (2/21/03).

[79] Neither the 2000 nor 2003 Form 5500 Schedule C for the Master Trust Cash Pool indicate that Towers Perrin served as an investment advisor/consultant to the Plan, as well as the actuary.

[80] Deposition of Michelle Bryan, U.S. Airline Pilots Association vs. Pension Benefit Guaranty Corporation, March 31, 2011, page 58. Prior to working for the Company, Bryan was employed by Towers Perrin.

Plan. “We thought there was some synergy to it,” the individual said.[81]

When the same firm serves as both actuary and investment consultant to a pension, the pension is exposed to additional conflicts of interests and risks. For example, increasing the projected investment returns related to a plan’s investments may permit an actuary to project lower contributions to the plan by the corporate sponsor. Further, the consultant may be rewarded for recommending a riskier asset allocation to achieve these higher projected returns, such as allocating a significant percentage of plan assets to hedge funds and private equity, if the investment consulting contract provides an advisory fee that is performance-based or based upon a percentage of assets under advisory.[82] Since the same firm performed both key functions for the Plan, it is necessary to scrutinize Towers Perrin’s actions, as well as duties, in both capacities to determine any potential harm.

Effective January 1, 2001, the five U.S.-based actuarial organizations adopted a Code of Professional Conduct which, in Precept 6, states: “An actuary shall make appropriate and timely disclosure to a present or prospective principal of the sources of all direct and indirect material compensation that the actuary or the actuary’s firm has received, or may receive, from another party in relation to an assignment for which the actuary has provided, or will provide, actuarial Services for that principal.” Annotation 6-1 of the Code states “An actuary who is not financially and organizationally independent concerning any matter related to the performance of actuarial Services should disclose to the principal any pertinent relationship that is not apparent.” Precept 7 of the Code regarding conflicts of interest states: “An actuary shall not knowingly perform actuarial Services involving an actual or potential conflict of interest unless: the actuary’s ability to act fairly is unimpaired; there has been disclosure of the conflict to all present and known prospective principals whose interests would be affected by the conflict; and all such principals have expressly agreed to the performance of the actuarial services by the actuary.”[83]

Based upon the deposition testimony mentioned above – i.e., that the individual and the investment committee were not aware of any potential dangers related to having the same firm serve as actuary and investment consultant to the Plan – it appears that Towers Perrin did not adequately disclose the potential conflicts of interest and potential related

[81] Id. page 123.

[82] Note that the Form ADV, uniform investment advisory registration statement of Towers Watson Investment Consulting, Inc. (formerly Towers Perrin) indicates that the firm may be compensated on a percentage of assets under advisement basis.

[83] Code of Professional Conduct, American Academy of Actuaries, Yearbook and Leadership Manual 2009, pages 69-72.

harm to the Plan, as well as all direct and indirect fees. If so, then Towers Perrin, as the actuary to the Plan, may have violated its professional obligations under the Code.

(The above conclusion is based upon our presumption that Michelle Bryan, a member of the Investment Committee (who was also a former Towers Perrin employee), testified truthfully during a deposition in U.S. Airline Pilots Association vs. Pension Benefit Guaranty Corporation. The 2000 and 2003 Forms 5500 for the US Airways, Inc., Master Trust Cash Pool solely indicate that Towers Perrin was compensated for actuarial services.)

The December 13, 2000, Investment Policy of the Plan indicates that the Company may seek advice from investment consultants, but no investment consultant is named in the Policy. We have not been provided with any contract for investment consulting services between the Plan and Towers Perrin, or any other investment consultant.

Towers Perrin had at least one affiliated securities brokerage that may have provided placement or trading services to the Plan's investment managers.

Towers Perrin apparently did not have a substantial pension investment advisory practice prior to its recent merger with Watson Wyatt. For example, a directory of the top ranked investment consultants worldwide for institutional, tax exempt advisory clients by Pensions & Investments as of June 30, 2008, does not include Towers Perrin in the list of 96 firms. This raises the question of whether Towers Perrin was selected as an investment adviser to the pension based upon competitive standing, or other considerations, such as actuarial or executive compensation consulting relationships. Whether the investment consulting contract was competitively bid and other investment consulting firms were considered for the Plan should be examined.

As mentioned earlier, the DOL, the SEC, and the GAO each have publicly stated that conflicts of interest related to firms that provide investment services to pensions are widespread, and that these conflicts have resulted in reduced returns and higher fees for retirement investors. Towers Perrin's investment advisory services were subject to various potential conflicts of interest at the time the firm served as investment consultant to the Plan, in addition to any conflicts discussed above related to its actuarial role.

For example, Towers Perrin had at least one affiliated securities brokerage firm which may have provided securities trading services, including private placements,[84] to

[84] For example, according to the Lighthouse Account Position Appraisal report prepared by SSBT as of March 31, 2003, the Lighthouse V Fund Limited was purchased in a private placement transaction. The report does not indicate the identity of the private placement agent involved or the amount of any fee related to the Lighthouse investment.

investment managers it recommended to the Plan. “Pay-to-play” schemes where investment consultants' recommend money managers to clients based upon payments (such as trading commissions) the managers direct to the consultant, instead of on the quality of the managers' performance, were of specific concern to the SEC, the DOL and the GAO.[85]

According to FINRA BrokerCheck, there are two firms currently or formerly registered as securities broker-dealers that are related to Towers Perrin. One firm, Towers Perrin Financial Solutions Ltd. was active with FINRA from January 2000 until it withdrew or terminated its registration in August, 2003, i.e., during the period Towers Perrin apparently served as investment adviser to the Plan recommending and monitoring investment managers. Whether the firm ever conducted brokerage activities with the Plan’s investment managers is unknown, and should be investigated further.

Towers Perrin Capital Markets, Inc. is listed as an active securities brokerage that was formed in November, 2007. This firm conducts five types of business, including selling investment advisory services. The reason Towers Perrin exited the securities brokerage industry in 2003 and re-entered it in 2007 is unknown. Whether any actual, or potential, litigation related to Towers Perrin Financial Solutions Ltd. was a factor should be examined.

Another Towers Perrin entity, Towers Watson Investment Consulting, Inc., is currently registered as an investment adviser with the SEC and has been registered since March, 1994. According to the firm’s Form ADV, while it does not provide continuous and regular management services or have any assets under management, it may earn fees based upon a percentage of assets under advisement. Conflicts of interest involving investment advisory activities of investment consultants were also a specific concern of the SEC, the DOL and the GAO.[86]

Whether Towers Watson Investment Consulting, Inc. had any relationships with the Plan’s investment managers is unknown. However, we do know that Towers Perrin had financial relationships with investment managers at this time. According to an October 11, 2001, press release on the Towers Perrin website available at that time, J.P. Morgan/American Century Retirement Plan Services and Towers Perrin announced that they reached “an agreement in principle to the formation of a strategic alliance to offer comprehensive retirement services.”

Finally, Towers Perrin is one of the leading executive compensation consultants. We have not been provided with any contract for executive compensation consulting services between the Company and Towers Perrin, and we do not know if Towers Perrin, in fact,

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[85] See notes 3-6 above.

[86] Id.

provided any such services to the Company or its executives. However, given Towers Perrin's prominent role in executive compensation consulting and the widely recognized dangers described below related to executive compensation consultants that provide other services to companies, the question of whether Towers Perrin provided executive compensation services to the Company, or its executives, should be examined.

