

International Experts

[SEC Faults Pension Consultants On Ethics](#)

May 16, 2005

— Dow Jones Newswires

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Many U.S. pension consultants fail to disclose conflicts of interest that may hamper their ability to provide unbiased investment advice, according to a report that suggests widespread violations of securities laws.

The Securities and Exchange Commission announced the findings in a report released today. The agency said that the findings, which cap a 1 1/2 year investigation of the pension consulting industry, could potentially lead to enforcement action against some firms.

"It is my hope and expectation that these firms will be dealt with in an enforcement context," Lori Richards, the director of the SEC's Office of Compliance, Inspections and Examinations, told reporters.

The SEC review of 24 pension consultants found that 13 provided products and services to both, money managers and the corporate pensions, 401(k) plans, or foundations to whom they recommended money managers. The agency also found that 14 of the consultants were affiliated with brokerage firms, raising additional concerns about whether consultants were compromising their role as investment advisers.

"We didn't find that there were any recommendations that were made that resulted in monetary loss," the SEC's Richards said. "The harm here, if you will, is that these conflicts of interest have the potential to cloud the objectivity of the pension consultant's advice. Conflicts of interest are serious, even if you can't trace them to direct monetary harm."

More than 1,700 pension consultants are registered with the SEC under laws that require those consultants to act in the best interests of clients and to disclose any conflicts of interest.

Although the law has been on the books for more than six decades, pension consultants told the SEC that they didn't realize they had such obligations, the report found.

The SEC urged pension consultants to quickly come into compliance with longstanding disclosure requirements. It also said that it would work with the Department of Labor to help educate pension-fund trustees about conflicts in the pension-consulting industry that could be detrimental to the performance of the funds.

Among the most serious conflicts uncovered in the sweeping investigation was an arrangement in which one pension consulting firm appeared to be recommending money managers who steered stock trades its way. That sort of arrangement raises the possibility that the money managers were recommended because they generated extra fees for the pension consultant rather than because of their performance record.

"It indicated pretty clearly to me anyway that the conflicts of interest were actually manifesting themselves in the quality of recommendations that that firm was making," Richards said.

SEC inspectors were hampered in their investigation in part because many pension consultants had failed to keep adequate records, the agency said.

Inspectors found that many pension consultants had not maintained records such as e-mail communications that would allow regulators to determine whether investment recommendations were compromised.

— Dow Jones Newswires



SEC Eyes Pension Advisors

By Harriet Johnson Brackey

— The Herald

SEC Eyes Pension Advisors

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SEC targets pension board advisors

Securities and Exchange Commission says many consultants who advise pension boards collect hidden payments from investment firms and fail to reveal conflicts of interest. The SEC has launched an investigation.

Many pension consultants receive hidden payments from investment firms that also do business with their pension plan clients and they fail to disclose these conflicts of interest, according to a Securities and Exchange Commission report.

The SEC, which didn't disclose the names of any companies involved, said Monday that it has launched an investigation into these practices.

The report reverberated through Florida's thousands of public and private pension plans, which often rely on the advice of consultants from some of Wall Street's biggest names.

"When a consultant holds itself out as providing unbiased, objective advice, that obligation must be met", Lori Richards, director of the SEC Office of Compliance Inspections and Examinations Director, said in a statement released after the yearlong sweep of the industry.

SEC eyes pension advisors

These consultants help pension boards select investments, pick money managers and review their eventual performance, often for hefty fees.

In the public sector, every community has a local police, firefighter and municipal pension managed by boards made up of local elected officials, cops and firefighters. Most rely on the seeming experts they hire for advice.

Merrill Lynch is the leader in Florida, advising 93 public pensions from Jacksonville to Hallandale Beach.

Smith Barney Citigroup is also a major player, managing the Dade County Firefighters Insurance Trust Fund among others.

CITIZENS LOSE MILLIONS

"The citizens of Florida are losing hundreds of millions of dollars," said Edward A.H. Siedle, president of Benchmark Financial Services in Ocean Ridge. His firm makes money by investigating pension funds and looking for money management abuses.

Siedle is a former SEC attorney who says he has examined pension records in a dozen Florida cities and has found numerous problems. These include compensation deals he says could be netting consultants 10 times more than the consultants discloses.

