

SHOW ME THE MONEY!

Given the increased scrutiny being placed on the investment community, along with the spotlight now being placed specifically on pension consultants, it is important and timely for trustees to make sure that all advisors to the plan are acting in the best interests of the plan.

Many Boards have engaged pension attorneys to assist them with making sure that they and their service providers are complying with the numerous legal issues governing the administration of their plans. Most Boards have been told that it is important that they understand their proxy voting policy and be aware of the corporate governance quotient of the individual securities in the funds. While these items are important, the overriding responsibility for implementing these issues into the investment process falls on the investment manager. The investment manager's prudent use of these tools is measured regularly through comparisons of their performance against various benchmarks and peer universes.

The 'Consultant Issue' is one of the most pressing and important topics facing pension trustees. In the event that the investment consultant is receiving undue compensation, this constitutes a direct loss to the plan and increases the funding requirement by the plan sponsor. In addition, a trustee allowing the undue compensation may be guilty of breaching their fiduciary duty by allowing the excessive compensation.

In order to assist the trustees in compiling accurate information, we have created the attached questionnaire. **Use it!** Consultants who are 'playing by the rules' will have no problem completing this type of questionnaire. Those who protest should be reviewed more thoroughly.

The following are a few of the underlying concepts governing investment consultants in the Florida municipal pension environment:

- ◆ A fiduciary has a duty and an obligation to place the interests of the Board of Trustees and the fund ahead of their personal and firm's interest. A fiduciary also has a duty and an obligation to fully disclose, in writing, any potential conflicts of interest.
- ◆ Under the Investment Advisors Act of 1940, advisors registered with the United States Securities and Exchange Commission are required to provide full disclosure to clients regarding their allocation of client brokerage.
- ◆ The Uniform Securities Act requires registered investment advisory firms to disclose any material conflict of interest that could impede an investment adviser's ability to provide unbiased and objective advice to a client. This disclosure must be provided in writing before any advice is rendered. This includes any compensation the adviser will receive from sources other than directly from the client. (i.e. mutual fund commissions, etc.)



Who is your Consultant's Client?

As public pension fund trustee, you **MUST** ensure that providers are upholding their fiduciary duties. Given your fiduciary capacity, you need to ask the following questions of your consultant. Request a response in writing and ask that the response be signed by the corporate (not local) compliance officer.

For the real answer, always follow the money!

- 1) Does your firm accept the role of a fiduciary to our plan?
- 2) Does the investment consultant **sponsor client conferences, outings or "institutes"**?
 - *If so, are money managers paying the consultant for inclusion?*
 - *If so, how much is paid?*
 - *If so, how often does a paying money manager end up in the consultant's finals presentations? Additionally, what percentage of finals "winners" have paid to attend consultant conferences?*
 - *How can I, as fiduciary, be assured that this level of financial support will not impair the consultant's selection and evaluation of money managers?*
- 3) Does the consultant own or have an **affiliation with a broker**?
 - *If so, what percentage of trades is executed through that broker?*
 - *If so, what commissions were paid versus what would have been paid strictly on an execution-only basis?*
 - *If so, has the consultant received 12b-1 fees for mutual fund trades?*
 - *Additionally, has the consultant received "finders fees," sub-accounting fees or sub-transfer agent fees above and beyond traditional 12b-1 fees?*
 - *Does the consultant rebate all of the 12b-1 fees paid by the client or does the clearing/executing broker retain a portion of the fee? (Consultants with affiliated brokers may rebate all of the "net" proceeds to client accounts; however, the clearing/executing broker will collect a fee (typically 10% or more of the 12b-1 fee) prior to the rebate. Be cautious of the phrase "We rebate/credit 100% of the proceeds we receive.")*
- 4) Does the consultant **sell guidance to money managers** regarding how they can best position themselves to win business?
 - *Managers often purchase such services to maintain "visibility" with the consultant.*
- 5) Does the consultant **sell performance reports/charts** to money managers?
 - *Managers often purchase such products to maintain "visibility" with the consultant.*
- 6) Does the consultant's firm (or parent company) have an **ownership interest in a money management firm**?
 - *If so, has the money management firm been introduced by the consultant in searches?*
- 7) Does the consultant maintain an "open door" policy toward manager meetings or **are there impediments or hurdles that need to be met prior to consideration for client accounts**?
 - *Does the consultant charge managers a fee to post data on its proprietary database?*
 - *Are managers expected to participate (for a fee) in consultant-sponsored events/outings? Randomly sample several recent searches and request the names of the finals candidates that have never paid the consultant (in hard dollars or trading "soft dollars") for conferences, charts or consulting services.*

FINALLY - Verify the consultant's responses with money managers!

- *Ask money managers if they've made direct or indirect payments (brokerage) to the consultant.*
- *Ask managers if they run trades of their other clients through the consultant's affiliated broker. Be aware that this might give the appearance of breaking the link between your business with the consultant and the manager's business with the consultant, even though one exists.*

REMEMBER - The best way to manage conflicts is to avoid them!