



Charles A. Service says use of derivatives carries both opportunities and responsibilities.

# Proper use of derivatives cuts risk

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WASHINGTON — Plan sponsors who use derivatives, contrary to what some may think, are not like substance abusers and shouldn't apologize for using them, said speakers at the Sixth Annual *Pensions & Investments* Investment Management Conference in Washington.

"I feel I should stand up here apologetically and say, 'My name is Charlie and I use derivatives,'" joked Charles A. Service, director of capital management and trust investments at Unisys Corp., Blue Bell, Pa.

But "why hamstring yourself?" he asked. "Derivatives are nothing more than a way to gain exposure to particular markets."

Properly structured, derivatives can minimize investment risks, but dozens of well-publicized losses by corporations, government organizations and pension plans in recent months have given them a bad rap.

Executives shouldn't be afraid of derivatives because of other plan sponsors' debacles. While the use of derivatives was blamed for the losses in most of these incidents, other factors played into the disasters, such as poor internal controls, Mr. Service said.

"It's essential to make very

clear the intent of the portfolio," Mr. Service said, adding plan sponsors should avoid fee arrangements that have hidden incentives that may increase the risk of the investment.

"There are a number of opportunities for pension plan sponsors to use derivatives," Mr. Service said. "There are a number of responsibilities for pension plan sponsors who choose to follow that course."

Pension plan executives can use derivatives reasonably safely by paying attention to a few, well-seasoned rules, he said:

- Ensure adequate control by making sure investment officers know their responsibilities and

investment policies are as specific as possible. Thus, a pension fund's investment policy should define the plan's objective of investing in derivatives, how much money can be invested in derivatives at any time and whether the fund can make leveraged bets.

- Underscore the intent of the investments with money managers. The operative phrase with money managers is "Trust but verify," Mr. Service said.

- Make sure you know what securities you hold in your portfolio.

- Check the compensation arrangements for money managers, so they don't have a hidden incentive to take undue risks at the plan sponsor's expense.