Forensic Investigation of the Jacksonville Police and Fire Pension Fund

Report to Jacksonville City Council by Benchmark Financial Services, Inc., October 28, 2015

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- **Key Findings:**

1. The lack of transparency of the pension fund Board of Trustees generally and in connection with this investigation amounts to a profound “red flag.”
2. City Council may ask Florida Governor Scott to reconsider investigating the pension due to statewide and national concerns raised in this report.
3. Federal Bureau of Investigation and U.S. Securities and Exchange Commission assistance may be advisable.
4. City Council should immediately subpoena information requested over the course of this investigation that the Board has failed to provide.
5. Board has failed to obtain insurance to protect pension from Board errors and omissions, as well as fidelity bond coverage to protect against fraud or dishonest acts by Board or staff. The Board has used plan assets for its own legal defense, as opposed to being used for the exclusive benefit of participants and beneficiaries—in violation of Employee Retirement Income Security Act (ERISA) fiduciary standards.
6. Board, staff and vendors may be subject to **personal liability** for any ERISA fiduciary breaches since pension adopted heightened ERISA fiduciary standards for Board, staff and all vendors.
7. Board has failed to provide oversight to ensure compliance with heightened ERISA fiduciary standards. Many contracts between Board, money managers and other vendors handling pension assets, as well as their business practices, do not comply with ERISA.

8. Board poor investment decision-making has resulted in at least **$370 million in underperformance losses.**
9. Board failure to scrutinize investment management fees has resulted in excess fees of **$6 million** annually or **$36 million** over the past six years.
10. Board failed to provide information that was repeatedly requested regarding an estimated **$5.7 million** in "commission rebates" and related expenditures—information required to identify whether there has been any potential embezzlement or misuse of such pension assets.
11. Board's recent **$27 million loss** in Energy Master Limited Partnerships was imprudent due to lack of diversification, lack of transparency, and high fees—an avoidable loss.
12. Board failed to heed credible warnings of conflicts of interest at former investment consultant, eventually settling with firm for **$273,696** without analysis or evaluation of any harm caused to the pension. Such conflicts (according to a U.S. Government Accountability Office analysis) may have cost the pension almost **30 percent** of its value**—$300- $500 million** over two decades.
13. Board failed to diligently monitor and record pension investment performance which necessitates corrective action and accurate reporting of true past pension performance to all stakeholders.
14. Board failed to scrutinize conflicts of interest related to, and compensation disclosed, as well as received, by its General Counsel and other law firms. City may seek assistance from the Florida Bar and U.S. Department of Justice.
15. Board-approved senior staff pension plan was deemed illegal by City General Counsel, and that plan may also fail to meet heightened ERISA fiduciary standards.
16. Allegations of waste, abuse and ethics violations regarding Board and staff travel should be resolved by limiting frequency, purpose and range of travel.

I. Executive Summary

The City of Jacksonville Police and Fire Pension Fund, with assets of approximately $1.43 billion, has long been surrounded by controversy. City leaders have debated reform of the Fund since at least 2008 when Florida TaxWatch, a nonprofit government watchdog group, raised alarms because the pension's unfunded liability was about $798 million at the time. According to Florida TaxWatch, today the unfunded liability "stands at over $1.65 billion."

The Fund's funded ratio dropped from 87 percent in 2000 to 39 percent in 2013—the lowest and most precipitous drop in funded ratio for any of Florida's large cities.

For years, residents have called for a forensic audit of the Fund to determine whether the pension violated any state laws or rules, largely due to a series of investigations by The Florida Times-Union which "created an appearance of impropriety and raised issues of questionable practices and leadership." Florida Governor Rick Scott was asked to authorize a state investigation of the Fund, as well as to specifically investigate a special pension plan the Board of the Fund created for senior staff members, including John Keane (the longtime executive director)—a plan that the City's General Counsel deemed illegal.

The Governor chose to stay out of the pension issues in Jacksonville, noting that such "concerns would be more appropriately handled at the local level." Any specific criminal violations should be referred to local law enforcement or the state attorney's office, said Scott.

The Jacksonville City Council unanimously voted on April 28, 2015 to hire Benchmark Financial Services, Inc. ("Benchmark") to provide an expert forensic review of the Fund. On June 24, 2015, Benchmark was contractually engaged by the City Council.

- **Limitations on Investigation**

We note with great emphasis that this investigation was conducted without the power to compel the Board of Trustees of the Fund, staff or others to comply with state disclosure laws or provide the information we requested. As discussed with the Board Chair and noted throughout the report, the Fund Administrator and other pension fiduciaries failed to provide a great deal of the information we requested—including key documents that we have been told do, in fact, exist.

For example, the Fund Administrator repeatedly represented to us—contrary to written representations by the General Counsel of the Fund to the Board—that no portfolio monitoring agreement ever existed between the Fund and the Fund's "primary securities litigation counsel," Bernstein Litowitz Berger & Grossmann.

The Fund Administrator repeatedly claimed to have no documents disclosing the dollar amount of fees the General Counsel actually earned in connection with specific class action litigations the General Counsel recommended the Fund initiate against publicly traded companies—despite the fact that the General Counsel himself stated in a letter to the Board that the final percentage, amounts and names of firms receiving such fees are always reported to the Board.

The historic investment performance information provided to us by the Fund's current investment consultant for the period from 1988 through today was neither prepared, nor confirmed, by the master custodian bank actually holding the assets—the most reliable source for such information.

Worse still, two decades of investment performance information was prepared by a former pension consultant to the Fund who was terminated as a result of an investigation by the United States Securities

and Exchange Commission ("SEC"). The SEC investigation concluded the firm breached its fiduciary duty to its pension clients by misrepresenting and omitting to disclose material information.

We are told the Board neither conducted nor commissioned any meaningful review of the former consultant's work—which included advising on key issues such as asset allocation, money manager selection and investment performance—or potential damages to the Fund resulting from any fiduciary breaches, subsequent to terminating the firm.

In response to our request for verified performance for the twenty-year period, we were told that the master custodian had indicated it could not at this time calculate performance for the period.

The performance information we were provided was clearly inaccurate, at least in part. Upon questioning, the current investment consultant acknowledged obvious inconsistencies in certain of the performance figures.

Any analysis of investment performance data portions of which, at a minimum, are clearly wrong is inherently less reliable.

While we have estimated Fund underperformance losses of approximately **$370 million**, we simply do not know for certain how well, or badly, the Fund's investments have performed over the decades—and, based upon the information we were provided, apparently neither does the Board nor anyone else currently involved with the Fund.

As mentioned above, certain significant information regarding potential conflicts of interest and fees paid by the Fund (directly or indirectly in connection with securities class action litigations), as well as fees paid by

other fiduciaries of the Fund, such as law firms, investment managers and consultants, to the Fund's General Counsel was not provided despite repeated requests.

Information we requested regarding the expenditure of an estimated **$5.7 million** in securities trading commission dollars "rebated" to the Fund was not provided.

We recommend that all information requests by Benchmark related to this investigation, as well as all responses by the Board, Fund Administrator and other plan fiduciaries, be made publicly available so that stakeholders, including pension participants and taxpayers, are able to evaluate for themselves the Fund's level of transparency and the integrity of its operations.

We understand that the City Council is subpoenaing the information which we requested but did not receive. It may be advisable for the City Council to ask the Governor to reconsider an investigation and, at the very least read this report before dismissing the matter as a local issue. In addition, Federal Bureau of Investigation and U.S. Securities and Exchange Commission assistance may be advisable. The Florida Bar and U.S> Department of Justice may also have an interest in certain matters herein.

- **Board Lack of Transparency Amounts to Profound "Red Flag"**

While the Fund's website proclaims that the Board of the Fund supports the Florida "Government in the Sunshine" laws designed to provide transparency and openness in government operations, the Board has repeatedly come under criticism from citizens, media, foundations and City Council members for failing to be responsive to public records requests. Further, the Board has reportedly spent hundreds of

thousands of Fund dollars in litigation related to requests for public records.

In connection with this investigation on behalf of the City Council, although we submitted our first document request on June 29, 2015, not a single record requested was provided to us by the Board or Fund Administrator for almost two months.

It is important to note the following regarding our initial request for documents:

1. Our request was not a "public records" request. It was a request by the City Council for records related to a pension substantially funded by the City.
2. Action by the City's Ethic Director, as reported in The Florida Times Union, immediately preceded and apparently prompted the late response in August to our June records request.
3. As a result of the Times Union article, the Board was on notice of the inadequate response to our requests and should have taken action to ensure complete cooperation with this investigation.
4. The overwhelming majority of the documents requested, such as annual reports and investment performance reports were obviously readily available.

In the context of a forensic investigation into a highly controversial, severely underfunded, underperforming public pension—a very public investigation commissioned by the City Council—the delays, incomplete and inconsistent responses, as well as failures to produce documents we experienced amount to a profound "red flag," in our opinion.

- **Board Failure to Provide Fiduciary Oversight - Delegation of Broad Responsibility to Administrator and Outside General Counsel**

A five-member Board of Pension Trustees has sole responsibility for administering the Fund. The Board provides investment oversight for the management of assets and has adopted a Statement of Investment Policy for the Fund.

As detailed throughout this report, in our opinion, the Board has failed to provide oversight, consistent with its fiduciary duties, with respect to matters as fundamental as verifying, evaluating and reporting investment performance of the Fund over time; investment manager and other vendor compliance with applicable heightened ERISA fiduciary standards adopted by the Fund; monitoring conflicts of interest and establishing corresponding safeguards; and reviewing, as well as assessing, the reasonableness of investment management and other fees paid by the Fund.

The Board delegates responsibilities to the Fund Administrator for the implementation of the Statement of Investment Policy and in the provision of administrative oversight of the investment managers to ensure that the Board's policies are being properly implemented.

On the one hand, the Board has delegated exceptionally broad responsibilities to the Fund Administrator, encompassing various portfolio investment matters. On the other, the Fund Administrator lacks any meaningful investment credentials.

The Board has also delegated broad responsibility to an outside law firm subject to numerous potential conflicts of interest related to matters such as opining as to the legitimacy of a senior staff pension plan fully-funded by the Fund and later deemed illegal by the City General Counsel; splitting fees with class action law firms he recommended to

the Board; receiving sponsorship fees for his annual client conference from other plan fiduciaries; and advice regarding retaining and later suing, as well as settling with, the former investment consultant.

- **Board Lacks Errors and Omissions - Fidelity Bond Insurance**

In response to our inquiry, the Fund Administrator indicated that the Board has no current errors and omissions or fidelity bond insurance coverage. (It is our understanding that the Board of the City of Jacksonville Retirement System also lacks such coverage.)

Currently, the cost of defending legal challenges to the Board's actions, e.g., denial of public records requests and allegedly illegal staff pensions, is paid out of Fund assets (and ultimately by taxpayers and participants)—as opposed to by an insurer. The Fund is also at risk regarding any loss resulting from fraudulent or dishonest acts by the Board or the staff.

The Board has an obligation, as an ERISA fiduciary, to manage the Fund exclusively for the benefit of participants. Opposing public records requests or defending allegedly illegal staff pensions does not, in our opinion, in any way benefit the Fund or its participants. Thus, in our opinion, Fund assets should not be used to defend the Board, staff and others in these matters.

As ERISA fiduciaries, the Board should obtain errors and omissions coverage to protect the Fund against loss resulting from errors or omissions by the Board or staff, in our opinion.

As ERISA fiduciaries, the Board should obtain fidelity bond coverage to protect the Fund against loss resulting from fraudulent or dishonest acts of the Board or staff, in our opinion.

A copy of this report, as well as any complaints filed against the Board or staff should be provided to any potential insurer.

Finally, as discussed below, as ERISA fiduciaries, the Board and staff may be *personally liable* for any past or future breach of fiduciary duty, including use of plan assets for personal benefit.

- **ERISA Fiduciary Standard "Highest Known to the Law" Adopted For Board, Staff and Service Providers**

The Introduction to the Fund's Statement of Investment Policy posted on its website states, "Although the Board of Trustees acknowledges that the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), does not apply to the Fund as a governmental retirement plan, it hereby adopts the fiduciary provisions of ERISA. The Board, the Fund's staff and the Fund's service providers shall discharge their responsibilities in the same manner as if the Fund were governed by the fiduciary responsibility provisions of ERISA."

(The City of Jacksonville Retirement System includes the same language in its Statement of Investment Policy posted on its website.)

The fiduciary duty established under ERISA is recognized as the "highest known to the law."

ERISA strictly prohibits a fiduciary from engaging in a self-dealing transaction that involves plan assets where a conflict of interest exists.

The disclosure of a material conflict, alone, is never sufficient under ERISA's duty of loyalty and self-dealing "prohibited transaction" provisions to avoid a violation of ERISA. Conflicts of interest are by definition contrary to ERISA's fiduciary duty of loyalty and self-dealing prohibited transaction provisions.

Failure to comply with ERISA's fiduciary requirements can result in significant penalties. ERISA provides that a fiduciary is personally liable

in the event of a breach of the fiduciary duty provisions. Furthermore, ERISA provides the fiduciary may have to make good on any losses to the plan caused by the breach and restore any profits gained by the fiduciary in using plan assets to its own benefit.

- **Lack of Compliance with ERISA Fiduciary Standards**

Since the Board has adopted the heightened fiduciary standards of ERISA in the Fund's Statement of Investment Policy posted on its website, stakeholders (including participants and taxpayers) may reasonably assume that the Board has established policies and procedures to ensure compliance with these standards. We found scant evidence of compliance with ERISA fiduciary standards.

In our opinion, it appears ERISA fiduciary compliance has been largely overlooked—despite the fact that these are heightened fiduciary standards, noncompliance can have serious consequences and there is a risk of significant personal liability.

For example, as mentioned below, Board failure to scrutinize investment management fees—as required under ERISA fiduciary standards—we estimate, alone, has resulted **in $6 million** in excessive fees paid each year or **$36 million** over the past six years. The Board's failure to conduct or commission any review of the damage to the Fund caused by its former investment consultant over two decades, choosing instead to accept a settlement of a mere $273,696, for an estimated **$300-$500 million in underperformance losses**, was exponentially costlier**.**

Our limited review of the investment management agreements and subscription agreements between the Board and its asset managers identified serious apparent ERISA non-compliance.

For example, the Investor Subscription Booklet for the Acadian Emerging Markets Equity II Fund LLC states that if the investor (the Fund) is not

subject to ERISA, the Fund acknowledges that Acadian may enter into certain transactions and represents that those transactions by Acadian will not result in a violation of any law to which the Fund is subject that is similar to the prohibited transaction provisions of ERISA and represents that entering into such transactions is permissible under the governing documents of the Fund.

The Fund Administrator indicated in the Acadian Investor Questionnaire that the Fund was not subject to ERISA.

