

Ban on Agents is Insult to Institutional Salespeople

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Do the accusations leveled against attorney Marc Dreier prove that all lawyers systematically commit fraud and forge documents? Can we conclude that since Arthur Andersen was convicted and subsequently collapsed from the Enron scandal that all accounting firms and CPAs cook the books?

These are silly questions to ask, of course. Unfortunately, a Securities and Exchange Commission investigation into corruption at the New York State Common Retirement Fund has caused some public pension plans to apply the same logic toward placement agents and all paid intermediaries working on behalf of institutional asset managers. Last week, state comptroller Thomas DiNapoli unilaterally banned the use of all “finders” by managers seeking state pension fund investments. The move followed ongoing investigations by New York Attorney General Andrew Cuomo and the SEC into alleged pay-to-play activity by a few firms seeking access to the \$122 billion fund.

The ban publicly identifies anyone who received a finder’s fee, and paints an unfair picture that implies that all sales intermediaries and the investors they solicit are crooks. It raises the questions, Why do we equate all paid finders with registered lobbyists and why do we assume that everyone who solicits business from public pension funds has a hidden political agenda? Frankly, for most public pension plans and investment managers that chose to follow rules that have existed for decades, those questions are insulting.

Indeed, many of us are well versed on the existing laws designed to crack down on pay-to-play activities. For example, when the Investment Advisers Act of 1940 was written nearly 70 years ago, it included a section titled “Cash Payments for Client Solicitations.” In crystal clear language, the rule – Rule 206(4)-3– describes the procedures for an investment advisor to properly utilize “solicitors” to obtain new business. Further, the Financial Industry Regulatory Authority’s rules regarding sales of private placements are extremely well-documented. There’s no ambiguity among sales professionals about what the rules are. (Keep in mind that FINRA provides regular updates to members about their legal obligations when selling certain products) The real problem is that the industry needs a refresher course in the existing rules and regulations. Making blanket policy decisions is not the most constructive solution.

The current situation also raises concerns for the managers that are typically most reliant on sales intermediaries: small and mid-sized managers. If this situation worsens, they may face a significant disadvantage in the marketplace versus their much larger competitors. This is also counter-intuitive to industry-leading institutions, such as CalPERS, that advocate disclosure and transparency and have extensive relationships with smaller emerging managers through legitimate industry finders.

Hopefully, I got a glimpse of the future during a recent conversation with an experienced research analyst at a large pension consulting firm. After reading the required disclosures of our compensation, in extraordinary detail, in our marketing materials, he noted that perhaps the entire industry could learn a lesson about transparency and disclosure from us. I hope that is the situation that plays out, rather than a scenario where all sales intermediaries, and the pension funds they market to, are wrongly stereotyped.