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Regulators Put Consultant Conflicts in Crosshairs

By Alyson Velati

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The Securities and Exchange Commission (SEC) is expected to follow the lead of other international regulators that are digging into the investment consultant and fiduciary management industry and move forward with an inquiry of its own, according to industry watchers.

Specifically, a recent investigation launched by a U.K. financial watchdog could spur the SEC to further probe the investment consultant industry, particularly firms that offer fiduciary management services and have outsourced CIO (OCIO) businesses, according to **Amy Lynch**, founder and president of **FrontLine Compliance**, a compliance services firm.

Conflicts within the investment consultant industry have previously been on the SEC's radar. But it has been years since the regulators have done a deep dive on these firms.

In January 2016, the SEC tagged "public pension advisers" as a top regulation priority, as reported. The SEC's exam unit was scheduled to "examine advisers to municipalities and other government entities, focusing on pay-to-play and certain other key risk areas related to advisers to public pensions, including identification of undisclosed gifts and entertainment." However, to date, further examinations have not come to fruition.

The SEC previously set its sights on investment consultants in May 2005, when the agency released a report that highlighted the results of an investigation of consultant firm practices. The agency revealed that more than half of the 24 consultants that were reviewed had provided services and products to both pensions and managers, leaving open the possibility of conflicts. The SEC cleared some consultants following the examination.

But, other consultants were sued following the SEC investigation.

Callan Associates was accused by the city of San Diego for giving special treatment to money managers that paid extra fees for educational and consulting services, as reported in 2005.

The consultant was later sued in 2006 by a retiree from the Illinois Teachers' Retirement System for alleged pay-to-play issues. The retiree said that Callan previously accepted fees from money managers attending Callan-sponsored conferences, as reported.

But consultants should be prepared for the spotlight, if the SEC decides to move in the same direction as its international counterparts.

Last week, the **Financial Conduct Authority** (FCA), the U.K. financial conduct regulator, announced it would be advancing an investigation into the investment consultant industry by bringing in the **Competition Market Authority** (CMA) to conduct a separate market investigation into investment consultant firms that have fiduciary management businesses.

In June, the FCA's asset management market study recommended that Her Majesty's Treasury – the British government department tasked with creating and implementing the government's economic and financial policies – to give it more regulatory control over the investment consultant market, including Aon Hewitt, Mercer and Willis Towers Watson, the three biggest investment consultants, as reported in the *Financial Times*.

The FCA fears that there is a severe lack of transparency with consultant firms that offer fiduciary management services. The CMA's investigation "will determine whether there are any adverse effects on competition in this sector. If any are found, it will decide whether – and if so, what – remedial action should be taken to address these," according to an announcement issued by the CMA.

The CMA investigation is slated to end by March 2019.

"I think the U.S. may very well follow in [the U.K.'s] footsteps to see if the SEC will conduct similar reviews for these types of firms," says Lynch. "I think [these firms] are riddled with conflicts of interests, therefore they need to mitigate those conflicts."

Some of these conflicts include the increased number of products offered by consultants, says **Brad Alford**, founder and CIO at Alpha Capital Management.

"But, they charge an additional layer of fees in these funds, which is known as double dipping," he says.

One example of this was seen with the **City of Atlanta General Employees' Pension Fund** and its consultant **Gray & Company**, which drew the ire of the SEC in 2015 after a pension trustee raised red flags over a recommendation from the consultant to invest in a product in which it had a financial interest.

"Fees are definitely a hot topic and how firms are being compensated," says Lynch. "Large consultants that have many lines of business increases the potential for conflicts."

Some clients may even get special treatment from consultants if they're involved with their other lines of business, she says.

Other conflicts that have cropped up over the years involve "pay-to-play conferences" hosted by consultants, which involve managers paying consultants to attend their conferences, says **Ted Siedle**, a former SEC lawyer who runs forensic firm Benchmark Financial Services.