In short, it appears that Acadian may not be aware of its obligation to manage Fund assets consistent with ERISA fiduciary standards and may not be managing the Fund's assets accordingly. While any such ERISA fiduciary breaches could conceivably give rise to liability for losses, the Fund has agreed to indemnify Acadian for any ERISA fiduciary breaches.

In the Eaton Vance Subscription Documents the Fund represented that it was not subject to the fiduciary responsibility standards and prohibited transaction restrictions of ERISA.

Certain of the practices permitted in the agreement with the Fund's Master Custodian, Northern Trust, appear to be inconsistent with ERISA fiduciary standards. For example, the contract indicates that Northern may deposit cash in any depository including its own banking department, without any liability for the payment of interest thereon and receive "float" income on uninvested cash.

The agreements between the Board and the Board's General Counsel and investment consultant raised additional ERISA fiduciary issues, in our opinion.

We recommend a complete review of the Fund's policies, practices, procedures and agreements for compliance with heightened ERISA fiduciary standards. In the event that the Fund has suffered losses as a

result of breaches of the ERISA fiduciary standard, damages may be recoverable from responsible parties.

- **Controversies Regarding Pension Staff**

Pension staff consists of seven employees. The Executive Director-Administrator of the Fund since 1990 has been John Keane. Most unusual, in addition to his role as Administrator of the Fund, Mr. Keane has been the lead negotiator for police and fire unions in pension reform negotiations.

Mr. Keane has been a controversial figure as a result of his frequent convention travel, over $400,000 in unused vacation pay and "questionable deals for his personally created pension."

On August 29th, Mr. Keane gave three-week notice that he would retire on September 18, 2015. However, at the Board's insistence, he agreed to stay on at the Fund through the end of the month. Most recently, it is our understanding he has been engaged as a consultant to the Fund.

- **General Counsel Potential Conflicts-Compensation Disclosure**

The legal counsel to the Board over the decades has been the Plantation, Florida law firm of Klausner Kaufman Jensen & Levinson. In effect, the Klausner firm acts as the outside General Counsel of the Board, supervising even other attorneys retained by the Board, as well as recommending attorneys and specific litigations. In certain documents Mr. Klausner refers to himself as General Counsel

As ERISA fiduciaries of the Fund, the Board has a duty to review any potential conflicts of interest related to the General Counsel and other law firms providing services to the Fund and all compensation paid to, or received by, these parties related to the Fund for reasonableness. Likewise, as ERSIA fiduciaries, the General Counsel and other law firms

providing services to the Fund have an obligation to disclose any potential conflicts of interest and all compensation they pay, or receive, related to the Fund.

As summarized below and detailed extensively in our report, based upon the limited information eventually provided by the Fund Administrator, it does not appear that the Board has fulfilled its fiduciary duty under ERISA to scrutinize the conflicts related to, and reasonableness of, the compensation paid to, or received by, the General Counsel and other law firms related to the Fund.

In an effort to identify potential conflicts of interest and all sources of compensation, we requested from the Fund Administrator documents reflecting any compensation in any form, direct or indirect, paid by any fiduciary of the Fund to the General Counsel or any related law firm or entity for the past 15 years. If the Fund did not have these documents, we requested that the General Counsel disclose this data to the Fund pursuant to his fiduciary duties and provide us proof of this request and response.

In response, the Fund Administrator provided only payee transaction information indicating that the Fund (no other fiduciary) over the past 10 years (not the 15 requested) paid the General Counsel directly approximately $2.72 million for professional services from October 2004 through August 19, 2015. The General Counsel provided no information to us.

1. *Compensation to General Counsel From Class Action Law Firms*

According to published reports (and the General Counsel himself), in addition to the $2.7 million in fees paid by the Fund to the General Counsel, his firm may have received millions in fees from one or more

securities class action law firms retained by the Fund to pursue litigation related to the Fund's investments.

It is our understanding that the General Counsel:

- Recommends class action law firms to monitor the Fund's investments and pursue litigation related to portfolio securities;
- Advises the Fund when to initiate or participate in a given lawsuit;
- Negotiates (on behalf of the Fund) fees paid to these law firms;
- Enters into fee-splitting arrangements with the firms he recommends for class action litigations whereby his firm receives a portion of the fees related to these cases.

Florida Rules of Professional Conduct applicable to lawyers effectively provide that a division of fees between lawyers who are not in the same firm may only be made pursuant to an agreement that fully discloses that a division of fees will be made and the basis upon which the division of fees will be made.

Any potential violations of such rules regarding full disclosure of fees, including any misrepresentation of fee arrangements by a lawyer should be reported to the appropriate authorities. An apparently isolated violation may indicate a pattern of misconduct that only a disciplinary investigation can uncover and reporting a violation is especially important where the victim is unlikely to discover the offense, according to the Florida Bar.

We note with great emphasis that even if any such fee-splitting arrangements among law firms may be permissible under certain conditions prescribed by laws generally applicable to Florida licensed lawyers, whether the General Counsel, as an ERISA fiduciary to the Fund, may receive such fees and whether the class action firms retained by the

Fund, as ERISA fiduciaries, may pay such fees to the General Counsel in connection with Fund litigation is an entirely separate matter. Any such dealings may amount to "prohibited transactions" under ERISA fiduciary standards and give rise to personal liability.

In general, full disclosure of the potential conflict of interest and amount of any compensation related to a transaction that could be considered fiduciary "self-dealing" under ERISA would be required, at a minimum.

We repeatedly requested the Fund Administrator provide contracts between the Fund and any class action securities law firms for either monitoring or litigation. While the Fund Administrator eventually did provide four portfolio monitoring agreements between the Fund and securities litigation firms, he did not provide any contracts or agreements between the Fund and the BLBG, the Fund's primary securities litigation counsel.

The Fund Administrator repeatedly stated—contrary to written representations by the General Counsel to the Board we reviewed—that no portfolio monitoring agreement ever existed between the Fund and BLBG.

Shortly after a Forbes article that mentioned fees the General Counsel received for referring cases to class action firms, the General Counsel wrote a letter to the Trustees, at the request of the Chairman, to review prior discussions concerning the Fund's role as a lead plaintiff in securities litigation matters.

The September 20, 2004 letter stated that the Board entered into an agreement with BLBG to monitor the Fund's portfolio and that in addition to any contingency fee agreement the Fund might enter into with BLBG, the General Counsel's firm would be paid a fee from any class settlement in which the Fund participated.

If a fee was paid to any law firm, the amount and the names of the payees would be reported in writing to the Board. No fee application or settlement decision would be made without the Board's prior approval. Fees, said the General Counsel, "are usually between 15-18% of the recovery. I usually receive between 5 and 10% of the approved fee. The final percentage and the dollar amount are always reported to the client."

Accordingly, we asked the Fund Administrator to provide the final percentage and dollar amount of all fees received by the General Counsel related to any class action litigation involving the Fund, as disclosed to the Board. If the final percentages and dollar amounts were not disclosed, we asked the Administrator so indicate. We received no response from the Fund Administrator.

While our requests for information regarding compensation to the General Counsel in connection with class action litigations were largely unsuccessful, based upon limited information obtained from alternate sources, we estimate that the General Counsel may have received the following additional compensation:

United Health Group: Assuming the General Counsel received 10 percent of plaintiff's counsel awarded fee of approximately $29 million or $2.9 million, the fees he received from this case alone may exceed total fees of $2.7 million paid directly by the Fund to the General Counsel over the past ten years.

Merrill Lynch: Of the $8.5 million settlement, fees of $2.125 million were awarded. The fees awarded represented 25 percent of the settlement—not the 15-18 percent the General Counsel told the Board usually applied. Assuming the General Counsel received 10 percent of the approved fee, he earned $212,500—nearly as much as the $273,696 the

Fund received from the Merrill settlement fund for harm caused to the Fund.

In connection with an Ernst & Young (Nextcard) settlement, of a $23.2 million offer made in April 2005, the General Counsel stated he would receive 10 percent of the fee ultimately paid to BLBG. Assuming BLBG received a fee of 18 percent and the General Counsel received 10 percent of that fee, the General Counsel may have received $417,600.

We note in this report that other Florida public pension lawyers claim that class action firms routinely offer them 18 percent. If true with respect to the General Counsel, then the total class action fees estimated above may be significantly understated.

It is our understanding that the City Council will subpoena from the General Counsel information regarding all payments to and from his firm and other law firms directly or indirectly related to the Fund. These parties should not object since, according to the documents we have reviewed, they supposedly have already provided all such fee-splitting information to the Board.

We note that the Fund pays the General Counsel $285.00 per hour for his legal services. As ERISA fiduciaries, the Board should examine any differential in the hourly rate he receives in connection with class actions, as well as any percentages in lieu of hourly rates.

2. *Compensation From Fund Fiduciaries to General Counsel*

According to the same 2004 Forbes article, the General Counsel received additional compensation from law firms (not related to legal services) and other fiduciaries of the Fund, such as investment consultants and investment advisors managing Fund assets.

According to published reports, both BLBG and Merrill Lynch, the Fund's terminated investment consultant, paid to sponsor the General Counsel's annual public pension client conference.

These payments between fiduciaries to the Fund pose a significant potential conflict of interest. For example, in addition to recommending BLBG to the Fund as primary counsel for highly-lucrative securities litigation, the General Counsel advised the Fund on conflicts of interest involving the former investment gatekeeper (Merrill Lynch), as well as the decision to terminate Merrill and later participated in litigation (resulting in fees paid to BLBG and his own firm) against Merrill.

We also note that Victor Zollo, President of the Fund's longest domestic equity investment manager, DePrince, Race & Zollo (which currently manages approximately $110 million for the Fund and has managed Fund assets since September 1994) was a speaker at the Klausner 2015 public pension client conference and the manager may have paid to sponsor the conference.

Based upon interviews with past sponsors of the conference, it is our understanding that the cost of sponsorship of the General Counsel's public pension client conference remains at $30,000.

From late June through September 2015, we repeatedly requested information from the Fund Administrator regarding any such payments by Fund fiduciaries to the General Counsel. The Fund Administrator's final response was "Unknown." When asked whether he would ask the General Counsel for such information—information the Fund Administrator stated he did not know—he did not respond to us.

It is our understanding that the City Council will subpoena from the General Counsel records of any compensation received from Fund fiduciaries.

- **Allegedly Illegal Senior Staff Pension Plan**

On July 30, 2012, the Times Union published an article stating that "since the late 1990s, Fund Executive Director John Keane has been signed up for a pension created for him by the fund with little outside notice." Both former City Council auditor Bob Johnson and current council auditor Kirk Sherman are quoted in the article as saying they were unaware of the existence of the pension program, which only covered a handful of fund employees, until that month.

According to the article, the existence of this "Senior Staff Voluntary Retirement Plan" was officially "recognized for the first time" in a recently released actuarial study of the Fund. The plan reportedly had $2.3 million in assets at that time, with the money invested along with the Fund's assets. The Plan could pay as much as $200,000 a year when Keane retired, according to the Times Union.

Shortly thereafter, the City's General Counsel issued an opinion that the Fund was not authorized under the City Charter to create the "Senior Pension Plan" and demanded the money spent to fund the pensions be repaid. The Fund's General Counsel countered that its opinion as to the legality of the plan, as originally expressed in 1999 (in connection with establishment of the plan), remained unchanged.

In 2012, the City Council voted unanimously to file a lawsuit regarding the plan but, for whatever reasons, never did. While the City General Counsel had gone so far as to tell the Fund to stop putting money into the account, a large cash infusion of more than $250,000 reportedly went into the account subsequently and effectively placed the account at over-funded status. On September 21, 2015, the Jacksonville City

Council voted 18-1 to take legal action regarding the specially created pension.

It appears that neither the City General Counsel nor the Fund General Counsel reviewed whether, in connection with the staff pension, the Board discharged its responsibilities consistent with the heightened fiduciary standards of ERISA.

We recommend that the City Council in connection with any potential litigation regarding the separate senior pension examine separately whether the Board, consistent with its ERISA fiduciary duties, followed a prudent process in deciding to take assets from the underfunded pension to establish, maintain and fully-fund the generous senior staff plan.

- **Allegations of Waste, Abuse and Ethics Violations Regarding Board and Staff Travel**

Public pension trustee and staff travel to attend lavish conferences globally, underwritten primarily by Wall Street (and, increasingly, plaintiff class action securities law firms) seeking to garner asset management and legal contingency fees from these funds has for decades been highly controversial nationally.

So controversial are these conferences that the website for the 2013 National Conference on Public Employee Retirement Systems held on the famed beaches of Waikiki, supplied board members hoping to shore up support for their expenses-paid trip a "2013 Attendance Justification Tool Kit."

Both the Fund Administrator and General Counsel are regular participants at public pension conferences and have long defended them. The General Counsel's firm has served as general counsel for more than 15 years to the above-mentioned National Conference of

Public Employee Retirement Systems and actually puts on its own annual public pension trustee and staff conference.

There is broad consensus that the educational content of many public pension conferences is suspect. Even the Fund's General Counsel has acknowledged the abuses, as the Fund Administrator has claimed the Board monitors conference attendance for value.

According to a memorandum to the Jacksonville Ethics Commission from Carla Miller dated November 3, 2014, during 2013 and 2014, the Ethics Office investigated complaints concerning allegations of waste, abuse and ethics violations pertaining to the travel of the Fund Administrator and Bobby Deal (Chair of the Board).

Miller concluded, "There is a lack of analysis and/or oversight of the many trips taken as to their value to the PFPF Fund." The Ethics Director recommendations to the Ethics Commission included additional review of Keane and Deal travel by the Council Auditor.

In our opinion, the likelihood that public pension board members and staff who lack investment experience will learn anything meaningful regarding pension investing through travel to exotic locations is remote.

Further, the risks related to such high-stakes marketing junkets are substantial and, in our opinion, far outweigh any educational benefit. The potential for corruption of the investment decision-making process at pensions, resulting in higher fees and lower performance, is obvious and enormous.

Most recently, the Fund Administrator's travel, including 31 trips since 2010—to destinations including Scotland and Canada and staying at hotels such as Caesars Palace, Hotel Frontenac, Four Seasons, and Trump Tower—has emerged as an issue in connection with the

estimated almost $475,000 he has already and is expected to collect for unused vacation days in the past five fiscal years.

In summary, given that: (1) public pension trustee and staff travel to lavish conferences globally has generated controversy for decades across the nation; (2) the Board and Keane's travel has been intensely criticized locally (including an Ethics, Compliance and Oversight Office Review); and (3) the severely underfunded status of the pension, it is recommended that the Board and staff eliminate such non-essential travel.

Most important, extensive travel by the Board and staff is inconsistent with the fiduciary obligation under ERISA to manage plan assets for the exclusive benefit of the participants, in our opinion.

