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Client Alert

A report for clients and friends of the firm July 2005

# Examination of Pension Consultants' Conflicts of Interest and Tips for Plan Fiduciaries

The Employee Retirement Income Security Act of 1974, as amended ("ERISA"), requires that fiduciaries of employee benefit plans administer and manage their plans prudently and in the interest of plan participants and beneficiaries. Recently, the Securities and Exchange Commission's Office of Compliance Inspections and Examinations ("OCIE") released a report entitled "Staff Report Concerning Examinations of Select Pension Consultants" (the "Report"), which provides the findings of the OCIE's examination of the practices, compensation arrangements and disclosures of consultants who provide services to sponsors of retirement plans. As a result of the findings of the Report, the Department of Labor and the SEC released a joint document entitled "Selecting and Monitoring Pension Consultants: Tips for Plan Fiduciaries," consisting of a series of questions developed to assist plan fiduciaries in evaluating the objectivity of a pension consultant's recommendations, with the stated goal of encouraging the disclosure and review of more and better information about potential conflicts of interest.

## The Report

The Report exposes the widespread failure of some pension consultants to disclose conflicts of interest that may impair their ability to impartially advise their clients. The Report also raises issues for fiduciaries of pension plans who make use of pension consultants, since the disclosure of a pension consultant's potential conflicts of interest is an important part of a plan fiduciary's selection and monitoring process of plan consultants. A copy of the complete Report is available on the Internet at www.sec.gov/news/studies/pensionexamstudy.pdf.

During the course of its examination, the SEC examined a cross-section of the consultant community consisting of 24 pension consultants who are registered with the SEC as investment advisers. The examination gathered information regarding: (1) the products and services provided to pension plan clients and products/services provided to money managers or mutual funds; (2) the method of payment for the pension consultants' services; and (3) the disclosure provided to clients. In its examination, the SEC found that:

- More than half of the consultants or affiliates examined provided products and services to both pension plan clients and money managers and mutual funds on an ongoing basis.

- A majority of the consultants examined have affiliated broker-dealers or relationships with unaffiliated broker-dealers which may provide a mechanism for money managers to compensate pension consultants, perhaps as a way to curry favor with the pension consultant.

- Many pension consultants have affiliates that also provide services to pension plan clients, which creates disclosure and conflict of interest issues.

- A significant portion of the pension consultants or their affiliates that provide products/services to money managers provided no or limited disclosure of material conflicts of interest.

- Many consultants ignore or are not aware of their fiduciary duties, including those under the Investment Advisers Act of 1940.

- Policies and procedures concerning conflicts and disclosures were inadequate.

Based on these findings, the SEC concluded that pension consultants should enhance their compliance policies and procedures to include those policies and procedures that will ensure that the adviser is fulfilling its fiduciary obligations to its advisory clients. In particular, the Report recommends that policies and procedures might include: (1) ensuring that their advisory activities are insulated from other business activities to eliminate or mitigate conflicts of interest in advisory activities; (2) making certain that all disclosures required to fulfill fiduciary obligations are provided to prospective and existing advisory clients; (3) preventing conflicts of interest or disclosing material conflicts of interest with respect to the use of brokerage commissions, gifts, gratuities, entertainment, contributions, donations and other emoluments provided to clients or received from money managers.

## Tips for Plan Fiduciaries

In light of the SEC's findings set forth in the Report, the SEC and the Department of Labor recommend the following ten questions for plan fiduciaries to ask their consultants:

1. Are you registered with the SEC or a state securities regulator as an investment adviser? If so, have you provided me with all the disclosures required under those laws (including Part II of Form ADV)?

2. Do you or a related company have relationships with money managers that you recommend, consider for recommendation, or otherwise mention to the plan for our consideration? If so, describe those relationships.

3. Do you or a related company receive any payments from money managers you recommend, consider for recommendation, or otherwise mention to the plan for our consideration? If so, what is the extent of these payments in relation to your other income (revenue)?

4. Do you have any policies or procedures to address conflicts of interest or to prevent these payments or relationships from being considered when you provide advice to your clients?

5. If you allow plans to pay your consulting fees using the plan's brokerage commissions, do you monitor the amount of commissions paid and alert plans when consulting fees have been paid in full? If not, how can a plan make sure it does not overpay its consulting fees?

6. If you allow plans to pay your consulting fees using the plan's brokerage commissions, what steps do you take to ensure that the plan receives best execution for its securities trades?

7. Do you have any arrangements with broker-dealers under which you or a related company will benefit if money managers place trades for their clients with such broker-dealers?

8. If you are hired, will you acknowledge in writing that you have a fiduciary obligation as an investment adviser to the plan while providing the consulting services we are seeking?

9. Do you consider yourself a fiduciary under ERISA with respect to the recommendations you provide the plan?

10. What percentage of your plan clients utilize money managers, investment funds, brokerage services or other service providers from whom you receive fees?

The Department of Labor and the SEC intend for these questions to encourage the disclosure and review of more and better information about potential conflicts of interest. The tips document is available on the Internet at http://www.sec.gov/investor/pubs/sponsortips.htm.

## Conclusion

ERISA imposes an obligation on plan fiduciaries to administer and manage employee benefit plans prudently and in the interest of plan participants and beneficiaries. Pension plan trustees and other fiduciaries should review the Report and heed the tips. We strongly recommend that all trustees and other fiduciaries contact their consultants to ask the questions in the joint release in order to evaluate whether their consultants are providing services to money managers and to make sure that their consultants have the policies and procedures in place that the SEC has recommended.

Plan trustees, pension consultants and other service providers can learn more about their fiduciary responsibilities under ERISA on the Department of Labor's Website (www.dol.gov).

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