

**First Mercantile's Investment Selection
and Due Diligence Process**

Since first offering collective investment trust funds (CITFs) in 1985, First Mercantile has developed one of the most rigorous due diligence processes in the retirement plan industry. Backed by a full-time staff of investment professionals, First Mercantile's Adviser Review Committee (ARC) serves as a fiduciary on the CITFs and oversees the entire due diligence process.

The ARC identifies and hires premier independent investment managers, providing an objective and unbiased assessment of the skill and capabilities of candidate investment managers.

Adviser Searches

The ARC initiates searches for new investment managers in order to enhance the breadth and depth of First Mercantile's investment offerings or to replace an existing investment manager that is not meeting expectations.

The search process employed by the ARC scans the entire universe of investment managers in an effort to identify those best suited for inclusion on First Mercantile's platform based solely on their merit.

Second, instead of using a traditional screening process, First Mercantile employs a holistic approach to manager selection. Most firms search for investment options based solely on the performance of a given investment manager versus a market benchmark or its peers. However, investment performance cannot be viewed in a vacuum. Instead, performance should be viewed as the result of the portfolio created by individuals executing a process according to their investment philosophy.

As such, First Mercantile combines quantitative and qualitative factors when evaluating investment managers for inclusion on its platform. The quantitative component of the process scores managers within a given investment style based on benchmark-relative performance and risk metrics over a variety of time periods. This quantitative component winnows the universe to the most attractive candidate firms, which First Mercantile subjects to a rigorous qualitative review. First Mercantile's team of investment professionals thoroughly reviews the capabilities of the firm in general and the personnel, philosophy, process and portfolio of the strategy under review in particular. Investment managers that continue to appear compelling after this exhaustive review then make a presentation regarding their firm's capabilities to First Mercantile's investment staff, which frequently performs additional on-site due diligence at the investment managers' offices. Ultimately, First Mercantile selects the investment manager it believes best suited to sub-advise a CITF based not solely on performance but instead on the comprehensive evaluation of the people, philosophy, process and portfolio that generated the performance.

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“The ongoing due diligence First Mercantile performs is among the most rigorous in the industry”

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Subsequent to selection, each investment manager must sign an Investment Policy Statement (IPS), which outlines the objectives and constraints for the CITF. The IPS serves as the cornerstone of the relationship between First Mercantile and the investment manager and is an integral part of the ongoing monitoring and due diligence First Mercantile performs.

Ongoing Due Diligence

As trustee of the CITFs, First Mercantile’s fiduciary role is of paramount importance. As such, the ongoing due diligence First Mercantile performs is among the most rigorous in the industry.

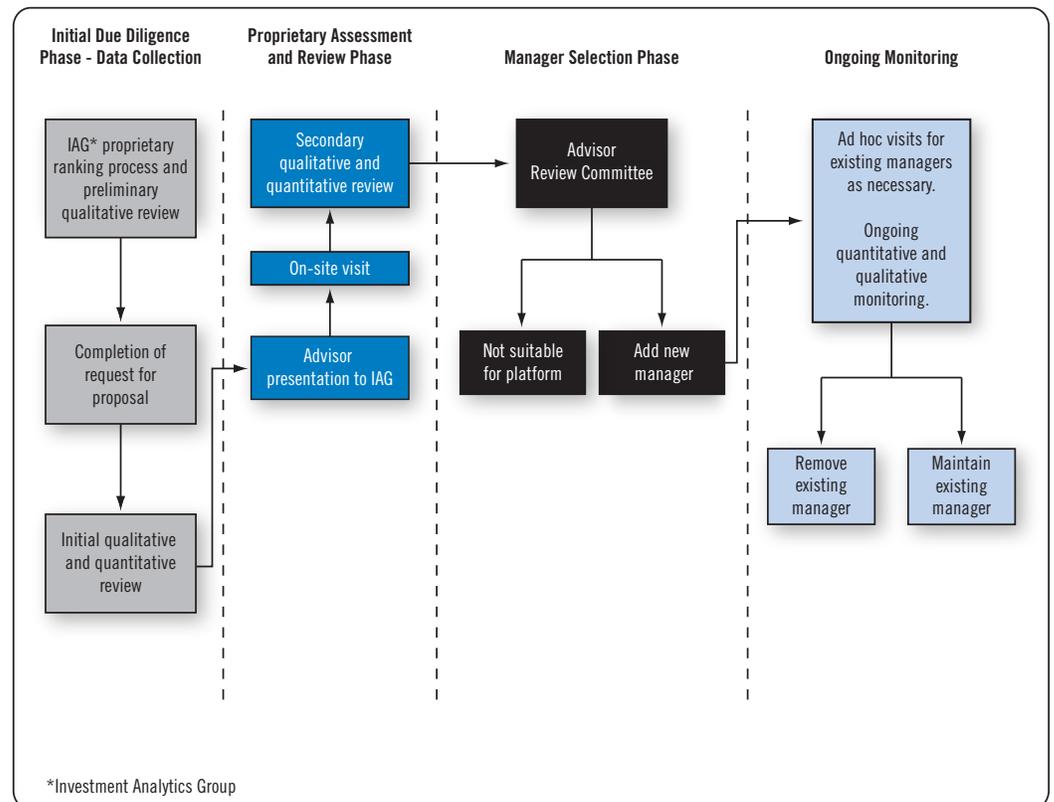
Using industry-standard software, First Mercantile’s investment professionals are able to review and evaluate trading activity in the CITFs on a daily basis. Securities purchased for a given CITF that are not part of its benchmark are evaluated quantitatively and qualitatively to ensure that the security’s inclusion is consistent with the objectives of the CITF. In many cases, First Mercantile’s investment staff will discuss such purchases with the investment manager to ascertain the rationale for the purchase in light of the investment manager’s process.