- **Board Lack of Scrutiny of Investment Management Fees- $6 Million in Excess Fees Paid Annually**

It is well established that sponsors of public and private retirement plans have a fiduciary duty to ensure that the fees plans pay money managers for investment advisory services are reasonable. Fees paid for retirement plan investment services have always been an important consideration for ERISA retirement plan fiduciaries. Further, in recent years such fees have come under increased scrutiny because of class action litigation, Department of Labor regulations, and Congressional hearings.

We requested from the Fund Administrator any analyses that may have been prepared for the Board to scrutinize whether the fees the Fund pays its asset managers are reasonable. Remarkably, according to the Fund's investment consultant, Summit Group, no fee analyses have been prepared for the Board by Summit or any third party for this $1.43 billion pension.

"The net fees paid are buried in the investment performance reports," we were told.

However, according to Summit, the Fund Administrator had instructed the firm to prepare the first such report for our review.

In our opinion, without a comprehensive fee analysis prepared by the investment consultant or a third party, the Board cannot fulfill its fiduciary duty to monitor the reasonableness of fees the Fund pays its investment managers.

We also noted the Fund has no most favored nation ("mfn") provision in any of its contracts with investment managers and does not require managers to certify quarterly or annually that the Fund is receiving the lowest fee they offer. However, the current investment consultant to the Fund agrees that mfn provisions are commonplace, particularly with respect to public pensions and helpful in reducing fees.

Even based upon the Summit analysis prepared for us (which, as explained in the report, we believe is deeply flawed) the fees paid to virtually all the U.S. Equity investment managers are 50 percent higher than they should be, in our opinion.

We recommend that all of the investment advisory fees the Fund pays its managers be fully disclosed to the Board and compared against the fees *public* pensions *actually* pay (as opposed to "published" fees), as well as, if need be, vigorously renegotiated. The emphasis on active management should be reexamined since (as noted below) long term underperformance of the active managers net of fees has been costly to the Fund.

For managers that utilize performance-based fees, the prospective fee in the Summit analysis included only the base fee and not any performance component. Further, we note that with respect to real

estate and Energy Master Limited Partnerships, we do not believe all applicable fees have been included in the Summit analysis.

In our opinion, investment costs could easily be dramatically reduced, saving the Fund perhaps **$6 million** annually or **$36 million** over the past six years, and, more importantly, improving performance. Further, we do not believe that the prospective fees for Year-End 6/30/15 amount to only 48 basis points or almost $8 million, as indicated in the Summit analysis. Rather, we estimate total investment management fees alone are **$10 million** or more annually.

- **Suspect Data Suggests $370 Million Underperformance Losses**

According to the Fund Administrator, Northern Trust (which has been the Master Custodian for the Fund for over a decade) cannot provide investment return information on a gross and net basis because the bank was not engaged to report on the Fund's performance in the past and cannot create a performance history at this time.

While the custodian can and does routinely provide performance information to pensions, the Board chose to have the former investment consultant, Merrill Lynch and now Summit, provide it. This is highly problematic because:

1. The custodian, as holder of the Fund's assets, is always in the best position to verify values and performances of the respective investment managers;
2. The consultant and the managers are subject to a conflict of interest in calculating performance; and
3. Here, as discussed extensively below, the integrity of the former consultant to the Fund—the party calculating performance over a two decade period—was challenged by regulators.

As a result, according to the Fund Administrator, the only performance reports that exist at this time for the 20-year period when Merrill Lynch was the investment consultant were prepared by Merrill—information which has not been verified by the custodian holding the assets.

Further, the current investment consultant, once retained, undertook no analysis of Merrill's performance reports. Summit was never asked by the Board to verify the Merrill performance figures. Rather, Summit simply "downloaded a giant spreadsheet in 2007 from Merrill and uploaded it into the Fund's performance history."

The Merrill gross and net annual performances reported from 1988 through 2001 were identical—no difference was indicated between the performance before and after fees. Since we know that the Fund paid investment management fees during this 13-year period, either the gross or net figures (or possibly both) must be wrong. Further, from 2002 through today, the difference between gross and net performance has inexplicably ranged from as low as 5 basis points to 55 basis points.

In conclusion, the performance of the Fund since 1988 is inaccurate, at least in part—a fact which the Board should have easily detected.

According to the current consultant, on a net basis—even based upon suspect long-term performance data provided by the former consultant—the Fund's US Equity, International Equity, and Fixed Income actively managed assets—approximately 83 percent of total assets—have underperformed their respective indices for virtually all 1, 3, 5 and 10-year periods. If the long-term performance is inflated (gross) then the actual (net) investment performance may be worse.

As discussed more fully in the report, we compared the adjusted net investment performance of the Fund that we were provided from 1988 through 2014 against a 75 percent S&P 500 and 25 percent Barclays Aggregate index and concluded that the performance of the Fund would

have improved by approximately **$370 million** had the assets been invested in low-cost, highly-liquid, fully-transparent index funds.

In other words, a significant factor contributing to the underfunding of the pension appears to have been poor investment decision-making by the Board.

We note with great emphasis that due to the Board's failure to diligently scrutinize Fund performance, the performance history is so uncertain that any analysis is inherently speculative. We understand the City Council may subpoena from the Fund's Master Custodian the relevant records since 1988, as well as verify and report to stakeholders the true net performance.

- **$27 Million Loss Gambling on Energy Master Limited Partnerships**

Three years ago, the Fund invested approximately $106 million or 6.75 percent of its assets with two investment managers who are paid to invest fund assets exclusively in Energy Master Limited Partnerships (MLPs). In addition to lacking diversification, these investments are subject to regulatory, interest rate, and liability risk. MLPs involve significant fees at the partnership level (2 percent or more)—in addition to the fees (75 basis points) the Fund pays the investment managers.

In the past year, the Fund's MLP investments have lost 33 percent in value and over a three-year period, they have significantly underperformed (3.5 vs. 12.5 percent) the public equity market.

Note that 9 percent underperformance over 3 years amounts to **$27 million** in underperformance losses without compounding.

According to the Wall Street Journal, as the price of oil has fallen, these investments have continued to plummet in value. The Alerian MLP

index fell 15.3 percent last month—the third-worst monthly loss in its nearly 20-year history. The average MLP mutual fund, according to Morningstar, lost 15.8 percent for the month.

In our opinion, gambling on opaque, high-cost, high-risk MLP investments is imprudent, especially for a severely underfunded pension—regardless of the multi-million loss outcome.

- **Need to Account for $5.7 Million in Commission Rebates**

"Commission recapture" is a process whereby a pension plan receives a rebate in connection with brokerage transactions incurred through the pension's investment managers. This rebate represents a portion of commission (equity trade) or spread (fixed income trade) charged on these investment transactions.

Commission recapture arrangements are indirect payment schemes that may compromise transparency and accountability, as well as present conflicts of interest for all fiduciaries involved.

Boards or staff who use recaptured funds for purposes other than the best interest of the plan and beneficiaries may violate their fiduciary duties and applicable law.

Even the largest public pension in Florida was scarred by a commission rebate scheme in 1999, when a member of the staff of the Florida State Board of Administration was discovered to have embezzled more than $400,000 in brokerage rebates.

According to a 1994 article, the Fund started its commission recapture program in 1987, when the Board instructed its money managers to place all buy and sell orders through a New York-based brokerage firm. From 1987 to 1994, the Fund Administrator publicly claimed that the Fund had saved more than $600,000 in commission costs. He also

indicated that commission recapture funds had been used to purchase the Fund’s office building.

The article goes on to quote the Fund Administrator saying that the Fund's policy is” ABC-all brokerage recaptured.”

We requested annual statements of commissions recaptured by the pension since 1987, as well as documents related to the expenditure of the recaptured amounts.

Instead we were provided with statements indicating commissions recaptured since 2005 (not since 1987, as requested) in the amount of $1.936 million. Assuming the Fund has recaptured approximately $200,000 per year since 1987, approximately **$5.7 million** in commissions may have been rebated.

In response to our question regarding how the commission rebates had been spent, we were simply told, “The funds were deposited into our General Account.”

As noted above, the Fund Administrator himself has mentioned in speeches that recaptured commissions were used to buy a building for the Fund’s offices.

In our opinion, stakeholders should be provided with a full accounting of all rebated dollars in order to determine whether they have—consistent with heightened ERISA fiduciary standards—been used for the exclusive benefit of the participants. In the event any such funds have been misused, the funds should be recovered.

Note that actively managed accounts with higher portfolio turnover generate greater commission rebates. The Board’s emphasis on recapturing commissions may have led to excessive reliance upon active management, contributing to the Fund’s overall underperformance.

We understand that the City Council may subpoena records related to the receipt and use of rebated commission dollars since 1987.

- **High Cost of Decades of Conflicted Gatekeeper Advice**

The Board utilizes the services of an investment consultant who advises the Board on investment policies and decisions, and who assists in implementing those decisions. The Board does not utilize an investment committee consisting of knowledgeable investment and financial professionals that could be helpful to assuring sound financial and investment decisions by the Board.

In early 1996, questions surrounding conflicts of interest related to pension consultants began to attract national attention.

By 2000, the dangers related to Florida-based pension consultants with affiliated securities brokerages were being discussed with local public pensions and their attorneys.

In 2002, Edward Siedle, President of Benchmark, was invited to give a speech specifically focused upon pension consultant conflicts at the annual Florida Police and Firefighters Pension Trustee Educational Seminar. The breach of fiduciary duty that results when an advisor, retained to provide objective advice to pensions regarding allocation of assets and selection of money managers to invest such assets, receives brokerage compensation from the very money managers he recommends to his pension clients was explained. Details regarding the first-ever investigation of broker-consultant conflicts for a public pension in Nashville that resulted in a $10 million recovery for the single public pension was provided. Attendees were warned of the potential damages to Florida police and firefighter pension plans.

Around this time, Siedle met with and discussed conflicts of interest involving Merrill Lynch—the Fund's then investment consultant—

specifically with the Fund Administrator, Fund General Counsel and attorneys from BLBG accompanying the Fund Administrator. In light of the potential harm to the Fund and other Florida public pensions, Siedle urged them to take immediate action.

In late 2003, the staff of the SEC announced an inquiry into conflicts of interest involving investment consultants to pensions. Benchmark worked closely with the SEC on this inquiry. Securities regulators from the State of Florida came to our offices to review files regarding the consultant abuses we had uncovered**.**

On May 16, 2005 the staff of the SEC's Office of Compliance Inspections and Examinations issued a report which, in part, concluded that conflicts of interest were pervasive and disclosure practices lacking in the investment consulting industry.

Weeks later, the SEC and Department of Labor issued a publication entitled "Guidance Addressing Potential Conflicts of Interest Involving Pension Consultants."

Most significantly, conflicts of interest at investment consulting firms were found to result in substantial financial harm to plans by the U.S. Government Accountability Office ("GAO") in a 2007 report, i.e., plans using consultants with undisclosed conflicts of interest had annual returns generally **1.3 percent lower.**

For almost twenty years, from 1988 through December 31, 2007, Merrill Lynch, a broker-affiliated investment consultant, served as the investment consultant to the Board. If, as the GAO study found, pension consultant conflicts cost plans 1.3 percent, then over a 20-year period, with compounding, such conflicts may have cost the Fund **almost 30 percent** of its value—perhaps **$300-$500 million**.

Apparently throughout the consulting relationship Merrill Lynch's trading desk received trading commissions from investment managers that Merrill Lynch Consulting Services recommended to the Fund, in addition to a "hard dollar" annual fee from the Fund.

The General Counsel of the Fund publicly stated that the trades by the Fund's managers with Merrill's brokerage arm were "separate, so conflicts are less inherent" and "even if trades are made through Merrill Lynch's brokerage arm, those fees never make their way back to the consulting arm."

In 2003, when, according to The New York Times, Merrill Lynch paid to sponsor the General Counsel's annual client conference, Board members and Fund General Counsel were, according to documents we were provided in connection with this review, questioning Merrill regarding conflicts and business practices.

In December 2004, The New York Times wrote an article, How Consultants Can Retire on Your Pension, which discussed that potential consultant conflicts were greatest at firms with brokerage or trading operations. It was also stated that Merrill Lynch Consulting Services in Jacksonville had almost 100 pension funds in Florida as its clients but that some Florida funds had already fired the firm and replaced it with an independent consultant.

In December 2005, The New York Times ran an article entitled, "Merrill Unit Subpoenaed on Pensions." It was now widely known that the SEC was investigating Merrill's pension consulting operation in Florida.

In early 2006, the SEC contacted the Fund requesting voluntary cooperation in an investigation of Merrill. The Wall Street Journal reported on March 12, 2007 that Merrill had begun issuing refunds to public pension clients in Florida. On Sunday, November 4, 2007, the New

York Times ran an article regarding the SEC investigation of Merrill and the letters the firm had sent to clients.

By late 2007, when an SEC enforcement action against Merrill appeared imminent, Fund General Counsel recommended terminating the agreement with Merrill effective December 31, 2007, as well as tasking the new consultant with an in depth review of Merrill's reports and practices to determine if any previously undisclosed concerns were present and authorizing discussion with the Fund's securities counsel to determine if the Fund had suffered a recoverable loss.

On May 2008, Merrill announced it was closing down its Florida pension advisory practice and in January, 2009, the SEC took action against Merrill. Merrill Lynch agreed to settle the SEC's charges and pay a $1 million penalty.

On July 15, 2010, 76 Florida local public pensions, including the Fund, filed a detailed putative class action complaint against Merrill Lynch.

On March 23, 2012, the parties entered into a settlement resolving the matter for $8.5 million. Attorneys for the plaintiffs, including BLBG and the General Counsel's firm, shared $2.125 million in legal fees.

In response to our request for information, we were provided with a check dated February 28, 2013 made out to the Fund in the amount of $273,696.64 and a letter indicating that the check represented the Fund's pro rata share of the net settlement fund from the class action case brought against Merrill Lynch. It appears that, aside from an earlier transaction management credit of $10,000, this is the total compensation the Fund received from Merrill Lynch.

Since, based upon the GAO study, pension consultant conflicts may have cost the Fund almost 30 percent we requested any evaluation or review of the damage caused to the Fund by Merrill over the decades.

The Fund Administrator provided no such analysis and, as indicated above, the new consultant indicated it undertook no such review.

In our opinion, the Board failed to heed credible warnings and adequately investigate conflicts of interest related to the Fund's consultant for years. Based upon the documents we were provided, it appears the Board did not question the receipt of compensation by the General Counsel's firm—an obvious potential conflict of interest noted in The New York Times—from the consultant during the period. Even after terminating Merrill, the Board failed to conduct or commission any review of the potential harm to the Fund caused by Merrill, choosing instead to accept a settlement of a mere $273,696, for an estimated (based upon GAO analysis) $300-$500 million in underperformance losses. The Board failed to investigate the fact that the gross and net investment performance of the Fund as reported by Merrill were inexplicably the same for many years.