Conflicts of interest among compensation consultants were investigated by the U.S. House of Representatives Committee on Oversight and Government Reform. A key finding of the Majority Staff December 2007 Report was that compensation consultant conflicts of interest were pervasive. Approximately half of the Fortune 250 companies received executive pay advice from consultants that were providing other services to the company. According to the Report, "The concern is that the ability of consultants to provide independent, unbiased advice to directors regarding the pay of senior executives can be compromised if the senior executives are at the same time paying the compensation consultants to provide other services to the company. These other services can include a wide range of activities, including employee benefit administration, human resource management, and actuarial services."[87]

Towers Perrin was one of the "six leading executive compensation firms" asked to submit nonpublic information regarding fees for services related to compensating employees other than senior executives. Towers Perrin maintained to the Committee that a consulting firm's ability to provide objective, independent advice regarding executive pay is not compromised simply because it provides other services to the company, and Towers Perrin described a variety of policies and practices it had instituted to ensure that its executive compensation consultants delivered unbiased advice. The Report stated that "there is evidence to suggest that the lines between those providing executive compensation advice and those providing other services may not be as bright as the consultants described." Further the Report specifically cited a then-recent Towers Perrin job posting for an executive compensation consultant which indicated that one responsibility of individuals hired to perform executive compensation services is "cross selling" other services to clients companies.[88]

Towers Perrin was later criticized in 2008 for the role it played in crafting a pay package for Angelo Mozilo, the chief executive of Countrywide Financial in 2006. "Mozilo regarded John D. England, the head of Towers Perrin's executive-compensation practice, "as his personal representative, even though he was being paid by Countrywide," the Democratic staff of the House Committee on Oversight and Government Reform wrote."[89]

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[87] Executive Pay: Conflicts of Interest Among Compensation Consultants, U.S. House of Representatives Committee on Oversight and Government Reform, Majority Staff December 2007.

[88] Id. pages 8-9.

8. Controversial Legal and Regulatory Histories of Other Investment Consultants to Plan

Three other investment consultants that were retained to provide advisory services to the Plan have controversial legal and regulatory histories. The PBGC itself has been questioned regarding its relationship with two of these firms, Wilshire Associates and Rocaton Investment Advisers.

According to the 2000 and 2003 Form 5500 Schedule C for the Master Trust Cash Pool, these three other firms that primarily provide investment consulting services to pensions are disclosed as either investment advisors or investment managers.

According to the 2000 Form 5500 Schedule C for the Master Trust Cash Pool, Wilshire Associates served as an investment manager to the Plan. At this time Wilshire Associates offered investment consulting to pensions, securities trading to asset managers and asset management services. In 2003, Wilshire Associates became embroiled in the mutual fund late trading scandals.

> *"It turns out that one of the biggest names in the business of fast trading of mutual funds is one of the most influential firms in the asset management industry. Wilshire Associates wears many hats. The 31-year-old company manages the Wilshire 5000-stock index, the best and broadest measure of the U.S. stock market; the firm also sponsors a $103 million index fund based on its own benchmark. Wilshire sells advanced software to money managers, pension funds and other investing giants. Perhaps most important, Wilshire recommends investment managers to pension funds and endowments, thus influencing which firms get to manage billions of dollars."*[90]

Three other investment consultants that provided advisory services to the Plan have controversial legal and regulatory histories. The PBGC itself has been questioned regarding its relationship with two of these firms.

The firm acknowledged that it engaged in rapid trading of stock mutual funds – one of the tactics being investigated in the fund industry at that time – but denied that it may have had a conflict of interest in doing so because the trading strategy could have hurt long-term investors, including Wilshire pension clients, who may have held shares in the

[89] Whom Do Consultants On Pay Work For? Washington Post, March 8, 2008.
[90] The Great Fund Ripoff, Money Magazine, September 22, 2003.

mutual funds in which Wilshire made rapid trades.[91] Nevertheless, it appears that Wilshire Associates contributed to at least one mutual fund late trading settlement.[92]

In 2004, Wilshire Associates sold its securities brokerage firm to BNY Brokerage.[93] Further, Wilshire Associates stated that it was taking steps to make its pension consulting work more independent of its other lines of business, such as securities trading and asset management, and the leader of its consulting and asset-management units left the firm.[94] In April 2006, Wilshire Associates revealed that it received a subpoena from the DOL in connection with the DOL's investigation of conflicts of interest among investment consulting firms.

On May 2, 2006, Representatives Edward J. Markey and George Miller wrote to the then Executive Director of the PBGC, Bradley D. Belt, regarding the PBGC's contractual relationships with Wilshire for investment consulting services. In addition to describing the terms of the contract between the PBGC and Wilshire, such as fees and scope of services provided by Wilshire to the PBGC, Belt in his May 16, 2006 response to Markey and Miller indicated the PBGC was aware of conflicts of interest involving the firm and, through its due diligence process, had addressed any conflicts concerns related to the firm's work on behalf of the PBGC. Belt specifically noted that while the agency used Wilshire Associates for a variety of investment consulting services, Wilshire did not provide asset management services to the PBGC. We have not been provided with a copy of any investment advisory contract between the Plan and Wilshire Associates, or any other documents that reveal the scope of services provided by this firm.

91 Wilshire Associates Used Rapid Mutual Fund Trades, Los Angeles Times, September 23, 2003.

92 The settlement in the MFS late trading litigation states that $1.45 million will be paid on behalf of Wilshire Associates. In Re Mutual Funds Investment Litigation, U.S. District Court for the District of Maryland, Case No. 04-MD-15863-04.

93 BNY Brokerage to Acquire the Execution and Commission Management Assets of Wilshire Associates, Wilshire website, September 21, 2004.

94 Concerns Raised Over Consultants to Pension Funds, The New York Times, March 21, 2004.

According to the 2000 Form 5500 Schedule C for the Master Trust Cash Pool, Callan Associates served as an investment advisor to the Plan. A 2002 audit of Hawaii's pension fund found that its consultant, Callan Associates, had recommended 16 money managers over time -- and 14 of them were paying Callan for marketing advice and other services. "The consultant's objectivity could be suspect," said the state auditor, Marion M. Higa, calling for further scrutiny. She noted that the Hawaii fund's overall five-year investment performance "ranks in the bottom 5 to 15 percent nationwide."[95] In 2006, Callan Associates entered into a $4.5 million settlement with the city of San Diego retirement system in connection with a lawsuit alleging conflicts of interest regarding payments the firm received from money managers it recommended.[96] In 2006, Callan was sued for alleged conflicts of interest in its role as investment consultant to the Teachers' Retirement System of the State of Illinois.[97]

In 2007, Callan Associates entered into a Cease and Desist Order with the SEC.[98] The matter concerned the incomplete disclosure of a conflict of interest by Callan Associates, a registered investment adviser and one of the nation’s largest pension consultants in its Form ADV Part II registration statement with the SEC. Since 1999, after Callan had sold its affiliated brokerage to BNY Brokerage Inc. (“BNY”), Callan had referred clients to BNY as Callan’s preferred securities broker.[99] Although Callan disclosed in its Form ADV Part II that it had a contractual relationship with BNY that required Callan to identify BNY as its preferred or exclusive broker, Callan failed to disclose that it was receiving annual payments that were contingent on Callan clients generating a certain level of commissions for BNY.[100] The omission of this conflict caused Callan’s public disclosures to be misleading.[101] We have not been provided with a copy of any

Callan Associates entered into a Cease and Desist Order with the SEC for misleading conflict interest disclosures.

[95] Id.

[96] ERS adviser settles “pay-to-play” allegation in San Diego, Bloomberg News, November 30, 2006

[97] Teacher retirement fund consultant facing lawsuit, Chicago Tribune, August 31, 2006

[98] Investment Advisers Act of 1940 Release No. 2650, September 19, 2007

[99] Note that both investment consulting firms mentioned above, Wilshire and Callan “sold” their affiliated brokerages to the same firm, BNY.

[100] Wilshire, on the other hand, disclosed on its Form ADV Part II that it had an incentive for referring its clients to BNY because it might be entitled to contingent payments from BNY if specific dollar amount levels of commissions were reached.

