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## Unmasking That Pension Consultant

IT'S something of a mystery why the huge and presumably powerful public pension funds in this country have been so loath to investigate whether they have been hurt by their consultants' conflicted loyalties. After all, the biases in these organizations are of enough concern to the Securities and Exchange Commission that it has conducted an industrywide investigation of pension consultants and may recommend enforcement actions against some of them.

Well, last week, the ice finally began to crack on this important issue. The board of the Public School Teachers' Pension and Retirement Fund of Chicago is reviewing a proposal to conduct a comprehensive conflict-of-interest audit of its investment consultant, Mercer Inc., a unit of [Marsh & McLennan](#). The fund has \$10.3 billion in assets and has been a Mercer client since 1990.

It may seem like a baby step, but remember that this is the don't-rock-the-boat pension world. Among these often meek managers, it is literally a shot across the bow.

If the Chicago teachers' fund goes ahead with the audit - it will decide next month - it may very well encourage other pension funds to conduct similar investigations.

It's about time.

Some \$5 trillion sits in pension funds nationwide. Their beneficiaries are teachers, firefighters, bus drivers and other public employees, as well as workers at private companies that still offer traditional pensions for retirement.

The people who run these pension funds hire consultants to help them identify the best money managers with whom they should invest. Unfortunately, these consultants can also receive revenue from money managers for other services the consulting firms provide. These financial arrangements between money managers and consultants can increase a pension fund's costs and lead to biased advice about money managers. Investment performance can be compromised.

But dubious pension consultant practices affect more than just retirees. If the pension funds don't earn

enough to meet their obligations, taxpayers in the affected towns and cities will have to pay the difference.

Pension consultants come in all sizes. Some work in small companies, others as part of larger organizations. Recently, big Wall Street brokerage firms have stepped up their pension consultant operations.

Consultants have a fiduciary duty to their clients and must disclose any potential conflicts of interest in their operations. When they have affiliations with firms that conduct trades for the pension funds they advise, these relationships can undermine the duty to put clients' interests first. Some relationships are hidden from view; a consultant can hire a money manager who agrees to funnel all trades through the consultant's brokerage arm, and the transaction costs are rarely spelled out. Another source of conflict has been the practice among big consulting operations like Mercer's and Callan Associates, a private company in San Francisco, to sponsor conferences at sumptuous resorts where money managers pay to mingle with pension fund overseers. The trouble with such arrangements is that the consultants may be tempted to recommend to their pension fund clients only those managers who pay to attend.

Mercer stopped holding conferences last year. But Callan and other consulting firms still sponsor them.

While such conflicts among consultants have existed for years, few pension funds have done anything about them. Some funds have hired small, independent consultants without the ancillary operations that create conflicts. A handful of pension funds have sued their consultants and received money in settlements.

For years, a trustee of the Chicago teachers' fund had requested a complete accounting from Mercer of the compensation it received from the fund managers it had recommended. For years, Mercer declined to comply, citing confidentiality agreements with the money managers.

Last year, Mercer became more forthcoming with the fund about the revenues it received and their sources, said Kevin Huber, the interim executive director of the fund.

Stephanie Poe, a Mercer spokeswoman, said that since Mercer began working with the teachers, the fund had outperformed its benchmarks. Mercer, she added, has provided all the information the fund sought relating to potential conflicts.

EDWARD A. H. SIEDLE, president of Benchmark Financial Services in Ocean Ridge, Fla., and a former lawyer for the S.E.C., investigates money management abuses on behalf of pension fund clients. If the Chicago teachers' fund decides to audit Mercer, Mr. Siedle will conduct the inquiry; he will not charge for his services.

"Our investigations reveal that investment consultant pay-to-play schemes involving collusion with money managers have cost funds amounts ranging from 10 to 15 percent of assets," Mr. Siedle said.

Ms. Poe said that Mr. Siedle was a frequent critic of Mercer and was involved in litigation against another Marsh unit. "While we welcome any objective independent review of our work," she said, "we question whether such an audit by this person can by its very nature be objective."

Mr. Siedle said that he was, in fact, now investigating four Mercer rivals and would have recommended an audit of the Chicago fund regardless of who its consultant was. The S.E.C. and the Labor Department have recently sought his views on issues involving pension consultants.

The Chicago fund recently put its consulting contract up for bid from other providers. Mr. Huber said this was not because of concerns about Mercer.

The fund hasn't done this since 1999, Mr. Huber said. "It's time to do it again to make sure we're getting a competitive price."

But price is rarely the whole story. Conflicts are costly but often come to light only after serious digging.

Here's hoping that other funds will follow the teachers' lead.