- **Current Consultant- Summit Strategies Group**

At least since the termination of Merrill Lynch, the investment consultant to the Board has been Summit Strategies Group.

While the list of the consultant's duties in the contract between the consultant and the Fund and the Statement of Investment Policy is extensive, conspicuously absent is any specific obligation to advise and assist the Board in negotiating and evaluating the investment advisory fees the Fund pays.

The Board's contract with Summit provides that information needed to provide the investment evaluations required of the Fund and its investment managers are generally contained in the records and reports of the custodian bank and that the consultant is entitled to reasonably rely upon such information.

While the custodian bank could provide such performance information, the Board under Merrill Lynch and now under Summit, continues to rely upon the consultant for performance analyses.

We recommend the contract between the Fund and its Master Custodian be amended to include calculating investment performance and that the Fund rely upon any investment consultant for only advice and analysis of such verified investment performance. We also recommend that the contract between the Fund and any investment consultant be amended to include a duty to advise the Board on the reasonableness of the investment advisory fees the Fund pays.

- **Plaintiff Class Action Monitoring Agreements**

The Fund has entered into agreements with multiple securities class action law firms to monitor its investment portfolio in order to determine whether the Fund has suffered any loss due to violations of federal and/or state securities laws, calculate losses, identify breaches of fiduciary duty and other corporate misconduct.

Some have severely criticized these "portfolio monitoring" arrangements between pensions and class action firms. One highly regarded federal judge, Judge Rakoff, noted in 2009, that such an arrangement was "about as obvious an instance of conflict of interest as I've ever encountered in my life." He said he was shocked that persons with a fiduciary duty to monitor pension investments would choose "to save a few bucks" by hiring a law firm to monitor those investments that could only profit by recommending litigation.

In response to plaintiffs' counsel's suggestion that his law firm analyzed and evaluated the merits of the case before recommending that the fund become involved in litigation, Judge Rakoff said that arrangement "makes crystal clear that the Iron Workers (the pension involved) *are*

being led by counsel rather than the other way around (emphasis added)."

We were provided with and reviewed portfolio monitoring agreements between the Fund and Bernstein Liebhard; Cohen Milstein; Berman DeValerio; and Spector Roseman. Again, we note that no portfolio monitoring or any other agreement between the Fund and the law firm of BLBG has been provided to us, despite our repeated requests.

The relationship between BLBG, the Fund and the Fund Administrator has been longstanding and is widely known.

The agreements Bernstein Liebhard and Berman DeValerio are relatively new (2011 and 2012, respectively) and seem quite broad, indicating that these firms will proactively identify instances of abuse by corporate management and breaches of fiduciary duties under federal securities, state securities, corporate and related areas of law. Whether class action securities firms, in general, are truly capable of ferreting out all such abuses is uncertain.

For example, based upon information provided by the Fund Administrator, it appears that no law firm monitoring the Fund's investments over the period from 1988 through 2008 notified the Fund of fiduciary breaches related to Merrill Lynch Consulting Services early on—breaches for which the SEC later took action against the firm.

Whether any firm monitoring the Fund's investments during this period represented that it would notify the Fund of any such fiduciary breaches should, in our opinion, be reviewed—if for no other reason than to determine whether the Fund should continue to rely upon any such firm to identify key fiduciary breaches related to its investments in the future.

- **Placement Agent Contingent Fees**

Placement agents are intermediaries or middlemen paid by external investment managers to market and sell their investment products. Placement agent fees are paid directly by money managers and indirectly by investors through higher asset-based fees than would be available absent the compensation arrangement between the manager and the intermediary.

The investment advisory contracts between the Board and the Fund's investment managers we were provided in response to our request generally include a provision stating that the manager warrants that it has not employed or retained a placement agent.

In response to our specific question the Fund Administrator represented that that no placement agent has ever directly or indirectly received compensation related to the Fund.

We note however, the following:

1. We were only provided with the most recent contracts to review. Whether older contracts contained such provisions is unknown.
2. Certain of the Fund's investments were made pursuant to subscription agreements and, as a result, there apparently were no representations regarding placement agents with respect to these investments.
3. Illiquid investments, such as those mentioned in item 2 above, commonly involve the use of placement agents.
4. Since placement agent fees are paid by the investment manager, the Fund Administrator may not be aware of any fee that may have been paid.
5. Whether compliance with the placement agent prohibition has been monitored or enforced over the years is unclear.

- **Conclusion**

As summarized above and detailed in our report, in our opinion, the Board has failed to provide oversight, consistent with its fiduciary duties, with respect to matters as fundamental as recording, evaluating and reporting investment performance of the Fund over time; investment manager and other vendor compliance with state and federal heightened ERISA fiduciary standards adopted by the Fund; monitoring conflicts of interest and establishing corresponding safeguards; and reviewing, as well as assessing, the reasonableness of investment management and other fees paid by the Fund.

While the Board, staff and others related to the Fund will, no doubt, dispute some or all of these findings, we believe that providing all the relevant information related to the issues identified in this report to the public, regulators and law enforcement, can only benefit all stakeholders in the Fund, as well as the nation.

END EXECUTIVE SUMMARY

II. Introduction

The City of Jacksonville, Florida Police and Fire Pension Fund ("the Fund") is a single-employer contributory defined benefit pension plan with assets of approximately $1.43 billion at September 30, 2015.

The Fund covers all full-time civil service members of the City Police and Fire Departments. Qualified membership is limited to only police officers and firefighters who are not members of any other pension fund. There were 5,038 total participants in the Fund as of September 30, 2014. The purpose of the Fund is to provide long-term benefits to the Fund's participants and their beneficiaries.

City leaders have debated reform of the Fund since at least 2008 when Florida TaxWatch, a nonprofit government watchdog group, raised alarms because the pension's unfunded liability was about $798 million at the time.[1] According to Florida TaxWatch, today the unfunded liability "stands at over $1.65 billion. It's increased three-fold since we called for reform in 2008."[2]

A Jacksonville Community Council study investigating Jacksonville's financial condition in 2009 concluded that the reasons for the massively underfunded pension included (i) lower investment returns than were assumed by the Fund, (ii) investment decisions and policies, (iii) changes in actuarial assumptions that asymmetrically locked in market gains but smoothed market losses, (iv) increased benefits (notably adding cost of living adjustments, or "COLAs" which employed a compounded 3 percent annual rate to benefit payments) and (v) changes in payroll.[3]

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[1] http://jacksonville.com/files/interactives/pensions/#part1

[2] http://news.wjct.org/post/jacksonville-rep-leads-workshop-examine-pension-problem

[3] "Our Money, Our City: Financing Jacksonville's Future," pg. 26.

On August 21, 2013, Mayor Alvin Brown appointed seventeen persons to the Jacksonville Retirement Reform Task Force, whose mission was to examine the Fund and make recommendations concerning its future and the design of and funding for pension benefits for Jacksonville police and firefighters. The Task Force was an enlarged and reconstituted task force from that which had been appointed by the Mayor on July 3, 2013.[4]

The Task Force completed its work on March 19, 2014, and on that date unanimously adopted its Report for delivery to the Mayor, the City Council President and the Administrator of the Fund.

As noted in the opening of the Report, in FY 2000, the Fund's deficit was approximately $124 million. In FY 2008, it increased to $798 million and in FY 2012 to $1.7 billion. At the same time, the Fund's funded ratio dropped from 87 percent in FY 2000 to 39 percent in FY 2013.

"These numbers are truly astounding. In FY 2000, the Fund was 87% funded; in FY 2008, 53% funded; and in FY 2012, 39% funded. *That is the lowest and most precipitous drop in funded ratio for any of Florida's large cities, despite the fact that every city in Florida – and for that matter in the country – experienced the same turbulent market conditions over that period of time*."

The Task Force Report contained numerous findings and conclusions and made recommendations with detailed explanations. With respect to investments, the Task Force called for the creation of a financial and investment advisory committee charged with advisory oversight to the Board of the Fund. Ethics, Certification and Disclosure Requirements

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[4] http://www.coj.net/retirement-reform/docs/retirement-reform-task-force-final-executive-summa.aspx

were recommended for Investment Managers and Advisors.[5] It was recommended that the Fund ordinarily use the Office of General Counsel of the City for its legal needs. Persons appointed to serve as Trustees of the Fund by the Mayor and City Council should be persons with professional financial or public pension experience. Also, greater disclosure on a timely basis on the fund's website was recommended. Finally, there were recommendations on the selection and compensation of a future Fund Administrator/Chief Investment Officer.

On December 15, 2014, state Representative Janet Adkins sent a letter to Florida Governor Rick Scott requesting the governor assign his inspector general and the Florida Department of Law Enforcement to look into the Fund's operations to determine if any state laws or regulations had been broken.[6]

Citing The Florida Times-Union articles about Jacksonville's pension issues, Adkins said they "create an appearance of impropriety, raise issues of questionable practices and possible mismanagement of the fire and police pension fund" that warranted a state investigation. Adkins specifically asked for an investigation of a special pension plan the Police and Fire Pension Fund board created for senior staff members, including John Keane, the longtime executive director.

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[5] It does not appear that any such requirements were recommended for other vendors, such as lawyers, investment consultants and custodians.

[6] http://jacksonville.com/news/metro/2014-12-16/story/state-rep-adkins-calls-gov-rick-scott-state-investigation-jacksonville

The Atlantic Beach City Commission and various members of the Jacksonville City Council sent letters of support backing Adkins' letter to the governor.

In early February 2015, Scott's office sent Adkins a letter signed by his chief inspector general, Melinda Miguel, who wrote that her office was choosing to stay out of the pension issues in Jacksonville.

"Based on our review, it appears that your concerns would be more appropriately handled at the local level," Miguel wrote. "If you are aware of specific criminal violations, you may refer this information to local law enforcement or the state attorney's office."[7]

The Jacksonville City Council unanimously voted on April 28, 2015 to hire Benchmark Financial Services, Inc. ("Benchmark") to provide an expert forensic review of the Fund. On June 24, 2015, Benchmark was contractually engaged by the City Council.

This investigation has focused upon transparency, governance and oversight of the Fund; state and federal fiduciary standards applicable to the Board, staff, investment managers, consultants, lawyers and other vendors, as well as compliance therewith; potential conflicts of interest and fiduciary breaches; disclosed and undisclosed fees paid by the Fund (or in connection with its assets) to investment managers and other fiduciaries; verifying, evaluating and reporting of investment performance; accounting, disclosure and use of commissions rebated to the Fund; fee-splitting by class action securities firms monitoring the Fund's portfolio investments and potential use of placement agent intermediaries in connection with the pension's investments.

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[7] http://jacksonville.com/news/florida/2015-02-03/story/scott-rejects-adkins-request-pension-investigation-says-issue-local

III. Limitations On Investigation

We note with great emphasis that this investigation was conducted without the power to compel the Board of Trustees of the Fund to comply with state disclosure laws or provide the documents we requested. As discussed with the Board Chair and noted throughout the report, the Fund Administrator and others failed to provide a great deal of the information we requested—including key documents which we have been told do, in fact, exist.

For example, the Fund Administrator repeatedly represented to us—contrary to written representations by the General Counsel of the Fund to the Board—that no portfolio monitoring agreement ever existed between the Fund and the Fund's "primary securities litigation counsel," Bernstein Litowitz Berger & Grossmann ("BLBG").

The Fund Administrator repeatedly claimed to have no documents disclosing the dollar amount of fees the General Counsel actually earned in connection with specific class action litigations the General Counsel recommended the Fund initiate against publicly traded companies—despite the fact that the General Counsel himself stated the final percentage, amounts and names of firms receiving such fees are always reported to the Board.

The historic investment performance information provided by the Fund's current investment consultant for the period from 1988 through today was neither prepared, nor confirmed, by the master custodian bank actually holding the assets—the most reliable source for such information.

Worse still, two decades of investment performance information was prepared by a former pension consultant to the Fund who was terminated as a result of an investigation by the United States Securities

and Exchange Commission ("SEC"). The SEC investigation concluded the firm breached its fiduciary duty to its pension clients by misrepresenting and omitting to disclose material information.

We are told the Board neither conducted nor commissioned any meaningful review of the former consultant's work—which included advising on key issues such as asset allocation and money manager selection—or potential damages to the Fund resulting from any fiduciary breaches, subsequent to terminating the firm.

In response to our request for verified performance for the twenty-year period, the master custodian indicated that it could not at this time calculate performance for the period.

The performance information we were provided was inaccurate, at least in part. In response to our questions, the current investment consultant noted obvious inconsistencies in certain of the performance figures provided.

Any analysis of investment performance data, portions of which, at a minimum, are clearly wrong is inherently less reliable.

While we have (below) estimated Fund underperformance losses of approximately **$370 million**, we simply do not know for certain how well, or badly, the Fund's investments have performed over the decades—and, apparently, neither does the Board nor anyone else currently involved with the Fund.

Certain significant information regarding potential conflicts of interest and fees paid by the Fund (directly or indirectly in connection with securities class action litigations), as well as fees paid by other fiduciaries of the Fund, such as law firms, investment managers and

consultants, to the Fund’s General Counsel was not provided despite repeated requests.

Information we requested regarding the expenditure of an estimated **$5.7 million** in securities trading commission dollars “rebated” to the Fund was not provided.

We recommend that all information requests by Benchmark related to this investigation, as well as all responses by the Board, Fund Administrator and others, be made publicly available so that stakeholders, including pension participants and taxpayers, are able to evaluate for themselves the Fund’s level of transparency and the integrity of its operations.

We understand that the City Council is subpoenaing the information which we requested but did not receive from the Fund Administrator and others and will provide any information it receives to stakeholders and, if appropriate, regulators and law enforcement.

This report represents our expert opinions based upon material provided by the Board, as supplemented by relevant information obtained from other sources deemed reliable, including published reports as noted. We reserve the right to amend this expert report based upon any additional data and documents that become available—including information we previously requested.

This report does not constitute legal, financial or tax advice and should not be relied upon as such. Rather, it is an expert opinion based upon certain evidence provided and reviewed.

IV. “Red Flags” Related to Board Lack of Transparency

The Fund’s website proclaims that the Board of the Fund supports the Florida "Government in the Sunshine" laws, designed to provide transparency and openness in government operations.” A link to the Florida Senate Website Archive is provided on the website through which members of the public can search for the relevant statute.[8]

Florida's Sunshine Law regarding open government establishes a basic right of access to most meetings of boards, commissions and other governing bodies of state and local governmental agencies or authorities.

Throughout the history of Florida's open government, its courts have consistently supported the public's right of access to governmental meetings and records.

As a Florida public pension, the Fund is subject to the Sunshine Law.