[101] Note that January 14, 2011, BNY Mellon Securities LLC, entered into a settlement with the SEC regarding BNY Mellon failure to provide “best execution” in connection with retirement plans’ trades. The settlement provided that the firm pay disgorgement of approximately $19 million and a civil money penalty of $1 million. Further, the firm agreed to retain an Independent Distribution Consultant to distribute sums to compensate pensions for losses attributable to

investment advisory contract between the Plan and Callan Associates, or any other documents that reveal the scope of services provided by this firm.

According to the 2003 Form 5500 Schedule C for the Master Trust Cash Pool, Rocaton Investment Advisors served as an investment advisor to the Plan. In 2007, Rocaton paid a $2.5 million settlement to the San Diego County Employees Retirement system for recommending a failed hedge fund, Amaranth Advisors. According to published reports, the San Diego fund suffered the greatest loss from Amaranth of any pension, amounting approximately $105 million.[102]

In September 2007, the PBGC paid Rocaton $395,000 to study the agency's finances and suggest how best to allocate its money. What the PBGC ultimately approved—reducing its investment in bonds to increase the money it held in stocks—differed little from the recommendation made by Rocaton. Rocaton's conclusions were subsequently criticized by the Congressional Budget Office and GAO, as well as the PBGC Inspector General.[103]

9. Violations of Investment Policy of the Plan and Specific Manager Mandates

The Investment Policy for the Plan states that the primary objective of the Plan is to ensure that future assets are sufficient to meet future Plan liabilities.[104] The Plan's investment objective is to achieve consistent positive real returns and to maximize long-term return within prudent levels of risk through a combination of income and capital appreciation. The Investment Policy states that risk to the Plan's assets will be minimized through the diversification of the Plan's investments across asset classes and through systematic allocation to various investment management styles within the equity, fixed income and real estate markets. Domestic equities, international equities, fixed income, real estate and private equity were among the different assets classes permissible under the Investment Policy.[105]

The Investment Policy states that US Airways, Inc. will retain competent, external, professional investment managers to invest the Plan's assets.[106] A specific mandate for each investment manager, including the degree of discretion, "normal" portfolio structure, maximum cash reserve level, quality and diversification guidelines, and

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trades undertaken on their behalf. Whether the Plan may be entitled to any compensation related to this settlement is unknown and should be investigated. Securities Exchange Act of 1934 Release No. 63724

[102] Rocaton Pays $2.75M For Recommending Amaranth, Money Management Letter, April 9, 2007, Vol. XXXII, No. 8.

[103] See: Rationale Behind Pension Agency's New Strategy Revealed, ProPublica, May 19, 2009.

[104] Investment Policy for the Retirement Income Plan For Pilots of US Airways, Inc., as of December 13, 2000, page 2.

[105] Id. page 3.

[106] Id. page 4.

performance standards, will be agreed to in writing between US Airways, Inc. and the investment manager at the time of appointment.[107]

In summary, in order to determine the degree of discretion granted to each external investment manager and assess whether the investment strategies pursued by each manager were consistent with these applicable guidelines, it is necessary to examine both the provisions of the Investment Policy and the respective manager's specific written mandate.

For example, while the Investment Policy states that international equity managers are authorized to purchase and sell futures, according to the Investment Policy such investments by managers are only permissible "as outlined in their specific guidelines in order to hedge foreign currency exposure for defensive purposes only."[108] Whether the Plan's $188 million in futures losses in 2001 was wholly, or partially, attributable to unauthorized investments in futures cannot be determined without access to the relevant documents related to the management of these assets of the Plan. Recall that Hagan at the PBGC testified that she did not review the Plan's investments in futures[109] and made no attempt to investigate the Plan's $188 million in futures losses in 2001.

Likewise, whether investments such as Airgate PCS Inc., Alkermes Inc., BearingPoint Inc., Check Point Software, Elam PLC, Human Genome Sciences, Internet SEC Sys. Inc. and JDS Uniphase Corp. cited by USAPA, that lost most if not all of their value over a very short period of time, were appropriate for, as well as consistent with the investment guidelines of, the Plan cannot be determined without reference to all of the relevant documents.

The Investigative Findings in the Hagan investigation included that "the Plan's investment portfolio was managed within the guidelines provided in the Investment Policy" and that each of the stocks mentioned above met all of the … Investment Guidelines/Restrictions under the Plan's investment Policy."[110] However, reference to the Investment Policy alone is not dispositive as to whether these investments complied fully with all the guidelines applicable to the Plan. The Investment Policy itself refers to written, specific mandates applicable to each manager and, as mentioned earlier, Hagan did not review any manager mandates.[111]

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[107] Id.
[108] Id. page 7.

[109] Nicole C. Hagan deposition May 16, 2011, page 154.

[110] Nicole C. Hagan Memorandum to Judith Starr, General Counsel, PBGC, November 24, 2010, pages 5 and 6.

[111] As mentioned earlier, Hagan testified she relied exclusively upon the Chief Investment Officer of the PBGC for analysis of these investments and whether they were appropriate for, as well as consistent with the investment guidelines of, the Plan. Neither she nor Mr. Greenburg contacted any of the Plan's investment managers to determine the analysis related to their decision to purchase and continue to hold any of these specific investments. She neither

10. Plan's 35 "Blind Pool" Private Equity Investments Were Complex, High Cost and High Risk

The Investment Policy of the Plan includes a target asset allocation, performance measurement standard and other provisions applicable to all investments of the Plan, including private equity, and the overall Plan as well. For example, the Investment Policy includes among the goals guiding the development of the portfolio structure of the Plan, maintaining an overall portfolio structure that is as simple as possible and minimizing fees in order to maximize return. [112]

In addition to the Investment Policy, US Airways maintained a separate document, the US Airways Master Trust Private Equity Partnership Portfolio Policies and Procedures effective March 31, 1998 (the "Private Equity Policy"), which provides additional policies and procedures related solely to private equity investments of the Plan. The Private Equity Policy is referenced as Attachment B to the Investment Policy.[113] Thus, reference to the Investment Policy and Private Equity Policy, as well as substantial other related documentation referenced in the Private Equity Policy is required in order to evaluate the private equity investments of the Plan.

The Plan invested in 35 high-risk, high-cost, illiquid, opaque "blind pool" private equity investments that would have had to earn in excess of 25% annually.

For example, the Private Equity Policy states that "there shall be a comprehensive reporting and monitoring system for the entire portfolio, oversight managers and individual investments. Situations involving underperforming investments, portfolio diversification deficiencies and conflicts of interest are to be reported. "[114] With respect to conflicts of interest involving proprietary investment products recommended by an oversight manager, an analysis of why competing non-proprietary products are not suitable must be presented for the Staff's review and any investment must be approved by the CFO and Director of Pension Investments.[115] We have not been provided with any of the documents related to the reporting of underperforming private equity investments, or conflicts of interest involving such investments.

reviewed any investment advisory contracts between the Plan and each of its external asset managers nor any of the written, specific investment mandates executed with each of the investment managers.

[112] Investment Policy for the Retirement Income Plan For Pilots of US Airways, Inc., as of December 13, 2000, page 3.

[113] We have not been provided with and have not reviewed Attachment A to the Investment Policy referenced under Investment Policy Administration.

[114]Master Trust Private Equity Partnership Portfolio Policies and Procedures effective March 31, 1998, page 5.

[115] Master Trust Private Equity Partnership Portfolio Policies and Procedures effective March 31, 1998, page 7.

The Private Equity Policy also references an annual Tactical Plan Guidelines (Appendix A) and Prospective Private Equity Partnership Investment Disclosure Form (Appendix B). The latter form requires the attachment of any Offering Memorandum and other relevant materials related to private equity investments. We have not been provided with and have not reviewed any such completed forms or related documents.

