

## MEMORANDUM

TO: All Retirement Boards

FROM: Joseph E. Connarton, Executive Director

RE: Annual Disclosure Forms

DATE: December 3, 2012

The Commission is providing this notice to retirement board as part of its effort to enforce the annual disclosure aspects of Chapter 32B. Although we will also forward this information to the vendors that PERAC believes are providing services to retirement boards and must comply with the statute, we ask that retirement boards forward this material to their vendors to assure maximum compliance.

Annual disclosure requirements must be filed by “all investment service providers”. All “investment service providers” includes, but is not be limited to, managers, partnerships, trusts, custodians, consultants, proxy services, securities litigation services and services related to the financial information (cash books, pooled fund statements, Annual Statements) the retirement boards must file with PERAC. PERAC’s existing regulations 840 CMR 17.04(7) and (8) have imposed similar disclosure requirements for many years. In addition, as outlined below, PERAC’s Placement Agent Statement requires similar filings.

On or before January 1 of each year and as part of the RFP process, all “investment service providers” or prospective investment service providers must file annual disclosures with the retirement board and PERAC. These include disclosure of arrangements for compensation paid or to be paid to the contractor or a related person by others in connection with the services the contractor provides to the retirement board or any other client; disclosure of compensation in whatever form paid or expected to be paid by the contractor or a related person to others in relation to the services provided to the retirement board or any other client; and disclosure of any conflict of interest that the contractor may have that may interfere with the ability of the contractor to provide unbiased and objective services to the retirement board.

### Disclosures – Chapter 32, Section 23B(d)

Under Section 23B the contractor must “...annually disclose to the commission and the retirement board compensation, in whatever form, paid or expected to be paid, directly or indirectly, by the contractor or a related person to others in relation to the contractors services to the retirement board or any other client;” (similar language appears in (c)).



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Under 840 CMR 17.04(8) the following must be disclosed:

(8) Compensation

(a) Disclosure of Additional Compensation Arrangements. Every qualified investment manager, and every consultant shall inform the Commission and the board of any arrangements, oral or in writing, for compensation or other benefit received or expected to be received by the qualified investment manager or consultant or a related person from others in connection with the qualified investment manager's or consultant's services to the board.

(b) Disclosure of Referral Fees. Every qualified investment manager and every consultant shall disclose to the Commission and the board any compensation paid or expected to be paid, directly or indirectly, by the qualified investment manager or consultant or a related person to others for referring the services of the qualified investment manager or consultant to the board.

“...any other client...”

One concern in this regard is the meaning of the term “...any other client”. PERAC believes that the statute did not intend that every possible arrangement relating to all public, private and individual clients of a contractor be disclosed. It is the position of the Commission that the statutory requirement to disclose the noted compensation “... in relation to the contractors services to ... any other client” can be met by disclosing such compensation in connection with the investment service being provided to the other clients in the same product or for the same service in which the retirement board is investing. For example, if the retirement board is investing in Venture Capital Limited Partnership V, compensation paid in relation to the retirement boards’ investment and the investment of others in that partnership must be disclosed.

The identity of the other client need not be disclosed.

“...compensation, in whatever form...”

The statute requires that “...compensation, in whatever form...” be disclosed. In many instances, such as in the context of cash payments, this term is clear. However, there exist many forms of compensation that may take place in relation to investment activities. For example, directing brokerage to a particular broker must be disclosed, purchase of services from a vendor that provides consulting services to a retirement board as well as payment for attending conferences sponsored by such a vendor also must be disclosed, (these types of arrangements are also required to be disclosed under PERAC’s regulations regarding compensation as noted above). It should be noted that the types of compensation provided in this context have evolved and new mechanisms for providing compensation have developed. Recently some managers have initiated compensation in the form of

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political and/or charitable contributions made in response to requests by potential or existing investors or their representatives. Any such contributions must be disclosed.

### “...directly or indirectly...”

This phrase establishes the responsibility for the service provider to disclose payments that are made to all parties in connection with the services to the retirement board. In the case of a third party marketer or placement agent the direct payment may be made to one firm or individual and that firm or person makes payments to other parties. For example, manager X retains placement agent Y in connection with the solicitation of prospective investors. Placement agent Y pays party Z in connection with that solicitation. A similar situation arises if manager X has a relationship with broker Y and broker Y pays third party Z from commissions received as a result of manager X's trading for the retirement board account. Disclosure must be made of all arrangements that result in any compensation to any party in connection with the services provided to the retirement board.

### “...in relation to the contractors' services to the retirement board or any other client.”

Following up on the discussion above, the phrase “...in relation to the contractors' services to the retirement board or any other client...” covers circumstances that are broader than payments for marketing or to placement agents. Clearly it encompasses the political/charitable contributions mentioned above. In addition, it includes payments in the course of performing services, for example, legal fees associated with the services being provided, as well as other ancillary matters.

### “...related person”

In addition the statute uses the term “related person”. The Commission interprets that phrase in a manner that is generally consistent with the definitions included in the SEC ADV Glossary of Terms. Applying that here results in a “related person” being any affiliate or any person that is under common control with the contractor. Section 23B defines a “person” as “a natural person, business, partnership, corporation, union, committee, club or other organization, entity or group of individuals.” “Control” means the power, directly or indirectly, to direct the management or policies of a person whether through ownership of securities, by contract or otherwise.

In short, the wisest course for a vendor and the surest way to meet the statutory requirement is to maximize disclosure even in instances in which the vendor may be uncertain as to applicability.

### Disclosures/Conflict of Interest

In addition to the compensation disclosure, the statute requires that contractors disclose to: “the commission and the retirement board in writing any conflict of interest the contractor may have that

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could reasonably be expected to impair the contactor's ability to render unbiased and objective services to the retirement board." Similarly 840 CMR 17.04 states:

(7) Disclosure of Conflicts.

(a) Every qualified investment manager, and every consultant when making an investment recommendation or taking an investment action, shall disclose to the Commission and the board in writing any conflict of interest the qualified investment manager or consultant may have and any beneficial ownership of the securities involved which could reasonably be expected to impair the qualified investment manager's or consultant's ability to render unbiased and objective advice.

(b) Every qualified investment manager and every consultant shall disclose to the Commission and the board in writing all matters which could reasonably appear to interfere with the qualified investment manager's or consultant's duty to the board or ability to render unbiased and objective advice.

(c) Every qualified investment manager, and every consultant shall also comply with all requirements as to disclosure of conflicts of interest imposed by law and by rules and regulations of organizations governing the activities of investment advisors and shall comply with any prohibition of such activities if a conflict of interest exists.

Again, although the contractor must make this determination, the best course would be to disclose if and when such a conflict may be present.

Forms

The Forms (enclosed) that must be filed in relation to these matters can be accessed and downloaded at <http://www.mass.gov/perac/form2012.html>.

Failure to Comply

The statute provides that "...Failure to file disclosures or the filing of inaccurate disclosures shall subject the contractor to proceedings under section 21A." Section 21A provides that contractors may be debarred from doing business with Massachusetts pension funds.

Thank You

The Commission understands that Chapter 32 Section 23B has been a challenge to all of us involved in public pensions in the Commonwealth and, on its behalf and that of PERAC staff, I would like to express our appreciation for the cooperation and assistance retirement board members and staff have provided as we implement this complex legislation.

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