However, the Board has repeatedly come under criticism from citizens, media, foundations and City Council members for failing to be responsive to public records requests. Further, the Board has reportedly spent hundreds of thousands of Fund dollars in litigation related to requests for public records.

Most disturbing is the litigation involving citizen Curtis Lee’s request for documents.

“Requesting documents from the pension fund triggered a showdown that has lasted five years and counting — it is now at the Florida Supreme Court.

[8] In our opinion, a direct link to the relevant statute would be more expedient.

Before Lee could even touch the documents he wanted to look at, he was told he would have to pay $326.

Lee said he would pay only for the documents he wanted to copy.

The pension fund still wanted the $326, plus $280 to have someone monitor him while he sorted through the records.

Lee sued.

A court last May ordered the pension fund to pay $75,000 of Lee's legal fees. At that point in the case, the pension fund had spent $290,000 in legal fees to fight Lee over the public records case.

The legal bill has continued to grow, now inching toward $450,000, all over what started as a $326 fee."[9]

In the same article, a City Councilman expressed his disapproval:

"Shame on the police and fire pension fund [for always appealing] and taking it to the Florida Supreme Court," City Councilman John Crescembeni said. "This is a citizen spending his own time and his own money trying to get information about an entity that is misbehaving. It is David versus Goliath. It really is, and we know how that turned out."

Barbara Petersen, president of the First Amendment Foundation was quoted as saying, "Frankly, it burns me up that the pension fund would be vilifying Curt Lee."

According to the Florida Times Union, Lee's access to public records request ultimately led to fundamental questions regarding the history of the City and the Fund's negotiations of pension benefits.

"The access to public records paved the way for Lee's 2011 suit against the pension fund and the city of Jacksonville, alleging that the entities had a years-long history of negotiating pension benefits in private, dating to talks that created the 30-year agreement. Lee, with the concerned taxpayer group, asked that a judge toss the pact

[9] http://jacksonville.com/news/metro/2015-05-17/story/curtis-lee-citizen-activist-jacksonvilles-don-quixote-superhero-or-super

on the grounds the pension talks were conducted behind closed doors, which is contrary to the state's Sunshine Law.

"Even though the original disagreement was over the $326 issue, it is much more important than that," Dees (Lee's lawyer) said. "I think it shows the importance of citizens being able to access government records; because without that, we would not have been able to build and support our case that they [the city and police and fire pension fund] had negotiated pension benefits behind closed doors — always."

The Florida Times Union also experienced seemingly unnecessary delays in its public records requests. On August 13, 2015, the paper wrote:

"For instance, a records request initially filed in April wasn't completed until a few weeks ago. The specific information the paper was looking for took under two hours to find, according to a calculation from the pension fund when charging the paper for the record's request."[10]

As mentioned above, the Jacksonville Retirement Reform Task Force Recommendations included enhancing transparency at the Fund.

Further, in a memorandum to the Jacksonville Ethics Commission from Ethics Director Carla Miller dated November 3, 2014, Miller recommended that "the PFPF Board give serious consideration to ending expensive litigation and appeals over Sunshine issues, including the Denton case (court upheld violations of the Sunshine Law in the Wyse case) and public records case against Curtis Lee (hundreds of thousands of dollars spent on a $350 initial cost for public records)."

In connection with this investigation on behalf of the City Council, although we submitted our first document request on June 29, 2015, not a single record requested was provided to us by the Board or Fund Administrator for almost two months.

[10] http://jacksonville.com/news/metro/2015-08-13/story/forensic-audit-stymied-delays-getting-records-pension-fund-city

It is important to note the following regarding our initial request for documents:

1. Our request was not a "public records" request. It was a request by the City Council for records related to a pension substantially funded by the City.
2. Action by the City's Ethic Director, as reported in The Florida Times Union, immediately preceded and apparently prompted the late response in August to our June records request.
3. As a result of the Times Union article, the Board was on notice of the inadequate response to our requests and should have taken action to ensure full cooperation with this investigation.
4. The overwhelming majority of the documents requested, such as annual reports and investment performance reports were obviously readily available.

In the context of a forensic investigation into a highly controversial, severely underfunded, underperforming public pension—a very public investigation commissioned by the City Council—the delays, incomplete and inconsistent responses, as well as failures to produce documents we experienced amount to a profound "red flag," in our opinion.

V. Board Failure to Provide Fiduciary Oversight - Delegation of Broad Responsibility to Administrator and Outside General Counsel

A five-member Board of Pension Trustees has sole responsibility for administering the Fund. The Board provides investment oversight for the management of assets and has adopted a Statement of Investment Policy for the Fund.

As detailed throughout this report, in our opinion, the Board has failed to provide oversight, consistent with its fiduciary duties, with respect to matters as fundamental as verifying, evaluating and reporting investment performance of the Fund over time; investment manager and other vendor compliance with applicable state fiduciary and heightened federal (ERISA) fiduciary standards; monitoring conflicts of interest and establishing corresponding safeguards; and reviewing, as well as assessing, the reasonableness of investment management and other fees paid by the Fund.

The Board delegates responsibilities to the Fund Administrator for the implementation of the Statement of Investment Policy and in the provision of administrative oversight of the investment managers to ensure that the Board's policies are being properly implemented.

On the one hand, the Board has delegated exceptionally broad responsibilities to the Fund Administrator, encompassing various portfolio investment matters.[11] On the other, the Fund Administrator lacks any meaningful investment credentials.

The Board has also delegated broad responsibility to an outside law firm subject to numerous potential conflicts of interest related to matters

[11] The Administrator of the Fund is also charged with the responsibility for managing and directing all administrative, personnel, budgeting, and support functions, including recommending the strategic and tactical allocation of investment assets in consultation with the Investment Consultant. The Administrator is charged with developing specified Asset Class investment portfolio objectives and policy guidelines, and providing the Board with monthly and quarterly reports of investment activities provided by the Investment Consultant. The Administrator has the responsibility for recommending policies for maintaining diversified portfolios and maximizing returns with respect to the broad diversified market standards of individual Asset Classes, consistent with appropriate risk constraints. The Administrator is responsible for recommending changes respecting the appropriateness of the goals and objectives in this Plan in light of actuarial studies and recommending timely changes to the Board when appropriate. The Administrator is also responsible for ensuring that an appropriate system of internal controls is developed to safeguard the assets of the Fund. http://www.coj.net/departments/police---fire-pension-fund/statement-of-investment-policy/december-20-2012.aspx

such as opining as to the legitimacy of a senior staff pension plan funded by the Fund (and later deemed illegal by the City General Counsel); splitting fees with class action law firms he recommended to the Board; receiving client conference sponsorship fees from other plan fiduciaries; and advice regarding retaining and later suing the former investment consultant.

VI. Board Lacks Errors and Omissions - Fidelity Bond Coverage

While the Board has required many, but not all, of the investment managers to maintain errors and omissions insurance coverage of at least $10 million,[12] as well as a blanket fidelity bond satisfying ERISA requirements,[13] in response to our inquiry, the Fund Administrator indicated that the Board and staff has no such insurance coverage.[14]

Currently, the cost of defending legal challenges to the Board's actions, e.g., denial of public records requests and allegedly illegal staff pensions, is paid out of Fund assets (and ultimately by taxpayers and participants) —as opposed to by an insurer. The Fund is also at risk regarding any loss resulting from fraudulent or dishonest acts by the Board or the staff.

The Board has an obligation, as an ERISA fiduciary, to manage the Fund exclusively for the benefit of participants. Opposing public records requests or defending allegedly illegal staff pensions does not, in our opinion, in any way benefit the Fund or its participants. Thus, in our

[12] For example, see Sawgrass Asset Management contract dated October 1, 2013.

[13] As an additional protection for plans, those who handle plan funds or other plan property generally must be covered by a fidelity bond. A fidelity bond is a type of insurance that protects the plan against loss resulting from fraudulent or dishonest acts of those covered by the bond.

[14] It is our understanding that the City of Jacksonville Retirement System also lacks any such insurance coverage.

opinion, Fund assets should not be used to defend the Board, staff and others in these matters.

As ERISA fiduciaries, the Board should obtain errors and omissions coverage to protect the Fund against loss resulting from errors or omissions by the Board or staff, in our opinion.

As ERISA fiduciaries, the Board should obtain fidelity bond coverage to protect the Fund against loss resulting from fraudulent or dishonest acts of the Board or staff, in our opinion.

A copy of this report, as well any complaints filed against the Board or staff, should be provided to any potential insurer.

Finally, as discussed below, as ERISA fiduciaries, the Board and staff may be personally liable in the event of a breach of fiduciary duty, including use of plan assets for personal benefit.

VII. ERISA Fiduciary Standard Adopted for Board, Staff and Service Providers

The Introduction to the Fund's Statement of Investment Policy states,[15] "Although the Board of Trustees acknowledges that the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), does not apply to the Fund as a governmental retirement plan, it hereby adopts the fiduciary provisions of ERISA. The Board, the Fund's staff and the Fund's service providers shall discharge their responsibilities in the

[15] http://www.coj.net/retirement-reform/docs/appendix/c-2---jpfpf-statement-of-investment-policy.aspx

same manner as if the Fund were governed by the fiduciary responsibility provisions of ERISA."[16]

Later in the Policy,[17] with respect to the Board, it is more narrowly stated:

"The Board of Pension Trustees, in performing its investment duties, shall comply with the fiduciary standards set forth in the Employee Retirement Income Security Act of 1974 at 29 U.S.C. S. 11 04(a)(1)(A) through (C). These provisions are attached hereto as Exhibit B in the form of ERISA Section 404(a)(1)(A) through (C). However, in case of conflict with other provisions of law authorizing investments, the investment and fiduciary standards referenced under Section 112.661, Florida Statutes, shall prevail."[18]

Finally, on page 35, specifically with respect to the Fund's external investment managers:

"The Fund's Investment Managers shall discharge their responsibilities in the same manner as if the Fund were governed by the fiduciary responsibility provisions of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Although

[16] The City of Jacksonville Retirement System includes this same language in its Statement of Investment Policy posted on its website.

[17] Page 8.

[18] ERISA Sec. 404. (a)(1) Subject to sections 403(c) and (d), 4042, and 4044, a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and – (A) for the exclusive purpose of: (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan; (B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. (C) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and (D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this title or Title IV. (2) In the case of an eligible individual account plan (as defined in section 407(d)(3)), the diversification requirement of paragraph (1)(C) and the prudence requirement (only to the extent that it requires diversification) of paragraph (1)(B) is not violated by acquisition or holding of qualifying employer real property or qualifying employer securities (as defined in section 407(d)(4) and (5)).

the Board acknowledges that ERISA does not apply to the Fund as a governmental retirement plan, it hereby imposes the fiduciary provisions of ERISA upon each Investment Manager whose performance shall conform to the statutory provisions, rules, regulations, interpretations and case law of ERISA. Each Investment Manager shall acknowledge within the investment advisory agreement that it is a fiduciary, as that term is defined by ERISA, of the Fund."[19]

ERISA is a federal law which protects the assets of millions of Americans so that funds placed in retirement plans during their working lives will be there when they retire. ERISA sets minimum standards for pension plans in private industry.[20]

According to the United States Department of Labor (which enforces ERISA), ERISA fiduciaries have important responsibilities and are subject to standards of conduct because they act on behalf of participants in a retirement plan and their beneficiaries. These responsibilities include:

- Acting solely in the interest of plan participants and their beneficiaries and with the exclusive purpose of providing benefits to them;
- Carrying out their duties prudently;
- Following the plan documents (unless inconsistent with ERISA);
- Diversifying plan investments; and
- Paying only reasonable plan expenses.[21]

An ERISA fiduciary also has an obligation to avoid transactions that are prohibited ("prohibited transactions") with respect to a pension plan.[22]

[19] As noted elsewhere, not all investment managers handling Fund assets have so acknowledged.

[20] http://webapps.dol.gov/dolfaq/go-dol-faq.asp?faqid=225

[21] http://www.dol.gov/ebsa/publications/fiduciaryresponsibility.html

[22] http://www.dol.gov/ebsa/fiduciaryeducation.html

Recent court cases have made clear that under the "exclusive benefit rule," fiduciaries have a duty not to mislead plan participants when discussing plan-related matters. Some courts have begun to expand this duty into an obligation not to mislead by omission or even to impose an affirmative duty to disclose material information.

A fiduciary's committing or allowing a violation of the securities laws also may constitute a breach of the fiduciary's duties under ERISA. This theory may allow ERISA's more generous enforcement scheme to be applied to what are, in essence, securities law violations.

ERISA prohibits certain direct or indirect transactions between a plan and a party in interest to that plan. Parties in interest with respect to a plan include, among others: 1) all fiduciaries of the plan; 2) any person providing services (fiduciary or non-fiduciary) to the plan; 3) any employer or union whose employees are covered by the plan; and 4) numerous parties affiliated with the foregoing in various direct or indirect ways.[23]

VIII. ERISA Fiduciary Standard Highest Known to the Law

The fiduciary duty established under ERISA is recognized as the "highest known to the law."[24]

In addition to the general fiduciary duties described above, ERISA strictly prohibits the fiduciary from engaging in a self-dealing transaction that involves plan assets where a conflict of interest exists.[25]

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[23] http://www.groom.com/media/publication/145_erisa_for_security.pdf

[24] Donovan v. Bierwith, 680 F.2d 263, 272 n. 8 (2d Cir. 1985).

[25] Section 406(b) of ERISA prohibits the following self-dealing transactions:

- A fiduciary may not deal with assets of the plan in his own interest or his own account;

The disclosure of a material conflict, alone, is never sufficient under ERISA's duty of loyalty and self-dealing "prohibited transaction" provisions to avoid a violation of ERISA. Conflicts of interest are by definition contrary to ERISA's fiduciary duty of loyalty and self-dealing prohibited transaction provisions.[26]

Failing to comply with ERISA's fiduciary requirements can result in significant penalties. ERISA provides that a fiduciary is *personally liable* in the event of a breach of the fiduciary duty provisions. Furthermore, ERISA provides the fiduciary may have to make good on any losses to the plan caused by the breach and restore any profits gained by the fiduciary in using plan assets to its own benefit.

IX. Lack of Compliance with ERISA Fiduciary Standard

Since the Board has adopted the heightened fiduciary standards of ERISA in the Fund's Statement of Investment Policy posted on its website, stakeholders (including participants and taxpayers) may reasonably assume that the Board has established policies and procedures to ensure compliance with these standards. We found scant evidence of compliance with ERISA fiduciary standards.

In our opinion, it appears ERISA fiduciary compliance has been largely overlooked—despite the fact that these are heightened fiduciary

- A fiduciary may not act in any transaction involving the plan on behalf of a party whose interests are adverse to the interests of the plan or the plan's participants and beneficiaries; or,
- A fiduciary may not receive any consideration for his own personal account from any party dealing with the plan in connection with a transaction involving plan assets.