In summary, the policies and procedures related to the Plan's private equity investments were highly complex.

The provisions in the Investment Policy and Private Equity Policy related to private equity fees and measurement of private equity performance appear to conflict.

For example, the Investment Policy provides that the Plan may invest in private equity and establishes a 5% private equity strategic allocation. The Policy states that private equity asset class investment performance will be measured against a *net of fees* (emphasis added) benchmark Internal Rate of Return (IRR) of 15%.[116] On the same page the Investment Policy states that the Plan's overall annualized total return, *after deducting for advisory, money management and custodial fees, as well as total transaction costs* (emphasis added), should perform above a customized index which includes a 5% allocation to the private equity asset class and a 15% IRR related to that allocation.

The Private Equity Policy states that the private equity portfolio is expected to generate a minimum IRR of 15% *net of all investment management fees and expenses* (emphasis added) and any individual fund investment is expected to produce a return in excess of 13% IRR.[117] However, later the Private Equity Policy states with respect to performance measurement that rate of return calculations will be net of all partnership fees and expenses, *but gross of oversight manager fees and expenses* (emphasis added).[118]

In summary, the various statements regarding performance measurement in the Private Equity Policy appear to be inconsistent and conflict with statements in the Investment Policy. The difference between gross and net performance can be substantial in private equity. Thus, private equity investment performance that may meet or exceed the performance benchmark on a gross basis, may amount to significant underperformance on a net basis.

Myriad, substantial fees are related to private equity investing – exponentially greater fees than those related to managing traditional publicly traded assets. Private equity investment management fees alone range from 1% to 3%.[119] In addition, the manager

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[116] Investment Policy for the Retirement Income Plan For Pilots of US Airways, Inc., as of December 13, 2000, page 5.

[117] Master Trust Private Equity Partnership Portfolio Policies and Procedures effective March 31, 1998, page 2.

[118] Master Trust Private Equity Partnership Portfolio Policies and Procedures effective March 31, 1998, page 5.

[119] A Handy Private Equity Cheat Sheet, CNNMoney.com, March 30, 2007.

receives a share of the profits, a "carried interest," that will vary depending upon the type of investment and the demand for the fund from investors. In private equity, the standard carried-interest allocation historically has been 20% for funds making buyout and venture investments. Certain private equity firms, such as Bain Capital, in which the Plan invested[120] charge fees that are significantly higher. Bain traditionally charges a 2% annual management fee and 30% carried interest.[121]

There may be additional transaction fees and other fees and expenses. Transaction fees, also known as "deal" or "success" fees are the fees charged by the private equity firm in connection with the completion of an acquisition for typically unspecified advisory services. According to a recent survey, the average transaction fees are 1.25% of deal size for deals under $1 billion, and 1% for deals over $1 billion.[122] Monitoring fees are commonplace and, of course, there are custodial expenses.

The Private Equity Policy states that separate account relationships will be established with one of more "fiduciary oversight managers" who will have discretion to make commitments to private equity limited partnerships, subject to portfolio diversification targets established in the Private Equity Policy, approval of an annual Tactical Plan by the Trust (Appendix A) and with prior notification as to program compliance via an Investment Disclosure Form (Appendix B).[123]

Myriad, substantial fees are related to private equity investing—exponentially greater fees than those related to managing traditional, publicly traded assets.

Fiduciary oversight managers also charge fees. Private equity fund-of-funds, such as Pathway Capital, in which the Plan invested,[124] have an additional layer of substantial fees to compensate the fund-of-funds manager. Funds of funds typically add additional management fees of 1% and a 10% carried interest. In order to determine net investment results, these substantial fees must also be deducted from gross returns.

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[120] See Master Trust's position appraisal for the period ending December 31, 2001

[121] Bain Capital Lowers Its Fees, Wall Street Journal, July15, 2011.

[122] Transaction and Monitoring Fees: What Is Now Market? DechertOnPoint, Summer 2008. See also Transactional Monitoring Fees: Does Anything Go? DechertOnPoint, January 2003.

[123] Id. page 4.

[124] 2000 Form 5500 Schedule C for the Master Trust Cash Pool.

As a result of the fees related to private equity investing, in order to achieve an IRR of 15% (net of all layers of fees), the Plan's private equity investments would have had to achieve a significantly greater gross return -- in excess of 25% for the Bain Capital and Pathway Capital fund. The likelihood of achieving these net investment results on a consistent basis is remote, even speculative.

In summary, while the Investment Policy states as goals maintaining an overall portfolio structure that is as simple as possible and minimizing fees in order to maximize return, the Plan's highly complex, high cost private equity program is utterly inconsistent with these goals. [125]

The Private Equity Policy states that the investments will be made "primarily through institutional blind pool limited partnership vehicles."[126] A "blind pool" is a form of limited partnership which does not specify or limit the investment opportunities the general partner may pursue. Blind pool investing is risky precisely because the investor does not know how his funds will be utilized.

In our opinion, blind pool investments are inappropriate for pension fiduciaries because they lack the hallmark of a prudent investment—transparency. Blind pool limited partnerships have resulted in scandals in the past which is not surprising since such offerings are most common toward the end of a prolonged bull market when investors are prone to throw caution to the wind.

"Blind pool" investing is risky precisely because the investor does not know how his funds will be utilized.

Investments in private equity funds pose additional risks. These investments have a long-term time frame and lack liquidity.

Private equity investment managers and the funds they manage have historically been exempt from registration and regulation under the federal securities laws. Lack of regulation has meant that these firms have not been subject to the disclosure and reporting requirements of the federal securities laws and have not been subject to periodic inspections by regulators. Further, conflicts of interest that may cause advisors to render investment advice that is not disinterested in violation of their fiduciary duties have not been disclosed or addressed. Potential conflicts involving fee arrangements, counterparties, co-investments, underwriters, portfolio companies, leverage providers, placement agents and valuations are vastly different from institutional separate accounts invested in publicly-traded securities.

[125] Investment Policy for the Retirement Income Plan For Pilots of US Airways, Inc., as of December 13, 2000, page 3.

[126] Master Trust Private Equity Partnership Portfolio Policies and Procedures effective March 31, 1998, page 1.

Investors have grown increasingly concerned with the appropriate reporting of the valuation of private equity funds. The interest stems from a number of sources, such as investor desire to measure interim performance, need for fair value data to report investments in their own financial statements, a manager's need to report and measure valuations in accordance with fund agreements, and the need to determine the allocation of distributions from funds. This has led to increased scrutiny of portfolio company values and the need for greater consistency of valuation methodologies employed by managers of private equity funds.

The general partners of private equity funds establish the valuation of illiquid positions in their fund portfolios and report these valuations to investors and intermediaries such as custodian banks, auditors and performance monitors. The general partner of a fund is subject to a conflict of interest in valuing a private equity portfolio since the greater the value of the portfolio, the higher the asset-based fee the general partner may earn. In order to reduce (but not eliminate) the conflict of interest inherent in valuing their own portfolios, general partners may utilize third party valuation agents to value their illiquid positions. Nevertheless, the managers of private equity funds largely control the valuations since third party valuation agents that do not support the general partner's valuations may be discharged.

Due to the unreliability of private equity valuations and potential conflicts of interest, the valuation of the Plan's private equity holdings must be viewed as suspect.

According to the Master Trust's position appraisal for the period ending December 31, 2001, the Master Trust held 35 private equity investments.[127] We have not been provided with any performance reports indicating the gross and net performance of the Plan's private equity investments. The Hagan investigation referred to earlier states that a report dated May 12, 2004, was prepared by Pacholder Associates, Inc. During 2003-2004, the PBGC retained Pacholder to value and advise the PBGC with regard to the limited partnerships in the Plan's portfolio as of the Plan's termination on March 31, 2003. We have not been provided with the Pacholder report.