On at least a monthly basis, First Mercantile comprehensively evaluates the performance of each CITF. Going beyond a mere comparison of the CITF’s return versus that of a benchmark, First Mercantile calculates a detailed performance attribution, which may compare the performance of the CITF versus that of its benchmark in a variety of ways. Performance attribution may be used to identify by economic sector, industry, price/earnings quintile or individual stock, to name but a few, the reasons a CITF outperformed or underperformed its benchmark.

On a quarterly basis, First Mercantile requires each investment manager to complete a due diligence questionnaire that encompasses matters such as personnel changes, growth in firm and strategy assets, introduction of new strategies, changes in firm ownership and notice of legal or regulatory infractions. The questionnaire enhances the qualitative component of First Mercantile’s ongoing due diligence and promotes early detection of issues that may negatively affect the investment manager. Additionally, First Mercantile’s staff reviews market commentary from the investment managers and conducts conference calls with their portfolio managers to review performance and discuss their outlook.

On an annual basis, First Mercantile requires each investment manager to complete a comprehensive due diligence questionnaire, which encompasses many of the matters addressed in the investment manager’s initial RFP. The questionnaire serves as another means of monitoring the investment manager. Additionally, information provided in the questionnaire serves to assist First Mercantile in preparing a comprehensive findings report on the investment manager, which is created on an annual basis as well.

The findings report evaluates the strengths, weaknesses and issues associated with the investment manager's personnel and organizational structure, investment philosophy and process, performance, portfolio and compliance. Finally, First Mercantile's staff performs on-site due diligence at the offices of a number of investment managers each year.



Watch List Process

First Mercantile makes every reasonable effort to ensure that each investment manager meets the objectives set forth in its IPS. Investment managers that are not meeting these objectives or that have undergone significant changes in staff, management, ownership or that have committed a regulatory infraction, are subject to inclusion on the ARC's Watch List. The purpose of the Watch List is to notify an investment manager that it is not currently meeting the objectives or expectations outlined in its IPS so that the investment manager will have an opportunity to address and correct these issues. The Watch List also serves to notify clients of issues affecting an investment manager. First Mercantile has developed the following general criteria for placing an investment manager on the Watch List:

- Trailing long-term returns (two trailing years or more) that, on an overall basis, do not meet objectives set forth in the IPS or that significantly trail the assigned benchmark;

- Trailing short-term returns (two years or less) that significantly underperform objectives set forth in the IPS or significantly lag the assigned benchmark such that the long-term performance of the portfolio is being eroded to a degree that the expectation is that a long time period will be required for performance to return to the levels set forth in the IPS;
- Material change in adviser or mutual fund's investment style or methodology;
- Change in portfolio manager or other significant personnel changes at adviser that may adversely affect adviser's ability to manage;
- Material change in firm ownership structure or management at adviser or mutual fund; or
- Material regulatory or compliance infractions at adviser or mutual fund that adversely affect adviser's ability to manage.

These criteria provide the ARC with a flexible framework and allow it to use discretion in placing an investment manager on the Watch List. The ARC may elect to place an investment manager in one of five Watch List statuses. These include:

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- **Hold** – the Committee maintains its concern over the issue(s) that originally warranted Watch List status. An investment manager will continue to reside on Watch List status until further notice.
- **Performance Improving** – Investment manager's performance has demonstrated signs of improvement; however, the ARC maintains concern over performance issues. Investment manager will maintain presence on Watch List until such time as the ARC is satisfied that material performance issues are resolved.
- **Search** – the ARC has deemed the issue(s) that warranted Watch List status to be of such a significant nature that replacement of the investment manager may be necessary. The ARC tasks First Mercantile's staff of investment professionals to initiate a search for possible replacements.
- **Replacement Selected** – Appropriate replacement investment manager has been identified.
- **Process of Being Replaced** – Process is underway to terminate the specific investment manager and to hire an identified and ARC-approved replacement.

First Mercantile's Watch List process is a deliberate approach designed to avoid haphazard replacement of investment managers based solely on lagging performance. The ARC recognizes that even the best investment managers may undergo periods of underperformance that last several quarters or several years. Combining the ARC's intimate knowledge of the investment manager's philosophy, process and portfolio with an analysis of prevailing capital market conditions, the ARC is better able to understand the causes of underperformance. This understanding helps the ARC make better decisions when determining whether to undertake a search for a replacement investment manager or to continue with the same investment manager with the expectation that its relative performance is on the cusp of demonstrating marked improvement.

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