

DOL and SEC Tell Pension Plan Fiduciaries to Assess Third Party Consultants

Pension plan fiduciaries are being reminded that they have an obligation to closely monitor the actions of third party pension consultants, with a particular emphasis on uncovering consultants' potential conflicts of interest. A joint publication, titled "*Selecting and Monitoring Pension Consultants*" was published June 1st by the U.S. Department of Labor ("DOL") on the Employee Benefit Security Administration website at <http://www.dol.gov/ebsa/newsroom/fs053105.html>, and concurrently on the U.S. Securities and Exchange Commission ("SEC") website, in the form of a "Fact Sheet." Issuance of this guidance closely follows a SEC staff report that raised "serious questions" regarding the potential conflicts of interest for pension consultants that could affect their objective advice to pension plan fiduciaries.

The joint DOL-SEC guidance goes to the heart of ERISA's requirement that fiduciaries of employee benefit plans administer and manage their plans prudently and for the exclusive benefit of plan participants and beneficiaries. Anyone who exercises discretionary authority or control over the management or administration of an ERISA plan, or who exercises any authority or control over the management or disposition of plan assets is a fiduciary. In the last few years, plan fiduciaries have seen a dramatically increased focus on their responsibilities, resulting in dozens of class action lawsuits alleging that fiduciaries have breached their duties with respect to certain requirements, such as the selection and monitoring of prudent investments, providing required disclosures, and the appointment of independent advisors.

The Fact Sheet also reminds plan sponsors that, in addition to ERISA's fiduciary requirements, an investment advisor providing consulting services has a fiduciary duty under the Investment Advisors Act of 1940 (the "Advisors Act") to provide disinterested advice and disclose any material conflicts of interest to clients. The consulting services of particular concern to the SEC are (a) assisting in determining a plan's investment objectives, (b) allocating plan assets, (c) selecting money managers, (d) choosing mutual fund options, (e) tracking investment performance, and (f) selecting other service providers such as custodians, administrators, and broker-dealers. In a review of 24 of the approximately 1,742 SEC-registered investment advisors who indicate that they provide pension consulting services, the SEC staff concluded that business alliances among pension consultants and money managers can give rise to "serious potential conflicts of interest" under the Advisors Act that must be monitored and disclosed to plan fiduciaries.

In order to evaluate the objectivity of recommendations provided by a plan's pension consultant, the DOL and SEC have developed a set of ten questions that plan fiduciaries should pose to the plan's consultants to elicit the information necessary to identify potential conflicts of interest, including:

- Do you or a related company have relationships with money managers that you recommend, consider for recommendation, or otherwise mention to the plan? If so, describe those relationships.
- 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)?
- 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 over-pay its consulting fees?

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- 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?
- If you are hired, will you acknowledge in writing that you have a fiduciary obligation as an investment advisor to the plan while providing the consulting services we are seeking?
- What percentage of your plan clients utilize money managers, investment funds, brokerage services or other service providers from whom you receive fees?

In light of the attention both the DOL and SEC are paying to potential conflicts of interest of a plan's consultants, plan fiduciaries should diligently assess their consultants to identify any conflicts that could impair their ability to provide objective, disinterested advice for the benefit of the plan's participants.

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Fact Sheet

**U.S. Department of Labor
Employee Benefits Security
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Selecting And Monitoring Pension Consultants - Tips For Plan Fiduciaries

The Employee Retirement Income Security Act (ERISA) requires that fiduciaries of employee benefit plans administer and manage their plans prudently and in the interest of the plan's participants and beneficiaries. In carrying out these responsibilities, plan fiduciaries often rely heavily on pension consultants and other professionals for help. Findings included in a report by the staff of the U.S. Securities and Exchange Commission released in May 2005, however, raise serious questions concerning whether some pension consultants are fully disclosing potential conflicts of interest that may affect the objectivity of the advice they are providing to their pension plan clients.

Under the Investment Advisers Act of 1940 (Advisers Act), an investment adviser providing consulting services has a fiduciary duty to provide disinterested advice and disclose any material conflicts of interest to their clients. In this context, SEC staff examined the practices of advisers that provide pension consulting services to plan sponsors and trustees. These consulting services included assisting in determining the plan's investment objectives and restrictions, allocating plan assets, selecting money managers, choosing mutual fund options, tracking investment performance, and selecting other service providers. Many of the consultants also offered, directly or through an affiliate or subsidiary, products and services to money managers. Additionally, many of the consultants also offered, directly or through an affiliate or subsidiary, brokerage and money management services, often marketed to plans as a package of "bundled" services. The SEC examination staff concluded in its report that the business alliances among pension consultants and money managers can give rise to serious potential conflicts of interest under the Advisers Act that need to be monitored and disclosed to plan fiduciaries.

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To encourage the disclosure and review of more and better information about potential conflicts of interest, the Department of Labor and the SEC have developed the following set of questions to assist plan fiduciaries in evaluating the objectivity of the recommendations provided, or to be provided, by a pension consultant.

- 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](#))?**

You can check yourself - and view the firm's Form ADV - by searching the [SEC's Investment Adviser Public Disclosure Web site](#). At present, the IAPD database contains Forms ADV only for investment adviser firms that register electronically using the Investment Adviser Registration Depository. In the future, the database will expand to encompass all registered investment advisers-individuals as well as firms-in every state. If you can't locate an investment adviser in IAPD, be sure to contact your [state securities regulator](#) or the [SEC's Public Reference Branch](#).

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

When pension consultants have alliances or financial or other relationships with money managers or other service providers, the potential for material conflicts of interest increases depending on the extent of the relationships. Knowing what relationships, if any, your pension consultant has with money managers may help you assess the objectivity of the advice the consultant provides.

- 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)?**

Payments from money managers to pension consultants could create material conflicts of interests. You may wish to assess the extent of potential conflicts.

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

Probing how the consultant addresses these potential conflicts may help you determine whether the consultant is right for your plan.

- 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 over-pay its consulting fees?**

You may wish to avoid any payment arrangements that could cause the plan to pay more than it should in pension consultant 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?**

Where and how brokerage orders are executed can impact the overall costs of the transaction, including the price the plan pays for the securities it purchases.

- 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?**

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As noted above, you may wish to explore the consultant's relationships with other service providers to weigh the extent of any potential conflicts of interest.

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?

All investment advisers (whether registered with the SEC or not) owe their advisory clients a fiduciary duty. Among other things, this means that advisers must disclose to their clients information about material conflicts of interest.

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

If the consultant is a fiduciary under ERISA and receives fees from third parties as a result of their recommendations, a prohibited transaction under ERISA occurs unless the fees are used for the benefit of the plan (e.g., offset against the consulting fees charged the plan) or there is a relevant exemption.

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

The answer may help in evaluating the objectivity of the recommendations or the fiduciary status of the consultant under ERISA.

For more information on the SEC staff's findings, please read [Staff Report Concerning Examinations Of Select Pension Consultants](#) . Plan trustees, pension consultants, and other service providers can learn about their fiduciary responsibilities under the Employee Retirement Income Security Act (ERISA) by visiting the Web site of the [U.S. Department of Labor](#). Pension consultants who have questions concerning their obligations under the Investment Advisers Act of 1940 should either consult with an attorney who specializes in the federal securities laws or contact the staff of the [SEC's Division of Investment Management](#).

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