26 http://www.groom.com/media/publication/1269_ERISA_Fiduciary_Comparison_to_Securities_Laws.pdf

standards, noncompliance can have serious consequences and there is a risk of significant personal liability.

For example, as mentioned below, Board failure to scrutinize investment management fees—as required under ERISA fiduciary standards—we estimate, alone, has resulted **in $6 million** in excessive fees paid each year or **$36 million** over the past six years. The Board's failure to conduct or commission any review of the damage to the Fund caused by its former investment consultant over two decades, choosing instead to accept a settlement of a mere $273,696, for an estimated (based upon GAO analysis) **$300-$500 million** in underperformance losses, was exponentially costlier**.**

Our limited review of the investment management agreements[27] and subscription agreements between the Board and its asset managers identified serious apparent ERISA non-compliance.

With respect to Fund's investments in the Acadian Emerging Markers Equity II Fund, Eaton Vance Institutional Senior Loan Fund, Silchester International Value Equity Group Trust, and the Principal U.S. Property Account, no "contract" was provided to us drafted by the Board between the investment managers and the Board requiring the managers to comply with the Fund's Statement of Investment Policy, including the ERISA fiduciary standards adopted by the Fund.

The Investor Subscription Booklet for the Acadian Emerging Markets Equity II Fund LLC[28] states that if the investor (the Fund) is not subject to ERISA, the Fund acknowledges that Acadian may enter into certain swap and other transactions and represents that those transactions by Acadian will not result in a violation of any law to which the Fund is

[27] We reviewed **only** the current investment advisory contracts between the Fund and its managers, as provided by the Fund Administrator. These contracts were generally created in 2013.

[28] We were not provided with and did not review any Private Placement Memoranda, Limited Partnership Agreements or any other such documents related to the Fund's investments.

subject that is similar to the prohibited transaction provisions of ERISA and represents that entering into such transactions is permissible under the governing documents of the Fund.

The Fund Administrator indicated in the Acadian Investor Questionnaire that the Fund was not subject to ERISA.

The Fund agrees to indemnify Acadian against all liabilities arising out of any breach of any representation, warranty or agreement of the Fund, including any misrepresentation related to the ERISA Questionnaire (to be completed by ERISA investors only and which the Fund indicated was "not applicable" and did not complete or sign).

Since the Statement of Investment Policy indicates that all Fund managers, including Acadian, will be held to ERISA fiduciary standards, then Acadian presumably cannot engage in any transactions that would be prohibited for fiduciaries under ERISA, unless there is an applicable ERISA prohibited transaction exemption.

For example, with respect to the payment of fees to the investment manager or its affiliates (in addition to the management fee) in order to avoid a prohibited transaction under ERISA, the prior written approval of an independent fiduciary on behalf of the Fund may be required. Brokerage, principal transactions and securities lending undertaken by the manager may be impacted by ERISA prohibitions. As disclosed by Acadian, ERISA compliance may require Acadian "to forgo certain investments or other arrangements on behalf of the Fund that otherwise may be desirable."

An Independent Fiduciary may have to "acknowledge that none of the Fund, the Investment Manager, or their affiliates, shall be responsible for compliance by the plan or entity with the provisions of ERISA

requiring that investments of such plan or entity be diversified so as to minimize the risk of large losses."[29]

In short, it appears that Acadian may not be aware of its obligation to manage Fund assets consistent with ERISA fiduciary standards and may not be managing the Fund's assets accordingly. While any such ERISA fiduciary breaches could conceivably give rise to liability for losses, the Fund has agreed to indemnify Acadian for any ERISA fiduciary breaches.

In the Eaton Vance Subscription Documents the Fund represented that it was not an employee benefit plan subject to the fiduciary responsibility standards and prohibited transaction restrictions of ERISA.[30]

Certain of the practices permitted in the agreement with the Fund's Master Custodian, Northern Trust, may be inconsistent with ERISA fiduciary standards.

For example, the contract indicates that Northern may deposit cash in any depository including its own banking department, without any liability for the payment of interest thereon and receive "float" income on uninvested cash. Also, the Board accepts that Northern may act as principal on foreign exchange transitions providing such service at rates established in its discretion and may retain any profit derived from such service.

With respect to the investment advisory contracts between the Board and Northern Trust, GAMCO Asset Management, Pinnacle Associates, Eagle Capital Management; Brown Advisory; Thompson, Siegel & Walmsley, Deprince, Race & Zollo, Inc., JP Morgan Investment Management, it is stated that "the advisor acknowledges that it is a

[29] Investor Subscription Booklet for the Acadian Emerging Markets Equity II Fund LLC, page 22.

[30] Page C-7.

fiduciary with respect to the management of the assets of the Fund and that it is subject to and shall be governed by the "prudent man rule" as that term is defined and interpreted under ERISA."[31]

This representation is not what is required under the Statement of Investment Policy:

"Investment Managers shall discharge their responsibilities in the same manner as if the Fund were governed by the fiduciary responsibility provisions of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Although the Board acknowledges that ERISA does not apply to the Fund as a governmental retirement plan, it hereby imposes the fiduciary provisions of ERISA upon each Investment Manager whose performance shall conform to the statutory provisions, rules, regulations, interpretations and case law of ERISA. Each Investment Manager shall acknowledge within the investment advisory agreement that it is a fiduciary, as that term is defined by ERISA, of the Fund."

Further, the contracts drafted by the Board state, "The Board represents that the Fund is not subject to ERISA."

The Board contracts also state that the investment adviser shall have no liability for any act or omission of a custodian or broker or dealer; if any losses are suffered by the Fund, the Fund will seek any recovery or pursue any remedy available against such custodian, broker, dealer or

[31] Note: In addition to the language above, certain investment advisory contracts between the Fund and Northern Trust (which serves as custodian to the Fund) also provide that NT "acknowledges that it will be an Investment Manager of the Designated Fund as that term is defined by ERISA and a fiduciary of the Trust Fund." Further, in amendments to those agreements it is stated that any securities lending will be in accordance with Department of Labor Prohibited Transaction Class Exemption 2006-16 and that an Investment Fiduciary will authorize payment of fees to the affiliate appointed as lending agent. The Harvest Fund Advisors contract states that the firm "acknowledges that it is a fiduciary with respect to the management of the assets of the account and that it is subject to all applicable provisions of ERISA (including Section 404 (a)).

third party as appropriate. The investment advisor shall have no responsibility relating thereto.

Under both the federal securities laws and ERISA, investment adviser fiduciaries may be held responsible for acts or omissions of all such third parties. For example, investment managers clearly have an obligation to be diligent in selecting brokers to execute client trades.[32]

The agreements between the Board and the Board's General Counsel and investment consultant raise additional ERISA fiduciary issues discussed below.

We recommend a complete review of the Fund's policies, practices, procedures and agreements for compliance with heightened ERISA fiduciary standards. In the event that the Fund has suffered losses as a result of ERISA non-compliance, damages may be recoverable from responsible parties.

X. Controversies Regarding Pension Staff

Pension staff consists of seven employees. The Executive Director-Administrator of the Fund since 1990 has been John Keane. In addition, according to the Fund's website:

"Mr. Keane has served as a member and Chairman of the Pension Advisory Committee, and Member of the Board of Pension Administration. He was elected to the first Police and Fire Pension Fund Board of Trustees when the Fund became independent of the City."

[32] Section 3 (a) in the contracts states that the investment advisor shall diligently execute transactions in a method and manner and at such times as to procure best price and execution; 3(b) investment advisor agrees to utilize commission recapture agents subject to its continuing duty to secure best execution and where it is reasonable to do so; and 3(c) may place orders for execution with brokers and dealers the advisor may select using reasonable efforts to obtain best available price and execution. This language generally reflects the duties applicable to investment managers when trading customer securities under the federal securities laws and ERISA.

Mr. Keane also has been active in numerous public pension associations.

"John has served as an Executive Committee member of the National Conference on Public Employee Retirement Systems, and served on the Administrator's Committee and Public Employees Committee of the International Foundation of Employee Benefit Plans.
John served three terms as a member of the Executive Committee of the Coalition to Preserve Retirement Security. He also serves on the Council of Institutional Investors Executive Committee and is a member of the Government Finance Officers Association Focal Group."

According to the Fund's website, Keane frequently speaks at seminars, conferences, and forums on public pension issues.

As mentioned earlier, the Board delegates responsibilities to the Fund Administrator and Keane's responsibilities are exceptionally broad, encompassing various portfolio investment matters. Yet the Fund Administrator lacks any meaningful investment education.

Keane is the first and — to date — only executive director of the city's Police and Fire Pension Fund. He does not hold an advanced degree in finance nor a related academic field.

Keane, who never advanced up the ranks in the fire department, earned a top salary of $56,000 a year as a firefighter.[33]

Most unusual, in addition to his role as Administrator of the Fund, Mr. Keane has been the lead negotiator for police and fire unions in pension reform negotiations.

"This is the only city in Florida where the city negotiated benefits with the pension fund as opposed to the union," attorney Bob Dees said.

According to former City General Counsel James C. Rinaman Jr.:

"There is no legal authority for the Fund to collectively bargain with the city for pension benefits on behalf of the police and fire unions. There is an inherent conflict

[33] Id.

of interest for the pension trustees to bargain for pension benefits. Their duties are limited to administering and managing the pension funds, and negotiating for new or increased benefits conflicts with performance of that duty."[34]

Mr. Keane has been a controversial figure as a result of his frequent convention travel, over $400,000 in unused vacation pay and "questionable deals for his personally created pension."[35]

"When pension-reform negotiations begin in earnest, the lead negotiator for the police and fire unions also will be negotiating for his own pension, a special, multimillion-dollar retirement that is unusual in several respects:

- He helped create it.
- The city concluded it was created illegally and demanded that the millions already spent to fund it be repaid.
- It is a senior executive retirement plan, something common in private business but rare for public servants. Unlike the union pension fund he oversees, his is also pre-funded, which is far from common in business.

Despite the city's cease-and-desist order, the money not only has not been repaid, but more than $250,000 in city money has been added to the plan since the city's objections. Now his pension is fully funded.

The plan is paid for at the expense of the dangerously underfunded Jacksonville Police and Fire Pension Fund.

And his personal pension has grown following a succession of five-figure pay increases that have elevated his annual salary to more than $300,000."[36]

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[34] http://jacksonville.com/news/metro/2014-05-03/story/while-john-keane-negotiates-jacksonville-police-and-fire-pension-fund

[35] http://jacksonville.com/news/metro/2015-09-05/story/john-keane-one-several-board-members-controversial-special-pension

[36] http://jacksonville.com/news/metro/2014-05-03/story/while-john-keane-negotiates-jacksonville-police-and-fire-pension-fund

On August 29th, Mr. Keane gave three-week notice that he would retire on September 18, 2015. However, at the Board's insistence, he agreed to stay on at the Fund through the end of the month.[37] Most recently, it is our understanding he has been engaged as a consultant to the Fund.

XI. General Counsel Potential Conflicts-Compensation Disclosure

The legal counsel to the Board over the decades has been the Plantation, Florida law firm of Klausner Kaufman Jensen & Levinson.[38]

The January 1, 2014 professional services agreement between the Board and the law firm states that the firm has expertise in the area of public employee retirement systems and is competent to perform the duties required.

The agreement indicates that in addition to attending all meetings of the Board; maintaining additional office hours at the offices of the Board; reviewing contracts and other documents for legal form and correctness; providing verbal and legal written opinions as requested by the Board, the firm will review and supervise the services of any other attorneys who may be retained by the Board. Further, the Board agrees to "help defray the costs of reasonable educational materials to be maintained at the office of the Board for use by the firm."

In effect, the Klausner firm acts as the outside General Counsel of the Board, supervising even other attorneys retained by the Board, as well

[37] http://jacksonville.com/news/metro/2015-09-08/story/jacksonville-city-council-delays-looking-legality-pension-departing

[38] On its website the firm claims to have provided legal services to Jacksonville Electric Authority; Jacksonville, Florida Retirement System; Jacksonville, Florida Sheriff's Office.

as recommending attorneys and litigations. In certain documents Mr. Klausner refers to himself as General Counsel.[39]

The agreement states that "the role of the attorney in representing the Board is that of a fiduciary and the attorney shall act in accordance with general principles of fiduciary responsibility."

The contract does not state that the firm, as a service provider of the Board shall discharge its responsibilities in the same manner as if the firm were governed by the fiduciary responsibility provisions of ERISA.

The Statement of Investment Policy of the Fund states, with respect to "other external service providers," that the Fund shall retain legal counsel to provide support for the legal needs of the Fund. The Policy includes an elaborate discussion of the fiduciary obligations specifically applicable to *any* service provider, as well as disclosure and conflict of interest prohibitions.

Unlike the contracts the Board has with many of the Fund's asset managers, the agreement does not require the law firm to maintain a $10 million errors and omissions insurance policy or fidelity bond.

The agreement states that the Board will pay the firm at a $285.00 hourly rate, together with a $200.00 monthly retainer.

As ERISA fiduciaries of the Fund, the Board has a duty to review any potential conflicts of interest related to the General Counsel and other law firms providing services to the Fund and all compensation paid to, or received by, these parties related to the Fund for reasonableness. Likewise, as ERSIA fiduciaries, the General Counsel and other law firms providing services to the Fund have an obligation to disclose any

[39] November 18, 2008 memorandum to Board Re: Securities monitoring services.

potential conflicts of interest and all compensation they pay, or receive, related to the Fund.

Based upon the limited information eventually provided by the Fund Administrator, it does not appear that the Board has fulfilled its fiduciary duty under ERISA to scrutinize the potential conflicts related to, and reasonableness of, the compensation paid to, or received by, the General Counsel and other law firms related to the Fund.

In an effort to identify all sources of compensation and potential conflicts of interest related to the General Counsel, we requested the following information from the Fund Administrator:

Please provide documents reflecting any compensation in any form, direct or indirect, paid by any fiduciary to the Plan to the Plan's attorney, Robert Klausner or any of his related law firms or entities for the past 15 years. If you assert that the Plan does not have these documents, please request that the Plan's attorney disclose this data to the Plan pursuant to their fiduciary duties to the Plan and provide us proof of this request and response.

In response, the Fund Administrator provided only payee transaction information indicating that the Fund (no other fiduciary) over the past 10 years (not the 15 requested) paid the General Counsel directly approximately $2.72 million for professional services from October 2004 through August 19, 2015. The General Counsel provided no information to us.[40]

1. Compensation to General Counsel From Class Action Law Firms

According to published reports (and the General Counsel himself), in addition to the fees paid by the Fund to the General Counsel (e.g., the

[40] Note: Our above request for information from the Fund Administrator included, but was not limited to, any such legal fees paid by the Fund to the General Counsel.

