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Can Pension Clients Be Hazardous To Your Financial Health?

by Susan M. Mangiero of Pension Governance, LLC

Despite a recent study that all is okay in corporate pension land, changes are taking place to indicate otherwise. Preparing for lots of pension buy-out business, investment banks hire actuaries in droves. Swap trading desks are similarly staffed, anticipating a surge in liability-driven investing. CPA firms scurry to find qualified professionals who can handle the alphabet soup of new accounting rules. Even those who breathed a sigh of relief with the final enactment of the Pension Protection Act of 2006 acknowledge the beginning of the end of "the way things were." Board members, CEOs, and CFOs wait for the other shoe to drop, assuming that the sequel to FAS 158 will compel wide swings in earnings. Congress and regulatory agencies busy themselves with a flurry of investigations. On top of everything else, longevity is forcing plan sponsors to rethink how to cut costs without alienating productive workers. The only constant is change. For traders who embrace volatility, life is good. For those in search of stability, hang onto your hats.

With all of this tumult underway, a little noticed trend seems to be emerging that could make pension clients high risk for service providers - asset managers, brokers, bankers, administrators, custodians, advisors, consultants, auditors, and ERISA counsel. At its simplest, there is a real question as to who has investment fiduciary responsibilities other than the plan sponsor. Some organizations wear the hat of fiduciary but charge steep fees to compensate for added liability exposure. Others disavow the role, going so far as to include text to that effect in their engagement letter. However, real questions remain. Will judges uphold the legitimacy of this stance or instead classify a service provider as a functional fiduciary against their will, thereby opening the door to claims of breach? If that occurs, asset managers, consultants, and other persons peripheral to a plan sponsor get the worst possible outcome – increased liability exposure without compensation.

Perversely, those who keep information secret as a way to avoid fiduciary status may be doing just the opposite. According to independent fiduciary Matthew D. Hutcheson, "When a person or institution claiming to be a non-fiduciary under ERISA withholds relevant information that alters future plan outcomes, he or she exercises control by degree and becomes a fiduciary at that very moment. The irony is breathtaking. Withholding relevant information from plan sponsors could in and of itself be construed a fiduciary act, carrying with it fiduciary implications."

Are service providers more vulnerable now than ever before? ERISA attorney Linda A. Ursin describes "mounting evidence that 'fiduciary' could be the veritable 'F' word for any one working with plan sponsors." Repeated negative headlines suggest a growing impatience with those who do not take good process seriously, including any experts hired by plan sponsors who are conflicted or do less than a thorough job. Additional disclosure rules lift the veil off structural funding problems with post-employment benefit plans and hasten the need for effective solutions and a demonstrated due diligence on the part of all relevant players.

Forthcoming elections and ongoing Congressional inquiries render questions about procedural prudence with respect to the role of the service provider that much more urgent. A large enough loss could conceivably trigger a populist response that external parties should have "known better" and failed to aid the "poor, well-meaning, understaffed" pension fund. Politicians, eager to install their choice for president next year, are in full dress mode for finger pointing.

Tracking lawsuits is another gauge of what appears to be a trend in going after the service provider. Anyone who reviews financial statements, renders investment advice, or manages money for retirement accounts is likely fair sport. Sub-par performance or outright losses agitate plan participants into filing complaints. Deep pockets and a temptation to assign blame make Wall Street a primary target. Fees, transparency, interdependencies, operational controls, and suitability are now regularly appearing on courthouse dockets across the nation. Regardless of whether a case settles or not, mounting a defense can cost millions, and negative headlines may linger in the form of diminished market share.

Valuation of instruments, for which no ready trading market exists, is one example of the "service provider dilemma." Even as the SEC announces its intent to investigate valuation practices employed by hedge funds, identifying who assumes responsibility is clear as mud. Is it the administrator, prime broker, pension consultant, or fund of funds manager who should and does take charge? After all, performance determines fees and likewise influences trade re-balancing or changes in overall asset allocation strategy. "It's not my job" is going to get someone in trouble if valuations tank and a hedge fund goes out of business, leaving pension investors holding the bag. The creators of the new database www.pensionlitigationdata.com cite hundreds of investment cases tied to allegations of fiduciary breach.

The bottom line is that pension woes will adversely impact plan participants, shareholders and possibly taxpayers. To the extent that service providers play a role in perpetuating trouble – perceived or real - they too will become part of the mix. What's the remedy? The best practices along the transaction continuum offer plan sponsors and vendors alike a chance to work together in an operating environment that is anything but static.

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