TUCKER ELLIS & WEST LLP
ATTORNEYS AT LAW

CLIENT ALERT **MAY 2005**

SEC STAFF RELEASES REPORT ON PRACTICES OF INVESTMENT ADVISERS THAT ACT AS "PENSION CONSULTANTS"

On May 16, 2005, the Staff of the U.S. Securities and Exchange Commission released a report commenting on focused examinations it conducted of a cross-section of Commission-registered investment advisory firms that indicated they provided services as pension consultants. As a result of the examinations, the Staff expressed concerns about several practices of pension consultants, including undisclosed conflicts of interest and the lack of adequate policies and procedures.

The report should be of interest not only to pension consultants but also to sponsors of pension plans and money managers who receive referrals from pension consultants. Moreover, the principles underlying the report apply equally to state-registered investment advisers.

As described by the Staff, pension consultants provide advice to pension plans and their trustees with respect to a broad spectrum of issues such as:

- Identifying investment objectives and restrictions
- Allocating plan assets to achieve various objectives
- Selecting money managers
- Selecting mutual funds in which plan participants self-direct their investments
- Monitoring the performance of money managers and mutual funds and making recommendations to hire or fire money managers
- Selecting other service providers, such as custodians, administrators or broker-dealers.

The Staff indicated that about 1,742 SEC-registered advisers provide pension consulting services.

The Staff noted that some pension consultants are "pure play" firms that offer only pension consulting services. Many, however, offer pension consulting services as part of a wider array of services. The Staff took particular note of advisers who provide services both to pension funds and to money managers that might be hired by those pension funds.

According to the Staff, "Concerns exist that pension consultants may steer clients to hire certain money managers and other vendors based on the pension consultant's (or an affiliate's) other business relationships and receipt of fees from these firms, rather than because the money manager is best-suited to the clients' needs." The Staff also questioned the extent to which pension consultants disclose these conflicts of interest. In some cases the Staff found that the contractual arrangements between pension consultants, their clients, and third parties were not well-documented.

The Staff also noted that many pension consultants who took care to insulate themselves from being fiduciaries under

ERISA appeared to be unaware that they *are* fiduciaries under the Investment Advisers Act of 1940. The Staff criticized firms for failing to tailor their written policies and procedures to their circumstances and, in particular to mitigate conflicts of interest.

Given the examination findings, the Staff concluded "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 Staff suggested that pension consultants should review their business operations to identify conflicts of interest and then design policies and procedures that address those risks. For example, pension consultants might include policies and procedures to:

- Ensure that the firm's advisory activities are insulated from its other business activities
- Ensure that all disclosures to fulfill fiduciary obligations are provided to current and prospective clients
- Prevent or disclose material conflicts of interest arising from brokerage commissions, gifts, gratuities, entertainment, contributions, donations, and other benefits received from money managers.

We believe that the Staff report is issuing "a shot across the bow" of pension consultants to warn them that they may be subject to increased scrutiny and that a continuing failure to meet the Staff's expectations will not be favorably received. In other words, if future routine examinations of firms providing pension consulting services demonstrate that the firms have not taken actions of the types recommended by the Staff, the Staff will feel that they have already given fair warning.

The Commission has a range of actions available to it, including censure or suspension or revocation of registration. To remedy a situation without using these formal sanctions, the Staff might pressure an adviser to send its clients notices to the effect that the adviser's past practices are considered inadequate by the Commission and announcing corrective action.

Advisory firms that provide pension consulting services, whether as their core business or only as a small portion of their business, should evaluate their pension consulting practices to identify potential conflicts of interest and then adopt polices and procedures tailored to those circumstances.

The full report is available at the website of the Commission: www.sec.gov. If you have any questions concerning the report or its possible application to your firm, please contact your regular Tucker Ellis & West LLP attorney or any of the following:

Glenn E. Morrical 216-696-3431
gmorrical@tuckerellis.com

Michael F. Harris 216-696-3738
mharris@tuckerellis.com

David S. Lu 216-696-5590
dlu@tuckerellis.com

Craig T. Gretter 216-696-2879
cgretter@tuckerellis.com