$2.7 million disclosed above), the firm may have received millions in fees from one or more securities class action law firms retained by the Fund to pursue litigation related to the Fund's investments.

As discussed further elsewhere, it is our understanding that the General Counsel:

1. Recommends class action law firms to monitor the Fund's investments and pursue litigation related to portfolio securities;
2. Advises the Fund when to initiate or participate in a given lawsuit;
3. Negotiates (on behalf of the Fund) fees paid to these law firms;
4. Enters into fee-splitting arrangements with the firms he recommends for class action litigations whereby his firm receives a portion of the fees related to these cases.

According to Forbes:

"The outside counsel to the Jacksonville Police & Fire Fund, Robert Klausner of Plantation, Fla., receives a varying cut of lawyer fees for work on cases he refers to class action firms, on top of a retainer for routine work. Fund trustees seem largely unaware of Klausner's arrangement. "There are a lot of suits we're probably involved in because our attorney [Klausner] is involved in a lot of things," says Barbara Jaffe, a Jacksonville fund trustee and an adviser with Wachovia Securities. Trustee Bobby L. Deal, a lieutenant with the Jacksonville police, says of Klausner: "He's on retainer. If there's any other compensation, I'm not aware of it." Klausner says his pay is adequately disclosed and that it's the job of the fund's administrators to keep the trustees well informed.[41]

Note in the above article, it is stated that the trustees of the Fund "seemed largely unaware of the General Counsel's arrangement" and the General Counsel stated that it was the job of the Fund Administrator

[41] http://www.forbes.com/forbes/2004/0920/150.html

to keep the trustees well informed (of the class action contingency fees his firm may have received).

For example, as discussed further below, the General Counsel apparently received a portion of the legal fees paid in connection with settlement of a Merrill Lynch Consulting Services Florida public pension class action lawsuit in which the Fund participated.

The Fund has also served as "lead plaintiff" in multiple class action cases. The lawyers representing the lead plaintiffs are generally awarded the fees by the court and generally keep most of the fees.

Florida Rules of Professional Conduct applicable to lawyers effectively provide that a division of fees between lawyers who are not in the same firm may only be made pursuant to an agreement that fully discloses that a division of fees will be made and the basis upon which the division of fees will be made.[42]

Any potential violations of such rules regarding full disclosure of fees, including any misrepresentation of fee arrangements by a lawyer should be reported to the appropriate authorities. An apparently isolated violation may indicate a pattern of misconduct that only a disciplinary investigation can uncover and reporting a violation is especially important where the victim is unlikely to discover the offense, according to the Florida Bar.

We note with great emphasis that even if any such fee-splitting arrangements among law firms may be permissible under certain conditions prescribed by laws generally applicable to Florida licensed lawyers, whether the General Counsel, as an ERISA fiduciary to the Fund, may receive such fees and whether the class action firms, as ERISA

[42] https://www.law.cornell.edu/ethics/fl/code/FL_CODE.HTM#Rule_4-1.5

fiduciaries, may pay such fees to the General Counsel in connection with Fund litigation is an entirely separate matter. Any such dealings may amount to "prohibited transactions" under ERISA fiduciary standards giving rise to personal liability.

In general, full disclosure of the potential conflict of interest and amount of any fees related to a transaction potentially involving fiduciary "self-dealing" would be required, at a minimum.

We repeatedly requested the following information from the Fund Administrator:

"Provide contracts between the Plan and any class action securities law firms for either monitoring or litigation from 2000 through the current year."

In connection with the contracts, provide any documents that are related to any referral fees or fee sharing agreements between any of these class action law firms providing services to the Plan and any fiduciary, including attorneys, to the Plan. For each of these agreements, please provide documents reflecting disclosure to, and approval of, these agreements by the PFPF Board."

While the Fund Administrator eventually did provide four portfolio monitoring agreements between the Fund and securities litigation firms, as discussed more fully below, he did not provide all contracts or agreements with all class action law firms.

The Fund Administrator also repeatedly stated—contrary to written representations by the General Counsel to the Board we reviewed—that no portfolio monitoring agreement ever existed between the Fund and BLBG.

With regard to the sharing of legal fees between the General Counsel and class action firms, the Fund Administrator initially responded:

No referral fees are paid to the General Counsel, nor does he bill the Fund for his time working with the Class Counsel on these matters. His compensation, if any, comes from the Court approved legal fees.

In response to our inquiry about any court approved fees:

Please provide the court orders approving the payment of fees related to any case in which the Fund has participated over the past 15 years as a lead or named plaintiff.

The Fund Administrator responded:

As I previously responded - We have none. All fees were Court approved in each case. Court orders are in the files of the individual cases. WE do not have copies of the pleading and other documents in these cases.

Shortly after the Forbes article (cited above) that mentioned fees the General Counsel received for referring cases to class action firms, the General Counsel wrote a letter to the Trustees, at the request of the Chairman, to review prior discussions concerning the Fund's role as a lead plaintiff in securities litigation matters.

The September 20, 2004 letter stated that the Board entered into an agreement with BLBG to monitor the Fund's portfolio and email reports were sent by BLBG to the Executive Director whenever a loss due to an unlawful activity had been identified.

According to the General Counsel, the Board had adopted a policy to delegate to the Executive Director and board counsel, the duty of reviewing those reports and determining whether to participate in litigation. In addition to a contingency fee agreement with the class action litigation firm, the General Counsel's firm would be paid a fee from any class settlement in which the Fund participated.

We note the following statement in the General Counsel's letter to the Board:

If a fee was paid, the amount and the names of the payees would be reported in writing to the Board. No fee application or settlement decision would be made without the Board's prior approval. Fees, said the General Counsel, "are usually between 15-18% of the recovery. I usually receive between 5 and 10% of the approved fee. The final percentage and the dollar amount are always reported to the client."

Thus, we asked the Fund Administrator:

In a letter dated September 20, 2004, Robert Klausner told the Board, "I usually receive between 5 and 10% of the approved fee (in class actions). The final percentage and dollar amount are always reported to the client."

Accordingly, please provide final percentage and dollar amount of all fees received by the Klausner firm related to any class action litigation involving the Fund, as disclosed to the Board. If the final percentages and dollar amounts were not disclosed, please so indicate.

We received no response to this last email to the Fund Administrator.

While our requests for information regarding compensation to the General Counsel in connection with class action litigations have generally been unsuccessful, based upon the information we have obtained from alternate sources, we estimate that the General Counsel may have received the following compensation in addition to the $2.7 million paid directly by the Fund:

United Health Group: Plaintiff's counsel awarded fee of $29,253,853.00 and costs of $514,591.78. Assuming the General Counsel received 10 percent of this amount or approximately $2.9 million, the fees from this case alone may have exceeded total fees of $2.7 million paid directly by the Fund over the past ten years.

Merrill Lynch: $8.5 million settlement; fees awarded of $2.125 million. The fees awarded represented 25 percent of the settlement—not the 15-18 percent the General Counsel told the Board usually applied. Assuming the General Counsel received 10 percent of the approved fee, he earned $212,500—nearly as much as the $273,696 the Fund received from the Merrill settlement fund.

In connection with an Ernst & Young (Nextcard) settlement, of a $23.2 million offer made in April 2005, the General Counsel stated he would receive 10 percent of the fee ultimately paid to BLBG. Assuming BLBG received a fee of 18 percent and the General Counsel received 10 percent of that fee, the General Counsel may have received $417,600.

We note in this report that other Florida public pension lawyers claim that class action firms routinely offer them 18 percent. If true with respect to the General Counsel, then the total class action fees estimated above may be significantly understated.

It is our understanding that the City Council will subpoena from the General Counsel and all other lawyers that provide services to the Fund, information regarding all payments to and between law firms directly or indirectly related to the Fund. These parties should not object since, according to the documents we have reviewed, they claim to have already fully and accurately provided all such fee-splitting information to the Board.

We note that the Fund pays the General Counsel $285.00 per hour for his legal services. As ERISA fiduciaries, the Board should examine any differential in the hourly rate he receives in connection with class actions, as well as any percentages in lieu of hourly rates.

2. Compensation From Fund Fiduciaries to General Counsel

According to the same 2004 article in Forbes, the General Counsel may have received additional compensation from law firms (not related to legal services) and other fiduciaries of the Fund, such as investment consultants and investment advisors managing Fund assets.

"Bernstein Litowitz also pays Klausner a sum he won't disclose (and which Berger puts at up to $30,000) to be the only class action lawyers with access to Klausner's annual powwows of pension officials."[43]

As fiduciaries to the Fund, in our opinion, both BLBG and the General Counsel, at a minimum, have an obligation to disclose any potential conflicts of interests, including any related compensation. Whether either law firm, as ERISA fiduciaries to the Fund, may pay or receive such fees is a separate matter.

Payments from BLBG to the General Counsel—who recommended BLBG for highly-lucrative securities litigation—pose a significant conflict of interest, as do payments from Merrill Lynch to the General Counsel.

As discussed extensively below, Merrill Lynch served as the Fund's investment consultant for nearly two decades, including in 2003 when, according to The New York Times, Merrill paid to sponsor the Klausner client conference.

"Pension consultants aren't the only ones holding conferences where money managers can hobnob with pension officials. Robert D. Klausner, a lawyer at Klausner & Kaufman in Plantation, Fla., whose firm provides legal counsel to many pension funds in Florida and elsewhere in the south, runs similar meetings.

Klausner & Kaufman's sixth annual client conference was in March at the Hyatt Regency in Fort Lauderdale, Fla. Among the eight companies that paid to sponsor

[43] http://www.forbes.com/forbes/2004/0920/150.html

the 2003 conference were Merrill Lynch and Davis Hamilton Jackson & Associates, a money manager based in Houston that Merrill often recommends to its pension clients."[44]

The General Counsel advised the Fund on conflicts of interest involving Merrill Lynch, as well as the decision to terminate Merrill and later participated in litigation (resulting in fees paid to BLBG and his own firm) against the Merrill.

We also note that Victor Zollo, President of the Fund's longest domestic equity investment managers, DePrince, Race & Zollo (which currently manages approximately $110 million for the Fund and has managed Fund assets since September 1994) was a speaker at the Klausner 2015 public pension client conference and the firm may have paid to sponsor the conference.

Based upon interviews with past sponsors of the conference, it is our understanding that the cost of sponsorship of the Klausner public pension client conference remains at $30,000.

From late June through September 2015, we repeatedly requested information from the Fund Administrator regarding any such payments by Fund fiduciaries to the General Counsel.

In an email to the Fund Administrator on September 9, 2015, we asked more specifically:

Please also disclose any payments, compensation, sponsorship fees, etc., the Klausner firm or any person or entity related to the firm may have received over the past 15 years from Merrill Lynch, BLBG or any other investment adviser, legal firm or financial institution that is or was a fiduciary to the Fund, including payments in connection with any conference organized by the Klausner firm.

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[44] How Consultants Can Retire on Your Pension, The New York Times, December 12, 2004 http://www.nytimes.com/2004/12/12/business/yourmoney/12pension.html

In response the Fund Administrator simply stated "None from the Fund."

When we indicated this answer was not responsive to the question and asked again for an answer, we were told:

The Fund did not pay any sponsorship fees. What question did you ask that I did not answer?

Our response:

I did not ask about payments from the Fund to the law firm and my question was not limited to sponsorship.

Fund Administrator again responded to our original question:

Unknown.

Our response:

Are you going to ask your Fund counsel for this information?

There has been no further response from the Fund Administrator to this question since September 9th.

It is our understanding that the City Council will subpoena from the General Counsel information regarding any compensation received from other Fund fiduciaries.

3. Retirement Reform Task Force Recommendation Regarding Legal Counsel

As mentioned earlier, the Retirement Reform Task Force Final Report noted that while the Fund had authority to employ separate counsel, it should ordinarily use the Office of General Counsel of the City (the

“OGC”) for its legal needs. The Fund should consult with the OGC should it find that it needed additional or separate counsel for specific purposes, including the nature of the work and the fee arrangement. The Report also noted that the Fund and the OGC had consulted concerning the need for specific pension and retirement-related advice, and the OGC indicated that she concurred with the engagement on such matters of the Klausner firm, which was the current counsel to the Fund.

The OGC further indicated that *she was familiar with and concurred with the fee arrangement that the Fund had with the Special Counsel. The Report stated that the OGC and the Special Counsel will consult regularly to assure that the legal needs of the Fund are being competently and efficiently handled for a reasonable fee* (emphasis added).

In our opinion, the services provided by the General Counsel, the compensation paid, directly and indirectly, and related conflicts of interest should be examined to ensure compliance with applicable law.

XII. Senior Staff Voluntary Retirement Plan

On July 30, 2012, the Times Union published an article stating that “since the late 1990s, Fund Executive Director John Keane has been signed up for a pension created for him by the fund with little outside notice.”[45] Both former City Council auditor Bob Johnson and current council auditor Kirk Sherman are quoted in the article as saying they were unaware of the existence of the pension program, which only covered a handful of fund employees, until that month.

According to the article, the existence of this “Senior Staff Voluntary Retirement Plan” was officially “recognized for the first time” in a

[45] http://jacksonville.com/news/metro/2012-07-27/story/jacksonville-police-and-fire-fund-executive-slated-receive-another-city

recently released actuarial study of the Police and Fire Pension Fund. The plan reportedly had $2.3 million in assets at that time, with the money invested along with the Fund's assets.

"The benefit, which could mean as much as $200,000 a year when he retires again, comes atop the roughly $60,000 pension now being paid yearly to Keane in addition to his $283,000-a-year salary as the pension fund's executive director."

Council auditor Kirk Sherman is quoted as saying "it appears that the pension might be a better deal than the one received by members of the fund Keane directs, because the size of the pension isn't capped at 80 percent." The pension also had a higher rate of accrual, according to pension fund critic Curtis Lee, although Keane said he believed it accrued at the same rate.

A council member was quoted as being shocked and concerned about the fiduciary responsibility of the Fund.

In a release dated August 6, 2012, Carla Miller, Director of the city's Ethics, Compliance and Oversight Office stated that the above article "raised questions in the community about this pension plan and that it is the intention of the Ethics, Compliance and Oversight Office to study this pension plan as to its formation and operation."[46]

The City Council Finance committee discussed the issue of the controversial staff pension plan during its hearing on the Fund's budget on August 10, 2012.

A. City General Counsel Opinion

On August 10, 2012, Cindy Laquidara, the City's General Counsel, issued an opinion that the Fund was not authorized under the City Charter to

[46] http://jacksonville.com/news/metro/2012-08-06/story/jacksonville-ethics-officer-investigate-pension-chiefs-special-benefit

create the "Senior Pension Plan" and demanded the money spent to fund the pensions be repaid.[47]

B. Ethics, Compliance and Oversight Office Opinion

Miller, the Director of the Ethics, Compliance and Oversight office attended Fund meetings on August 15th, 17th and 28th. On Friday, August 24th, documents were provided to her from the Fund in response to her questions.