The general partner of a private equity fund is subject to a conflict of interest in valuing the private equity portfolio since the greater the value of the portfolio, the greater his fee.

[127] See Master Trust's position appraisal for the period ending December 31, 2001.

As mentioned above, according to the December 31, 2000, financial statements, a significant portion of the Plan's assets (27%) lacked quoted market prices and the fair value of these assets was estimated by unidentified third parties. Presumably all, or most, of the Plan's 35 private equity holdings were included in this 27%. The identities of the parties that estimated the fair values of the private equity holdings are unknown and due to the unreliability of private equity valuations and related potential conflicts of interest, the valuations must be viewed as suspect.

While, according to the financial statements, the plan administrator obtained certifications from the trustees and insurance company of the Plan that all the information provided by them is complete, no auditing procedures were performed by KPMG to verify the value of the highly illiquid private equity investments assets held in the Master Trust.

11. Identity of, and Conflicts of Interest Related to, Private Equity Consultant Remain Unknown

1998, states: "As approved by the CFO and Director of Pension Investments, the Consultant shall advise on program development, conduct Oversight Manager Searches when requested. The Consultant will also be available to be retained to conduct special project work when requested by US Airways." It is later stated that "the Consultant will provide independent third party advice and information…" No consultant is named in the Policy. The Private Equity Partnerships Portfolio Policies and Procedures dated March 31,

We do not know the identity of the private equity consultant, if any, retained by the Plan. We have not been provided with any contract between the private equity consultant and the Plan, or any other documents that reveal the scope of services provided by this firm, or compensation paid to the firm. We are unable to determine whether the private equity consultant was truly independent, or subject to any potential conflicts of interest. For example, we do not know if the private equity consultant received payments from any of the private equity managers he recommended to the Plan.

Given the traditionally significant role of the private equity consultant in hiring, monitoring and terminating private equity managers, and the resulting potential conflicts of interest, a review of documents related to the private equity consultant is critical in a fiduciary breach investgiation of a pension.

12. Missing Investment Consultant Contracts and Performance Reports

We have not been provided with any contracts for investment consulting services between the investment consultants to the Plan and the Plan. Investment consulting services contracts typically include key provisions relating to duties of the investment consultant, such as portfolio evaluation, asset allocation and manager selection, as well as performance monitoring and reporting; advice regarding investment objectives and guidelines; fiduciary status of investment consultant; compensation of investment consultant and manner of payment; disclosure obligations and conflicts of interest.

We have not been provided with any of the performance reports (or any other reports) related to investments in the Plan prepared by either the general investment consultant to the Plan, or any private equity consultant (see discussion below) to the Plan. Performance reports prepared by the general investment consultant indicate the performance of each manager, as well as the Plan as a whole, compared against various relevant performance benchmarks on a gross and net of fees basis. Performance reports prepared by the private equity consultant may provide greater detail regarding strategies and portfolio holdings of the private equity managers. As a result of the tremendous influence investment consultants exert over pensions, review of investment consultant contracts, compensation arrangements and performance reports is critical in a fiduciary breach examination of a pension.

13. Master Trust Data Raises Significant Questions

According to the limited financial statements we have been provided, the assets of the Plan are maintained in a master trust with the assets of several other pension plans sponsored by the US Airways, including plans for management, flight attendants and mechanics. Each pension sponsored by the US Airways has an undivided interest in the assets of the trust. The plans do not own any assets outright.

According to the financial statements, the Plan's share of assets in the trust fund and the value of the trust fund are reported to the Plan by the trustees as having been determined through the use of fair values for all assets and liabilities. The fair value of approximately 73% and 96% of master trust assets were determined by quoted market prices as of December 31, 2000 and 1999, respectively. The fair value for the remaining assets each year were estimated based upon appraisals and other valuation techniques determined by third parties.

Noteably, the percentage of assets lacking readily available market values increased signifcantly (23%) over the course of one year.

As of December 31, 2000 and 1999, the Plan's interest in the master trust was approximately 49% and 66% respectively. That is, the Plan's interest in the master trust fell significantly (17%) in 2000. This suggests that the Plan was heavily invested in illiquid, risky investments—riskier than the investment s in the other plans. If true, the justification for the greater risk in the Plan should be examined.

14. Missing Minutes of Meetings of Investment Committee

We have not been provided with any of the minutes of the meetings of the Investment Committee of the Plan, presuming the Investment Committee did, in fact, meet. Minutes of such meetings generally reveal the process followed with respect to drafting and complying with the Investment Policy, determination of asset allocation, and selection of managers. Of particular interest is the process followed with respect to hiring managers and other vendors (such as actuaries and investment consultants), as well as the parties which recommend, or determine, which managers are hired. Review of minutes of the meetings of the Investment Committee of the Plan is critical in a fiduciary breach investigation of a pension.

15. Missing Investment Manager Reports, Contracts and Mandates

According to the SSB reports, approximately 30 investment managers (not including private equity managers) were retained to manage the investments in the Master Trusts. According to the deposition of a former member of the Investment Committee, the investment managers provided periodic reports to the investment adviser, or consultant, to the Plan. We have not been provided with any of the periodic reports provided by the investment managers. The periodic reports include investment performance information, as well as portfolio holdings. We have not been provided with any of the investment advisory contracts between the investment managers to the Plan and the Plan. The investment advisory contracts indicate the fees for investment advisory services. Competitive investment advisory fees generally indicate arm's length negotiations. On the other hand, higher fees may indicate conflicts on the part of the parties responsible for negotiating fees on behalf of the Plan. Review of investment manager reports and contracts is critical in a fiduciary breach investigation of a pension.

16. Missing Trading Records Precludes "Best Execution" Cost and Other Analyses

We have not been provided with any of the securities trading confirmations related to the Plan, or any analysis of the quality of the execution of the Plan's securities trading. The trade confirmations indicate the identity of the brokerages executing trades; whether the securites trades are executed on an agent or principal basis; date and time of the trade; any commissions paid, as well as the name of the security, quantity traded, and price.

Most importantly, if the Plan's trading records exist in electronic format, it is possible to expeditiously undertake a transaction cost, or "best execution," analysis related to the Plan.

Every securities broker-dealer handling customer orders has a duty to obtain best execution for the order. The SEC has stated that ''the duty of best execution requires a broker-dealer to seek the most favorable terms reasonably available under the circumstances for a customer's transaction."[128] A brokerage's duty to seek best execution of customer orders derives from the common law duty of agent loyalty, which obligates an agent to act exclusively in the principal's best interest. The agent is under a duty to exercise reasonable care to obtain the most advantageous terms for the customer.[129]

Pensions routinely monitor the brokerages that execute securities trades on their behalf for best execution compliance. The cost of such monitoring is minimal for even a large plan, perhaps $20,000 a year.[130]

Reviews of trading records and transaction cost analyses are critical in fiduciary reviews of pensions because trading abuses are commonplace and commissions related to trading represent a significant cost to plans. Finally, compromises to the integrity of a plan's investment process are often revealed through a review of trading records.

Reviews of trading records and transaction costs are critical because trading abuses are commonplace and commissions related to trading represent a significant cost to plans.

Diversification of brokerage, i.e., allocating trades among various firms and competitive costs related to trading are generally regarded as indicative of arm's length trading. On the other hand, concentration of trading with a single brokerage, or a limited number of firms, and/or excessive trading costs may be indicative of conflicts of interest on the part of one or more of the parties responsible for trading on behalf of the Plan and that the best interests of the Plan are not being exclusively pursued. The investment managers hired by a plan also have a duty to seek best execution in trading the assets of the plan they manage.[131]

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[128] Order Execution Obligations, Exchange Act Release No. 34-37619A, 60 Fed. Reg. 48290, 48322.