Merrill declined to comment for this story. Smith Barney's Florida pension consultant declined to comment.

The SEC looked at 24 pension consultants who are registered with the SEC as investment advisors. If found:

- More than half the consultants sell products and services to both their pension plan clients and money managers or mutual funds.
- Consultants host conferences that pension board members attend for free. Money managers pay to be present. Their fees can be channeled to cover the travel costs of the pension board members. Some of these are reportedly elaborate events in exotic locations.
- Most consultants have a relationship with a broker dealer that provides a channel for money to flow back to the consultant "perhaps as a way to curry favor."



- Many consultants don't disclose conflicts of interest arising from these practices.

"I hope the boards will read and understand the report," said Joe Bogdhan, an independent pension consultant from Winter Haven, Fla.

He says pension boards regularly overpay for services such as stock trades because of the cozy relationship between brokers and money managers. "If they go back and do audits for the past 10 years, they'll be amazed at how much they've paid," he said.

Another issue raised by the SEC report: Many consultants wrongly believe that they are not legally required to be fiduciaries for their plans. A fiduciary is required to put the interest of the client first.

DISCLOSURES SOUGHT

Kenneth Ingham, whose Miami firm Ingham Group advises more than 600 pension plans, says that if a broker gets a fee from a money manager of commissions on stock trades from a pension fund client, the broker should disclose that and rebate it to the fund. "The problem is most brokers don't," he said.

The report, he says, "will likely cause major changes in the way thousands of small public and private pensions view their advisors.

The SEC is calling for pension consultants to separate their consulting activities from other businesses, to increase disclosure and put policies in place to prevent conflicts of interest.



Study Hints At Bias of Advisers On Pensions

By Albert B. Crenshaw

— Washington Post

Study Hints At Bias of Advisers On Pensions

By Albert B. Crenshaw

Many of the firms that provide advice to operators of pension and 401(k) plans appear to have undisclosed financial ties to companies whose services they recommend, according to a study released yesterday by the Securities and Exchange Commission.

The study, though of a small sample of the more than 1,700 registered investment advisers that provide pension-consulting services, raises questions about whether pension-plan operators and 401(k)-plan participants always get the unbiased advice required by federal law, SEC officials said.

"Pension consultants provide important advice to pension plans and their trustees with respect to identifying and selecting the money managers to manage the plan's money," said Lori Richards, director of the agency's Office of Compliance Inspections and Examinations.

More than half the consulting firms examined were found to provide products and services, such as software and consulting, to money managers and mutual funds at the same time they were helping pension plans choose such providers.

"In essence, these pension consultants have business ties to the same money managers who are vying for their attention to be recommended by the pension consultant" to the consultant's clients, Richards said.

And while the data the agency obtained from most of the consultants did not enable it to determine whether consultants skewed their recommendations to favor managers, in three of the six firms where such analysis was possible, it found that the consulting firm recommended money managers who purchased services from it more frequently than those that did not.

About a third of the consulting firms studied had a brokerage arm and provided brokerage services to pension plans and 401(k) plans they advised.

The study did not find evidence that money was lost by a pension plan as a result of the conflicts, but in the case of 401(k) plans, the "ultimate harm that could be caused" would be that the investment choices provided to an employee "would be based not on the money manager or mutual fund that is best for that employee but based on whether or not the pension consultant has received payment from that mutual fund," Richards said.

In addition, few consultants informed pension-plan clients of these relationships. Richards described disclosure information ranging from "none to very poor." She said most consultants did not realize that by law they have a fiduciary duty to the pension plan and must put the plan's interests ahead of their own.

The study, which began in December 2003, covered only 24 consulting firms, but Richards said they represented a "cross-section of the industry," which ranges from one-person operations to firms with several hundred employees. The firms included in the study were not identified.

"We do think these findings are very serious," Richards added.

Where the study turned up apparent violations of the law, she said, "our enforcement division is investigating. It is my hope and expectation that these firms will be dealt with in an enforcement context."

Richards said the SEC's aim is to prompt fuller disclosure by consultants and more and better questions by pension-plan sponsors and trustees. "I think disclosure will go a long way," she said.

