

Trusted Advisers

Navigating a plan's relationship with its investment consultant

PERHAPS the most important trusted adviser to an employee benefit plan is its investment consultant. A retirement plan often will rely upon its investment consultant to help formulate investment policies, develop asset-allocation methodologies, recommend investment managers, and measure and evaluate investment performance. The Department of Labor (DoL) has long held that a plan's use of an investment consultant is evidence of procedural prudence.

However, the plan's fiduciaries must ensure that the advice the plan is receiving from its investment consultant is unbiased, free of conflicts, and focused on meeting the investment objectives of the plan. Federal regulators have increased their scrutiny of potential conflicts between an investment consultant and its plan client, or conflicts outside that client relationship involving the consultant and third parties.

In recent years, the Securities and Exchange Commission (SEC) has issued reports based in part on the agency's concern that investment consultants were placing clients' plans in investment products that paid the highest compensation to the investment consultant. The SEC and DoL also have issued guidance for plans reminding their fiduciaries to ask for more information and solicit answers to questions that will reveal potential conflicts of interest.

The DoL's national office also has opened a Consultant/Adviser Project (CAP) as part of its national enforcement initiatives. This enforcement project is aimed at investigations "seek[ing] to determine whether the receipt of...compensation, even if disclosed, violates ERISA because the consultant/adviser used its position with a benefit plan to generate additional fees for itself or its affiliates."

In the DoL investigations we are defending, we have seen increased scrutiny by the DoL on consultant conflicts. In particular, the focus by the DoL has been on the types of internal quality controls and oversight procedures that a plan has in place to ensure that there is no personal, business, or financial relationship between the plan's investment consultant and a proposed investment manager, or between the proposed manager and the plan's fiduciaries. The breach of fiduciary

duty lawsuits that are being brought under ERISA or state law that involve the services provided by investment consultants also focus on impermissible and undisclosed conflicts of interest. Some of these lawsuits involve alleged "pay-to-play" schemes whereby an investment consultant allegedly received "kickback" fees from investment managers it ultimately recommended to a plan. The most notorious of these conflict cases involve, of course, Bernard Madoff and his brokerage firm. Plaintiffs in these cases have alleged that the investment consultants turned a blind eye to the red flags involving investing directly or indirectly with Madoff because of the enormous fees the investment consultant would earn based on the placement of those investments with Madoff.

It is safe to say that the DoL and the plaintiffs' bar will continue to pay close attention to conflicts of interest in the investment consultant space for years to come.

In view of the current regulatory and legal environment, we offer the following tips to ensure that plan fiduciaries understand and appreciate any potential conflicts of interest involving their investment consultants. First, plan fiduciaries may want to solicit written representations from any prospective investment consultant regarding any personal, business, or financial relationship between the prospective consultant and the plan's fiduciaries. Second, the plan may want to amend its investment policies to include a requirement that its investment consultant represent when recommending an investment manager that, to the best of the consultant's knowledge, there is no personal, business, or financial relationship between the consultant and the proposed manager. Finally, plan fiduciaries may want to adopt a formal policy requiring that any investment recommendation be made through its investment consultant (in which any potential conflict of interest presumably has been vetted).

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