[129] In re Merrill Lynch, 911 F. Supp 754, 769 (1995).

[130] For example, Abel/Noser, a leading provider of transaction cost analysis to pensions provides such services to over 400 pensions and measures over $7 trillion in annual global trading. The firm's clients include Alcoa, CalPERS, CalSTRS, Fairfax County Supplement Retirement System, Florida State Board, IAM National Pension Fund, Johnson and Johnson, Louisiana School Employees Retirement System, Louisiana Teachers' Retirement System, Shriners Hospital, Pension Fund of the Christian Church, Farmer's Insurance Group, and New York City Teachers Retirement System.

[131] See, for example, remarks of Paul Roye, as Director of the Division of Investment Management in Priorities in Investment Adviser Regulation, Remarks Before the IA Compliance Summit and Best Practices Update in Washington, DC (April 8, 2002) and in Mutual Fund Management: Taking Responsibility, Maintaining Trust and Influencing Positive Change, Remarks Before the 2002 Mutual Funds and Investment Management Conference in Orlando, Florida (March 25, 2002), where he said, "As you know, best execution is a duty of every money manager to its clients and also is an issue of substantial current interest to the Commission and the staff."

For example, according to a Driehaus Capital Account Position Appraisal dated November 30, 2001, the firm managed approximately $60 million of Plan assets. The manager's Portfolio Purchase Report and Portfolio Sales Report for the period November 1, 2001 to November 30, 2001 indicates that 100% of the securities purchases and sales for the period were executed by a brokerage, Neuberger and Berman. Since the November 2001 reports are the sole trading records we have been provided related to Driehaus Capital, we do not know whether this is an isolated phenomena. However, the concentration of trading evident in these reports raises a "red flag" that requires further review. In addition, since Driehaus had an affiliated brokerage at this time, whether the Driehaus brokerage affiliate may have had a revenue-sharing arrangement with Neuberger and Berman is an issue to be explored.

The Independent Auditors' Report prepared by KPMG dated September 7, 2001, states that "the trustees and insurance company execute investment transactions on behalf of the Plan." The limited records we have been provided related to the Plan's trading confirm that State Street brokerage executed securities trades on behalf of the Plan.[132]

As mentioned above, when custodians include securities trading (including foreign exchange transactions) in the "bundled" price which they charge a pension plan, there is a lack of transparency and overcharges may result. A best execution analysis of all of the Plan's securities trading should reveal overcharges by any brokers, including brokers affiliated with the Plan's custodians.

We have not been provided with any soft dollar[133] or directed brokerage agreeements[134] related to the Plan that may exist. Given the potential for abuse inherent in these arrangements, review of any such arrangements is critical in a fiduciary breach investigation of a pension.

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[132] See, for example, AXA Rosenberg Portfolio Purchase Report February 1, 2003 to February 28, 2003, page 8.

[133] The SEC has defined soft dollar practices as arrangements under which products or services other than execution of securities transactions are obtained by an investment adviser from or through a broker-dealer in exchange for the direction by the adviser of client brokerage transactions to the broker-dealer. There is an inherent conflict of interest in soft dollar arrangements since the adviser is using client commission dollars to purchase research for himself—research he would otherwise have to pay for himself. See Disclosure by Investment Advisers Regarding Soft Dollar Practices, Advisers Act Release No. 1469 (Feb. 14, 1995).

[134] In a "directed brokerage" arrangement, a pension asks its investment advisers, subject to the advisers' satisfaction that the pension is receiving best execution, to direct commission business to a particular broker that has agreed to provide services, pay obligations or make cash rebates to the pension. Directed brokerage does not involve the same conflicts posed by soft dollars. Advisers do not receive products, cash rebates, or services in exchange for client commissions under these arrangements. Instead, the advisers' clients, e.g. pensions, receive the products, services or cash rebates generated by their commissions. See Inspection Report on the Soft Dollar Practices of Broker-Dealers, Investment Advisers and Mutual Funds, The Office of Compliance, Inspections and Examinations, U.S. Securities & Exchange Commission, September 22, 1998. Nevertheless, directed brokerage arrangements pose unique dangers.

17. Private Equity Alchemy Investment Involved Piling Risk Upon Risk

The Investment Policy Statement of the Plan dated December 13, 2000, provides that, “to be considered for any appointment, an investment management firm will have demonstrable financial stability, no potentially conflicting affiliations, low turnover of personnel, capacity to undertake the Company’s account, a competitive record of performance and relevant experience and expertise.” With respect to private equity, the Policy requires “institutional limited partnerships.”

Owning 100% of the Alchemy private equity fund that lacked any investment performance track record amounted to piling risk upon risk.

In addition to the Investment Policy, the Master Trust Private Equity Partnerships Portfolio Policies and Procedures effective March 31, 1998 states that all private equity investments must be of institutional investment quality, defined as being of a quality whereby the investment would be considered acceptable by other prudent institutional investors.

Alchemy Partners is a private equity and distressed investing advisory firm based in London that was founded in 1997 by Jon Moulton. Alchemy Partners advises Alchemy Partners (Guernsey) Limited, the fund manager to Alchemy Investment Plan L.P. (Alchemy Investment).

Alchemy Investment was a private equity investment held by the Master Trust, as reported in the Master Trust’s position appraisal for the period ended December 31, 2001.

Alchemy Investment was organized on November 29, 1999 to make equity investments related to leveraged buy-outs and management buy-outs in the UK, Germany, Austria and Switzerland. The Plan’s investment in Alchemy Investment began in 1999, apparently at inception of the fund.

Best practices require that investment managers, as well as the funds they manage, possess established track records in order to be considered prudent for pensions. Generally each investment should have a minimum track record of three years during which the same portfolio management team managed the fund. At the time the Plan invested in Alchemy Investment, the fund lacked any investment performance track record whatsoever and the investment advisor to the fund had only been in existence for two years. Thus, it appears that Alchemy Investments lacked the two hallmarks of a prudent investment for pensions. The fund was not, in our opinion, “institutional quality.”

Further, the Master Trust owned 98% of Alchemy. While under the terms of the Private

Equity Policy of the Plan ownership of up to 100% of any particular partnership was permitted, best practices for pensions limit the percentage of an investment a plan may represent to a minority position, generally less than 30% in order to reduce risk. Owning virtually 100% of a private equity fund, lacking any investment performance track record, amounts to piling risk upon risk.

The Hagan investigation relied upon information regarding the value of Alchemy provided in a report dated May 12, 2004, that was prepared by Pacholder Associates, Inc., which report, we repeat, we have not seen. Further, Hagan relied upon a J.P. Morgan Asset Management Investment Summary of Alchemy (Air) Second Quarter 2009 and representatives of JP Morgan's Private Equity Group for performance information.[135]

For example, Hagan states that Alchemy Investments' IRR from November 29, 1999, its inception, to December 31, 2003 was 10.49%.[136] She notes that Alchemy Investment's IRR was "not far below" the IRR in excess of 13% individual private equity investments were expected to achieve as indicated in the Private Equity Policy.

Contrary to Hagan's assertion, the difference between 10.49% investment performance and a 13% policy objective is 2.51%, or approximately 20%, and, with respect to evaluating investment manager performance, is enormous. Further, as noted earlier, unreliability related to valuation and performance reporting of private equity portfolios are serious concerns. Only through an audit of the private equity partnership—which apparently did not happen here—can these issues be adequately addressed.

Neither Hagan's memorandum nor the e-mails she cites as her source for this performance information indicate whether the 10.49% IRR is gross or net of all applicable fees.[137] Since, as mentioned earlier, fees and transaction costs related to private equity funds and oversight managers may be substantial, amounting to in excess of 5%, any analysis of the performance of Alchemy Investments should focus upon net of all applicable fees, not gross, investment performance.

