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Unintended consequences

New York's placement agent, marketer ban could bust, not boost, transparency

By Donna DiMaria

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The New York State Common Retirement Fund's ban on the involvement of marketing intermediaries from the investment manager selection process and New York Attorney General Andrew M. Cuomo's public pension code of conduct will have the unintended result of making marketing and sales practices less transparent and much more difficult to monitor. The restrictions will also serve to limit the ability of smaller and new firms to market to institutional investors as well as limiting worthwhile investment opportunities for pension funds.

Let us be clear: The Third Party Marketers Association's members firmly support the concept of a code of conduct that governs the decision-making process of public and private investment plans and that leads to the disclosure of any and all conflicts of interest. What we are against is the widespread banning of third-party marketers, who operate in an ethical and professional manner and according to the rules and regulations now in place.

The association represents 75 professionally managed firms that provide marketing services to the investment management community. The association was formed to maintain a standard of excellence in the industry and share information and ideas among the principals of independent sales and marketing firms. Association members are appalled and disappointed at the behavior of politically connected intermediaries and state officials in the recent pay-to-play scandal surrounding the New York Common Retirement Fund. As citizens, the members of the association condemn corruption at any level of the government or the private sector. As members of an organization devoted to best practices in the marketing of investment management services, we take some comfort in seeing bad behavior by apparently disreputable and dishonest individuals being punished.

Bold action yes, but ban is overkill

It is understandable that New York state authorities felt they needed to respond to these events and to take bold actions that convince its citizens that the vast majority of managers hired to make investments on their behalf are chosen on the basis of their qualifications, track record and skills, and those that are not will be dealt with accordingly. Rather than identifying the areas where the system failed, on April 21, Thomas P. DiNapoli, New York state comptroller and sole trustee of the common fund,

issued a new and sweeping policy that “banned the involvement of placement agents, paid intermediaries and registered lobbyists in investments with the NYCRF.”

Unfortunately this reaction did not address the underlying problems of the pay-to-play scandal. It did, however, make the investment manager selection process less transparent by removing from the process third-party marketers, most of which are registered with regulatory entities.

To compound this situation, on May 14, Mr. Cuomo issued a press release outlining the settlement reached with Carlyle Group and promulgated his code of conduct, which he plans to use to revamp the public pension fund investment system. In this press release, Mr. Cuomo stated by “eliminating the third-party intermediaries that have become dens of corruption, we will ensure reform.” This action by Mr. Cuomo is irrational and clearly counterproductive.

By eliminating the use of third-party marketers, the common fund ban and Mr. Cuomo’s code of conduct are, in effect, removing the marketing functions from the oversight of the Securities and Exchange Commission, Financial Industry Regulatory Authority and the state securities commission. They are decreasing visibility and lessening confidence in the investment process. Without third-party marketers, investment managers seeking to be hired by institutional investors will have to hire an internal staff of marketing professionals to represent their strategies to these investors. While it is our experience that most of these professionals are scrupulous and do not engage in the practices that have led to the current issues, these employees would not operate under any formal regulatory framework that would ensure the same transparency that third-party marketers must provide.

Marketers: more than just introductions

It should also be noted that most third-party marketers provide much more to investment managers than mere introductions to investors. In fact, most third-party marketers provide a value-added service that extends throughout the entire sales cycle and in most cases includes providing investor relation services to those accounts they helped to secure.

The ban on third-party marketers has further consequences that can harm the overall manager selection and investment process for pension funds and other investors. The universe of potential investments has expanded dramatically in the past decade, with an ever-expanding universe of potential strategies, vehicles and managers. It is estimated that during 2008, more than 1,200 private equity and real estate funds went to market in an attempt to actively raise capital. Conservatively, this represents less than one-third of the total number of alternative investment managers that will be looking to raise capital during the next three years. In addition, there are literally thousands of investment advisers and hedge fund managers who are also seeking capital investments. As a practical matter, it is unreasonable to expect that all of these investment managers will have the experience, resources or required marketing skill sets to adeptly represent themselves to institutional investors as they try to raise assets.

By banning third-party marketers, New York state deprives, in particular, smaller and newer managers of professional marketing services that many cannot afford to establish in-house. New and exciting investment strategies in areas such as alternative energy, infrastructure and green technologies have been successfully established by “emerging

managers” with the help of third-party marketers. Moreover, the growing interest in hiring minority- and women-owned firms, many of which have been recently established, also rely on the services of third-party marketers. Depriving these managers of the cost-effective and efficient alternative that third-party marketers provide is unfair to them and does nothing to address the issue of corruption that we all condemn.

Ban could crimp investment opportunities too

This ban is also likely to have the unintended consequence of placing constraints on a variety of investment opportunities that could be appropriate for some retirement funds and deprive them of investments that would be additive to the funds’ overall investment strategies, increase the rate of return, ensure retirement security for the plan participants and lower taxes for the state’s taxpayers.

The Third Party Marketing Association fully endorses a framework that increases the integrity of the decision-making process. We strongly encourage an open and meaningful dialogue with the pension community and other institutional investors, regulators and investment managers to develop policies and procedures that can effectively monitor the conduct of all parties and can appropriately identify individual interests that might influence investment policies and practices. Rather than pursuing an avenue of dismissal and avoidance, we support the pursuit of policies and procedures that increase transparency of all parties involved (including the investors themselves) with the important goal of improving the investment process, the resulting portfolio and, importantly, investment performance.

The association hopes to work with Messrs. Cuomo and DiNapoli to create an effective and executable code of conduct that will govern the relationship between the public pension funds, investment managers and third-party marketers. Our goal is to work toward a code that assures transparency in the investment process of pension funds, such as the New York fund, while providing the citizens of New York the best opportunity to benefit from the best investment professionals available.

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