But while sponsors of traditional pension plans have an incentive to pay attention to such disclosures -- the employer typically is obligated to make up any investment shortfall out of its own pocket -- sponsors of 401(k) and similar plans might not. In these retirement-investment plans, problems such as poor investment performance and high mutual-fund fees hurt workers but do not necessarily have much impact on the employer.

Richards said the law does not appear to require plans to disclose consulting relationships to workers.

— Washington Post



Wake Up Call For Trustees

By Shawn Harris

— Finance Week

Wake up call for trustees - Hidden costs draining retirement funds

By Shawn Harris

Many of the firms that provide advice to operators of pension and 401(k) plans appear to have undisclosed financial ties to companies whose services they recommend, according to a study released yesterday by the Securities and Exchange Commission.

Invest products and management fees are becoming an increasingly contentious subject, heightened no doubt by the current low inflation, lower return environment. Though an additional 50 basis points now coming off performance has a noticeable effect, it's remarkable how many private investors and even retirement fund trustees seem blissfully unaware of exactly what they're paying for adviser commissions, administration costs and management fees.

There also seems to be a perception gap between what can be termed the broad service provider industry and clients paying for that service. Service providers, which in many cases have seen margins squeezed over the past few years, argue that the value they can add is at least well worth the cost, or that their share of the value chain is too low.

Perhaps not surprisingly, clients who examine costs and independent bodies that monitor those costs argue the opposite.

Having listened recently to a number of investment industry heavyweights argue convincingly and eloquently regarding providing investors with value for money and analysing the value chain at the annual Momentum Investment Summit. I was intrigued to read a paper by Karin Biggs, partner in the retirement funds division at Ernst & Young, criticising both retirement and fund trustees and service providers for losing "hundreds of millions of rand" a year from retirement funds.

Biggs's contention is that poor disclosure of fees on the part of service providers and failure to understand the full costs or push for full disclosure from trustees before signing long-term service agreements resulted in the loss to retirement funds and, ultimately, ordinary members' retirement benefits.

Biggs says: "More often than not, trustees are oblivious to the conditions of these agreements, what they entail and how much they will cost. Trustees have to ask the questions and get the service providers to disclose the relevant information."

But who are the service providers guilty of this poor or non-disclosure? Biggs says that it's often the fund administrators and asset managers - an answer that surprised me, as they feel that they're on the receiving end of the value chain.

A number of institutional asset managers will also tell you that margins for retirement fund business are unbearably tight due to competition and the collective bargaining power of large retirement funds and investment advisers.

Sure, an industry stalwart such as Tim Cumming, director of global developments at Old Mutual Asset Managers in the United States, can take an international perspective regarding the industry and explain why the structure of the industry in SA and smaller market results in some higher fees from SA asset managers and administrators.

However, the issue here isn't so much about absolute costs but rather hiding or disguising those costs, perhaps to take advantage of less financially sophisticated trustees. When that takes place, the perpetrators ought to be named and shamed, but it's difficult to prove.

But it gets worse. Biggs adds that while the retirement fund sector is governed by legislation that compels service providers to disclose all information, trustees cannot seek legal redress "if they themselves have not sought out this information from their service providers prior to signing the contract".

So it appears that trustees who negligently sign a service agreement will to grin and bear the additional costs. And hope that retirement fund members don't find out - or they could face a lynch mob back at the office.

Is this poor disclosure deliberate on the part of service providers or simply due to lack of sufficient financial training for trustees? Biggs feels that it's a bit of both, but that at times disclosure in documents is deliberately complicated or full costs and commissions are hidden outright to "earn more fees".

So what can trustees do? Biggs says that it's important when selecting a service provider that trustees set clear objectives and criteria upfront before sending a contract out to tender. It's also important to monitor the service level agreements trustees enter



into, particularly regarding the operational side.

Hiring an investment consultant to scrutinise costs should also avoid potential hidden fees and commissions, but Biggs cautions that trustees must ensure that the consultant is truly independent of the service providers. Investment consultant fees should as a matter of course also be carefully analysed and justified if necessary.

Biggs says: "The immediate challenge for trustees is to obtain the necessary and required skills and knowledge to successfully manage and control the functions and operations of retirement fund."

— Finance Week



Further Reading

Conflicts of Interest and Risk Governance

Carlo V. di Florio

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<https://www.sec.gov/news/speech/2012-spch103112cvdhtm>