18. Lighthouse Hedge "Fund of Funds" Was Laden with Fees

According to the US Airways Hedge Funds Composite Position Appraisal as of December 31, 2003, the Plan invested approximately $93 million in Lighthouse V Fund Limited, a hedge fund-of-funds. Hedge funds typically charge an asset management fee

[135] In 2006, Pacholder was merged into J.P. Morgan Investment Management Inc.

[136] Hagan states that this IRR information was obtained from e-mails from John Greenberg and Mark Thorne, dated November 17, 2010. She further states that PBGC's Corporate Investments Department obtained Alchemy's IRR from JP Morgan's Private Equity Group. The November 2010 email indicated that the IRR in British pounds was 4.40%.

[137] As mentioned earlier, the benchmark standard for private equity investment performance stated in the Policy is an internal rate of return (IRR) of 15%, *net of fees, including advisory, money management and custodial fees, as well as transaction costs (emphasis added).*

of 2% of assets (although management fees range from 1-4% annually), plus a "performance fee" of 20% of a hedge fund's profits (although performance fees range from 10% to 50%). Funds of hedge funds charge a fee for managing assets, say 1%, and generally include a performance fee based on profits, perhaps 10%. As the SEC cautions investors on its website, “these fees are charged in addition to the previously mentioned fees paid to the underlying hedge funds.”[138]

There are additional substantial fees related to hedge fund of funds, such as one-time, up-front placement or origination fees (1-2%), multiple layers of operating expenses (1.5%), and portfolio trading costs (2%).

Lighthouse V Fund Limited is described as a diversified fund seeking LIBOR + 5% for benefit plans and insurance accounts. Years later, as of July 2007, the fund held $624 million in assets. While we do not know the total assets in the fund at the time the Plan committed $93 million, it is likely that the Plan’s investment represented a significant percentage of total assets of the fund at that time. The management fee related to the fund of funds ranges from 80 basis points to 1.5% and the performance fee ranges from 0-10%.[139]

In order to generate a net positive return an investment in the Lighthouse Fund would have had to exceed 12% annually.

It appears that the multiple layers of asset management, performance, and organizational fees related to the Lighthouse V Fund, combined with trading and organizational expenses, amounted to approximately 8% of assets under management and 30% of any potential gains. Thus, in order to generate a net positive return an investment in the Lighthouse Fund would have to exceed 12% annually to match a risk-free return of 3%.

According to a report entitled “Hedge Funds: Too Much of a Good Thing” there is some merit to investing in as much as 20 hedge funds if an investor’s portfolio consists solely of hedge funds; however, if only 20% of an investor’s total portfolio is in hedge funds, the advantage of owning 20 hedge funds through a hedge fund of funds is much diminished. It is impossible for any single underlying hedge fund manager to significantly add value and it seems likely the vast number of managers will result in, at

[138] Hedging Your Bets: A Heads Up on Hedge Funds and Funds of Hedge Funds, http://www.sec.gov/answers/hedge.htm

[139] See HFA Holdings Limited, Operational Update and Proposed Merger with Lighthouse, July 2007.

best, a market rate of return net of fees, with significantly greater investment and operational risk.[140]

Further, research has shown that on average fund of fund managers fail to deliver additional return. Over a recent ten year period the compound pre-tax return of a fund of funds composite would have been 1.5 percentage points lower than Bernstein's hedge fund composite. The reason that funds of funds have not fared well, according to Bernstein, is their multiple fee structure. Fund of fund managers need to pick not just better-than-average funds to produce incremental return, but among the best, concludes Bernstein.

> ***"Putnam's long history of bad practice has cost the investing public billions…"***
>
> ***Money Magazine***

A December 18, 2006, Bloomberg News article entitled "Dirty Wall Street Secret: Hedge Funds of Funds Pay T-Bill Rates," also questions the investment merits of hedge funds of funds.

As mentioned earlier, according to the Lighthouse Account Position Appraisal report prepared by SSBT as of March 31, 2003, the Lighthouse V Fund Limited was purchased in a private placement transaction. The report does not indicate the identity of the private placement agent involved or the amount of any fee related to the Lighthouse investment.

Given the multiple layers of fees related to this investment, the lack of competitive performance of hedge fund of funds generally, and the potential conflicts of interest and undisclosed fees, additional scrutiny of this investment is warranted.[141]

19. Scandals at Putnam Investments

According to various Account Position Appraisal records, Putnam Investments managed approximately $100 million in Plan assets from 2001 through 2003 in an international equity portfolio. Both Putnam's lackluster investment performance track record and history of sordid business practices prior to and during this period, are "red flags" regarding this firm. How Putnam came to be hired initially to manage substantial Plan assets, e.g., the independence of the investment consultant that recommended Putnam, and how it performed once hired, deserve special scrutiny.

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[140] Hedge Funds: Too Much of a Good Thing, Bernstein Wealth Management Research, June 2006.

[141] Note that the Plan also invested in a private equity fund of funds, Pathway Capital Management. As a fund of funds, Pathway also would be subject to multiple layers of high fees. Further, given the dozens of private equity funds in which the Plan invested directly, the diversification provided by the Pathway fund of funds would have been unnecessary.

As stated in a Money Magazine article entitled, Putnam: The Greed Machine, in 2003, "For over a decade, Putnam has epitomized nearly everything that has gone wrong with the mutual fund business. Quietly, relentlessly, Putnam has morphed from an investment firm into a marketing monster that all too often pursued its own growth at the expense of its fund investors. The insider trading that has dominated this fall's headlines cost Putnam's investors an estimated $1 million. *But Putnam's long history of bad practice has cost the investing public billions -- both in potential gains forgone and in actual losses on funds that never should have been created at all* (emphasis added)."[142]

Edward Siedle, founder of Benchmark and former Director of Compliance/ Legal Counsel of Putnam Investments, provided information to the SEC in 1989 regarding his own internal investigations of Putnam business practices and to New York Attorney General Eliot Spitzer in connection with Spitzer's 2003 investigation of Putnam's practices.[143]

20. "Cherry-Picking" Fraud at Ark Asset Management and Plan Losses

"Cherry-picking" fraud at Ark Asset Management may have cost the Plan.

According to the 2003 Form 5500 Schedule C for the Master Trust Cash Pool, Ark Asset Management served as an investment advisor to the Plan. In 2009, Ark entered into a settlement with the SEC related to fraudulent trade allocation, disclosure and books and records violations by the firm between August 2000 and December 2003.[144] During this period (when the firm managed Plan assets), a portfolio manager at Ark engaged in fraudulent trade allocation practices – "cherry-picking" – by favoring firm proprietary accounts over client accounts in the allocation of securities. According to the SEC, Ark did not disclose this scheme to its clients. As a result of this fraudulent conduct, Ark realized at least $19 million of ill-gotten gains in the form of performance fees from the firm proprietary accounts. Any harm the Plan suffered as a result of this proprietary trading scheme should be determined.

Further, according to the PBGC, Ark was one of eight external investment managers the PBGC used to manage its assets. Thus, this matter should have been investigated by PBGC related to its own portfolio[145]

21. AXA Rosenberg Securities Fraud

[142] Money Magazine, November 21, 2003.

[143] Inside Putnam: Reform or Damage Control? New York Times, December 7, 2003.

[144] Investment Advisers Act of 1940, Release No. 3091 / September 29, 2010.

[145] Letter from Bradley D. Belt, the Executive Director of the PBGC, to Representatives Edward J. Markey and George Miller, May 16, 2006.

According to a February 28, 2003 Account Position Appraisal Fund Summary, AXA Rosenberg managed approximately $55 million in Plan assets. In 2011, three AXA Rosenberg entities agreed to settle SEC charges of securities fraud for concealing a significant error in the computer code of the quantitative investment model that they used to manage clients assets by paying $217 million to harmed clients plus a $25 million penalty.[146] On November 2, 2011, the firm and its co-founder Barr Rosenberg agreed to pay $65 million to settle a class action lawsuit brought by four pension funds. According to published reports, AXA Rosenberg managed $29 billion of assets in June 2011, down from about $70 billion at the end of 2009, in part reflecting client withdrawals stemming from the coding error.[147]

While the SEC release states that the SEC found the error was introduced into the model in April 2007, whether the computer error, or other errors, may have existed prior to 2007 and whether the Plan may have suffered any related harm should be investigated.

22. Directed Brokerage Violations at Capital Guardian

Whether Plan trading commissions were directed to brokerages that assisted in selling shares of the American Funds should be investigated.

According to a December 31, 2001 Account Position Appraisal Asset Summary, Capital Guardian managed approximately $125 million in Plan assets. Subsequent Account Position Appraisal reports indicate the firm continued to manage Plan assets through the end of 2003.

Capital Guardian is part of The Capital Group Companies, Inc., a global investment management organization that manages assets for institutional accounts and publicly owned mutual funds. Capital Research and Management Company is an affiliated investment adviser that manages the American Funds family of mutual funds.

The Capital Guardian Portfolio Sales Report for the period December 1, 2001 through December 31, 2001 indicates that many trades related to the Plan's account at Capital Guardian were executed by J.P. Morgan Securities, Merrill Lynch, Salomon Smith Barney, UBS Warburg and Morgan Stanley Co. Inc. Each of these firms has a significant national sales force involved in marketing mutual funds, including the American Funds, to retail investors. In 2005, the National Association of Securities Dealers (predecessor to the Financial Industry Regulatory Authority), charged American Funds Distributors ("AFD"), the principal underwriter and distributor of the American Funds, with violating

[146] http://www.sec.gov/news/press/2011/2011-37.htm.

[147] AXA Rosenberg settles coding lawsuit for $65 million, Reuters, November 2, 2011.

applicable industry rules by directing approximately $100 million in brokerage commissions over a three-year period – 2001 through 2003 – to about 50 brokerages that were the top sellers of American Funds. The payments were made to reward the firms for past sales and to encourage future sales of American Funds.[148]

In 2006, the AFD was fined $5 million by the NASD for paying improper incentives, i.e., directing commissions to brokerages that pushed the company's mutual funds to their customers.[149] On February 14, 2008, Capital Research and Management Company entered into a settlement with the California Attorney General related to the company's alleged misuse of revenue sharing and directed brokerage arrangements with broker-dealers.[150]

The above-referenced regulatory actions related to Capital Research and Management Company and AFD, affiliates of Capital Guardian, directing mutual fund securities trades to brokerages during the period of time when Capital Guardian was utilizing some of those same brokerages for trades related to the Plan's assets. Thus, the issue of whether Plan trading commissions were directed to brokerages that assisted in selling shares of the American Funds arises and should be investigated.

Note that Capital Guardian's current Form ADV, Part 2A indicates that the firm "may place orders for a client's portfolio transactions with broker-dealers who have sold shares in the funds managed by CGTC or its affiliated companies; however, it does not consider whether a broker-dealer has sold shares of the funds managed by CGTC or its affiliated companies when placing any such orders for a client's portfolio transactions."[151] While compliance with this representation regarding current brokerage allocation practice is impossible for clients to verify (because the very same firms previously paid commissions for impermissible purposes may now receive the same commissions for supposedly permissible purposes), the firm's directed brokerage practices during the period it managed assets of the Plan is the relevant inquiry.

23. Conclusion

In conclusion, Benchmark acknowledges that this fiduciary breach investigation is incomplete, thwarted by its inability to obtain the overwhelming majority of the relevant documents related to the pension. This review by Benchmark was required because the PBGC since 2003 has not adequately investigated fiduciary breaches with respect to the

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[148] NASD New Release, February 16, 2005.

[149] American Funds Hit By Fine, Censure, Los Angeles Times, August 31, 2006.

[150] Office of the Attorney General, Press Release February 15, 2008.

[151] Capital Guardian Trust Company, Form ADV, Part 2A, page 30, September 28, 2011.

Plan, or, for that matter, with respect to any of the thousands of other terminated pensions under its trusteeship.

In our opinion, the PBGC, as the statutory trustee to the Plan, clearly has the duty under ERISA and other federal law to investigate the earlier trustees' management of the Plan.

Investigating fiduciary breaches and conflicts of interest requires substantial work. However, the alternative, i.e., to do nothing, should be unacceptable.

Perhaps most important, if undertaken routinely, *PBGC investigations of fiduciary breaches related to terminated plans can:*

- Enhance understanding of the connection between fiduciary breaches and harm to pensions;
- Quantify the damages related to fiduciary breaches; and
- Improve industry conduct by holding parties that contribute to the demise of pensions responsible.

As noted by Bradley D. Belt, the then Executive Director of the PBGC, in his May 16, 2006 letter to Representatives Edward J. Markey and George Miller, "there is not necessarily a connection between the failure to disclose conflicts of interest as found by the SEC, and resulting harm to a pension plan. Making that determination requires substantial work." In his letter Belt indicated that the PBGC at that time (2006) was reviewing these conflict issues to determine what follow-up actions would be appropriate. In the past 6 years PBGC has gone no further in investigating fiduciary breaches.

We investigate fiduciary breaches and require disclosure of conflicts of interest because they are "material" to investors. That is, it is widely recognized that self-dealing schemes and other forms of wrongdoing have the potential to harm investors by undermining investment performance. While investigations of fiduciary breaches may not always establish a causal connection between breaches, or conflicts, and losses sustained by a Plan, failure to investigate merely ensures that those who have profited at the expense of pension sponsors and participants are not held accountable.

Investigating fiduciary breaches and conflicts of interest indeed requires "substantial work," as well as access to records related to the pension. However, the alternative, i.e., *"to do nothing"*, should be -- *unacceptable.*

About Benchmark Financial Services, Inc.

Founded in 1999, Benchmark Financial Services, Inc. provides “enhanced integrity” investment management fiduciary consulting and forensic investigative services to institutions, law enforcement, regulators and wealthy individuals. "Enhanced integrity" refers to the proprietary heightened due diligence and monitoring methodology that the Company utilizes to reduce risk and increase returns. The firm has pioneered the emerging field of forensic investigations of the money management industry and has conducted investigations worldwide involving in excess of $1 trillion in assets under management.

Benchmark was founded by Edward Siedle in 1999. The media has referred to Siedle as "the Sam Spade of Money Management," “the Financial Watchdog” and "the Pension Detective." He began his career in law with the SEC's Division of Investment Management, which regulates money managers and mutual funds; he later served as Legal Counsel and Director of Compliance to Putnam Investments, one of the largest international money management firms. Since 1989, Siedle has founded and managed firms offering specialized services to municipalities, pension funds and money managers.

He is nationally recognized as an authority on investment management and securities matters. He has testified before the Senate Banking Committee regarding the mutual fund scandals and the Louisiana State Legislature regarding pension consultant conflicts of interest. He was a testifying expert in various Madoff litigations. Articles about him have appeared in publications including Time, BusinessWeek, Wall Street Journal, The New York Times, Barron's, Forbes, the Boston Globe, and Institutional Investor. He widely lectures and has appeared on CNBC, Fox Business News, Wall Street Week, and Bloomberg News. He writes a “Financial Watchdog” column for forbes.com. Mr. Siedle is an active member of the Florida Bar and a retired member of the Massachusetts Bar.