Miller issued her Interim Report on August 28, 2012 noting, "this plan was created for 3 people working for the Fund that were already on city pensions and were not eligible for another city pension nor were they eligible for the State Retirement pension. The "Senior Pension Plan" ("SPP") was created in September 2000 by the Fund and benefits were backdated."[48]

According to Miller, there were two questions to be answered: is the SPP legal and was it disclosed to City Council or to the City Council Auditor in a meaningful, transparent and appropriate manner?

As to the legality of the plan, Miller noted there were two viewpoints:

"Office of General Counsel: The PFPB is set up under Article 22 of the City's Charter to manage a trust (the pension funds). It was not set up to create other pensions with long term obligations to the taxpayers of Duval County. Specifically, in the Charter under Section 22.07, it states "nothing shall empower the board to amend...the pension plan without the approval of the Jacksonville City Council."

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[47] http://jacksonville.com/news/metro/2012-08-16/story/jacksonville-city-halls-top-lawyer-says-pension-police-and-fire-pension

http://jacksonville.com/files/interactives/pensions/part-3--jacksonville-pension-crisis--jacksonville.com.html.

[48] Interim Report, August 28, 2012 Office of Ethics, Compliance and Oversight.

Setting up a separate "Senior Pension Plan" within the overall Police and Fire pension plan is an unauthorized amendment to the Police and Fire Pension Plan.

Also, Article 16 of the City Charter establishes the Pension system of the City and does not authorize any agency other than City Council to create new plans.

The Fund: The position of the PFPF Board attorney, Bob Klausner, is that the city Charter, Section 22.04 "General Powers" gives the Board the power under (e) to: "fix the compensation of the administrator. It is the opinion of Mr. Klausner that, legally, "compensation" includes the creation of a pension, by definition."

Miller stated the disclosure inquiry was completely separate from the question above regarding whether the SPP Plan is legal. In brief, the two positions on this issue were, according to Miller:

"City Council Auditor: City Council Auditor states that his office was not aware of the "Senior Pension Plan" until 2012.

Fund Director: In a letter to the ECO office, the PFPF Director states that the Senior Pension Plan was disclosed in "Budgeted Pension Contribution Requirements" and in the city's accounting system."

Miller noted that more documentation was needed on this issue. "Where exactly is notice to the city on the Senior Pension Plan? Is it clear and unambiguous?) Have independent audits of the City recognized this liability and if not, why not? Citizens want to know not only that the plan is legal and reasonable, but that it was transparent in its implementation."

On May 7, 2013, Miller sent a letter to General Counsel Laquidara regarding the SPP stating:

"Representations were later made to the City Council that a lawsuit would be filed in this matter. It has been 9 months since OGC issued its opinion on the Plan and a lawsuit on this has not yet been filed by the City. Additionally, City Council Auditor started an audit on the PFPF over a year ago. That audit has not been released to date.

In February, 2013, a suit was filed by Randy Wyse of the Firefighter's Union as to whether or not the PFPB should be the entity (through its Director, Keane) to negotiate for the firefighters union. The "Wyse" case is now in mediation, which makes its proceedings confidential and not transparent to the public.

Since mediation is now occurring in the Wyse case and the lawsuit on the Keane Senior Pension Plan has not yet been filed, I am concerned about the possibility that the Director's compensation and pension issues will be rolled into a global settlement in the Wyse case. If this path is taken, I believe it would be detrimental to the public trust. **The public deserves an answer from the Court on the legality of the special pension plan created by the Board for 3 people. If this "Senior Pension Plan" is an illegal plan, it should be cancelled. If it is a legal plan, the Board and its attorneys who approved it should be exonerated from any accusations that it wasn't legal.**

It is my opinion that the issues involving special financial benefits to Director Keane be handled separately and not be used as a bargaining chip to get other issues resolved in the Wyse litigation. And, an audit on the Police and Fire Pension Fund that has been worked on for over a year should be issued and made public so that any findings in that audit can be considered in the litigation and settlements (emphasis added).

Perhaps my apprehension of this scenario occurring is unfounded (and you are free to clear up any of my misconceptions on this) but there seems no other way to explain the delay in filing suit on the Plan which was announced 9 months ago.

The Wyse suit was filed in February-- only 3 months ago. While a global settlement wrapping up all pension issues for the city is a laudable goal, it should not come at the price of condoning potentially illegal and/or corrupt actions and in the absence of the audit information."

In conclusion, according to a July 13, 2015 email from Miller to Patrick Greive:

"It was my understanding at that point that OGC was going to file suit in the matter. City Council, I believe, passed a resolution directing OGC to file this suit. I turned over any records I had to Loree French in OGC who was preparing the case so that it could be filed. (But it never was.) Therefore, I did not do any further work on the

situation until May 7, 2013, when I sent a letter to GC Laquidara about my concerns with the case. On May 9, 2013, Mayor Brown announced his pension reform which included a provision on the "illegal" pension plan. That version of pension reform was voted down by City Council in June, 2013. That is all I have on the matter."

C. Council Auditor Report

The Council Auditor's Office Police and Fire Pension Fund Audit report dated November 21, 2012 was finally released to the public on July 18, 2013.

The audit questioned whether the plan was properly authorized, since the City Council had not approved it and the City's General Counsel had stated the plan was not created legally. The audit said the plan had not been disclosed to the state Department of Financial Services until 2011, despite laws requiring actuarial reports every three years. Instead, the audit found, the money to pay for the separate pension had essentially been invisible, lumped in with the assets of the larger Police and Fire Pension Fund.

"The Mayor's Office and the City Council need to continue to pursue changes in the state law to address the unconscionable structure of the Police and Fire Pension Fund Board of Trustees. The Police and Fire Pension Fund Board of Trustees is responsible for managing the assets of the Police and Fire Pension Fund while the City is responsible for funding the liabilities…Stated simply, the board controls the pension assets while the city retains the liability to fund the pension payments."[49]

[49] http://www.coj.net/city-council/docs/council-auditor/police-and-fire-pension-fund-audit---report-736.aspx

D. Fund General Counsel Opinion

In a letter dated May 20, 1999, the law firm of Klausner, Kaufman, Jensen & Levinson opined to the Board of the Fund that it had the right to grant a retirement plan to the Fund Administrator, as well as prior service credit. In a letter dated November 2, 2000, the Klausner firm provided an original final copy of the SPP for inclusion on the agenda for the next scheduled Board meeting. The plan had been adopted by the Board on September 20, 2000.

In a letter to the Board dated September 25, 2012, the Klausner firm opined that the Board of the Fund had "the clear right to create and maintain a retirement program for its employees as part of their compensation." The firm noted that its opinion as to the legality of the plan, as originally expressed in 1999 (in connection with establishment of the plan), remained unchanged. The 1999 and 2012 opinions focused exclusively upon Florida law.

In 2012, the City Council voted unanimously to file a lawsuit regarding the plan but, for whatever reasons, never did. While the City General Counsel had gone so far as to tell the Fund to stop putting money into the account, a large cash infusion of more than $250,000 reportedly went into the account subsequently and effectively placed the account at over-funded status. On September 21, 2015, the Jacksonville City Council voted 18-1 to take legal action regarding the specially created pension.

E. Compliance with ERISA Fiduciary Standard

As discussed earlier, the Fund adopted the heightened fiduciary standards of ERISA in its Statement of Investment Policy. ERISA requires pension fiduciaries (such as the Board, the Fund's staff and the Fund's legal counsel) to generally refrain from any form of self-dealing and to act solely in the interest of plan participants and their beneficiaries, with the exclusive purpose of providing benefits to them.

It appears that neither City General Counsel nor the Fund General Counsel reviewed whether, in connection with the establishment and maintenance of the staff pension, the Board discharged its responsibilities consistent with the heightened fiduciary standards of ERISA.

In a recent article on the separate senior pension:

Dan Carr, a member of the Concerned Taxpayers of Duval County urged the council to vote in favor of the resolution, designed to get a legal opinion on the matter.

He lambasted the creation of the special pension saying that it came at the expense of the poorly funded pension fund which is about 43 percent funded while the senior plan is fully funded.

"This is blatant discrimination against the rank-and-file [police and fire pension fund members]," said Carr. "... The question is simply 'is this plan legal?' I urge you in the defense of taxpayers and in the name of common sense to pursue this litigation."[50]

We recommend that the City Council in connection with any potential litigation regarding the separate senior pension examine separately whether the Board, consistent with its ERISA fiduciary duties, followed a prudent process in deciding to take assets from the underfunded

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[50] http://jacksonville.com/news/metro/2015-09-08/story/jacksonville-city-council-delays-looking-legality-pension-departing

pension to establish, maintain and fully-fund the generous senior staff plan.

XIII. Board and Staff Travel

Public pension trustee and staff travel to attend lavish conferences globally, underwritten primarily by Wall Street (and, increasingly, plaintiff class action securities law firms) seeking to garner asset management and legal contingency fees from these funds has for decades been highly controversial nationally.

"Critics of government spending – and some pension officials – say travel to exotic destinations by those overseeing ailing pension funds is unseemly, especially as taxpayers watch their public services diminish to offset growing pension costs.

"There's no such thing as a free trip to Waikiki," said Joe Nation, a professor of the practice of public policy at Stanford University, who specializes in public employee pensions. "Everybody loses; taxpayers will have to pay more, or beneficiaries will have to pay more, or a combination of the two."

Nation, a former Assembly Democrat from Marin, added that the pension managers "would have higher returns and their beneficiaries would be better off if they were to forgo this trip (to Hawaii) or travel close to home."[51]

In 2005, the Rocky Mountain News ran a story criticizing the 16-member board of trustees of the Colorado Public Employees' Retirement Association for living the "life of a jet-setting retiree" attending conferences in places like New Orleans, San Francisco, Miami Beach, and Honolulu, as well as international destinations such as

[51] http://californiawatch.org/money-and-politics/retirement-systems-send-members-hawaii-summit-18817

Madrid, China, Spain, and Paris—even as the pension reported its funding ratio had slipped from 105.2 percent in 2000 to 70 percent.[52]

Trustees of Pennsylvania's employee pension fund also have come under scrutiny. The Patriot News of Harrisburg reported that trustees had spent more than $207,000 over a seven-year period traveling to out of state conferences.[53]

So controversial are these conferences that the website for the 2013 National Conference on Public Employee Retirement Systems held on the famed beaches of Waikiki, supplied board members hoping to shore up support for their expenses-paid trip a "2013 Attendance Justification Tool Kit."

The site also included "7 Tips for Building Your Case for Attending the Annual Conference," which suggests that trustees emphasize how the conference could help them "build a networking list" and identify ways to help "save your fund money."[54]

Both the Fund Administrator and General Counsel are regular participants at these conferences and have long defended them.

The Klausner firm has served as general counsel for more than 15 years to the National Conference of Public Employee Retirement Systems, which organized the Hawaii conference mentioned above, billed as the largest gathering of its kind for public pension plans.[55]

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[52] http://www.plansponsor.com/NewsStory.aspx?Id=6442463934

[53] http://www.plansponsor.com/MagazineArticle.aspx?Id=4294991614

[54] Id.

[55] https://www.calpers.ca.gov/docs/board-agendas/201410/full/item11-02.pdf

Further, as mentioned in the 2005 article below, the Klausner firm actually puts on its own annual public pension trustee and staff conference.

“"People who are critics of these programs lose sight of the fact that trustees are fiduciaries, and it is their responsibility to keep up with what's going on," says Keane.

Even if not required by statute, pension trustees and senior staff at every public fund in the country are required to participate in continuing education as an essential element of their fiduciary responsibility, says Robert D Klausner, an attorney with Klausner & Kaufman, PA, in Plantation, Florida. Klausner's law firm puts on an annual educational conference for public fund trustees and staff.”

"If you have investments in Europe, sometimes you have to go see them; it's part of a trustee's fiduciary duty," says Klausner. "If you buy timber in British Columbia, you better go see it to make sure the trees are actually there. Sometimes trustees have to put their feet on the ground at the location and eyeball the project or investment themselves." Even though it may sound extravagant, going to China to learn firsthand about investment opportunities in the world's fastest growing economy can actually be prudent, he adds. Moreover, if a fund has direct ownership in any real estate, fund trustees have an obligation to go and physically see that investment. Klausner says that, in the past, there have been frauds that have occurred when trustees did not go to make sure that what they invested in was really there. Nor can this obligation be avoided by simply avoiding these types of assets. Klausner says that, in today's economic environment, stocks and bonds alone do not return enough money to meet the funds' actuarial needs.”[56]

In our opinion, the likelihood that public pension board members and staff who lack investment experience will learn anything meaningful regarding pension investing through travel to exotic locations is remote.[57]

[56] http://www.plansponsor.com/MagazineArticle.aspx?Id=4294991614

[57](Ironically, the greatest threat, in our opinion, to the financial integrity of the Fund–involving the former investment consultant and extending two decades—was discussed extensively at a public

Even in those few states, like Florida, where board members are required to fulfill an educational requirement,[58] exotic and frequent travel is unwarranted:

""We want to save money," said Greg Frank, a management analyst for the San Joaquin County Employees' Retirement Association, a $2 billion plan covering roughly 11,000 current and future retirees. "We give the trustees classes to attend that are local, in places like Berkeley. It's real easy to keep it in California and keep costs down."

In the same article California Assemblyman Bob Wieckowski is quoted as saying, "I didn't think that running up travel expenses and hotel rooms was a requirement of getting educated. "We're asking the public to show fiscal restraint, the cities and counties and the state are providing less services, and people are paying more taxes. So you would think these decision-makers would reflect that."[59]

Further, the risks related to such high-stakes marketing junkets are substantial and, in our opinion, far outweigh any educational benefit.

Wall Street money management marketers who gladly pay, by way of example, for public pension trustees to take hot air balloon rides over Albuquerque and helicopter rides over Maui at these conferences obviously believe trustees will reciprocate by choosing them to manage pension assets—resulting in rich asset-based fees. The potential for corruption of the investment decision-making process at pensions, resulting in higher fees and lower performance, is obvious and enormous.

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pension conference in Tallahassee in 2002 and at subsequent public pension conferences in Florida—an issue which was not addressed by the Fund until years later.

[58] Florida Statues require that local retirement system have investment policies that provide for the continuing education of the board members in matters relating to investments and the board's responsibilities. Chapter 112.661 (14).

[59] http://californiawatch.org/money-and-politics/retirement-systems-send-members-hawaii-summit-18817

For example, Corporate (CorPERS) membership for the National Conference of Public Employee Retirement Systems conferences *alone* costs $10,000 per year; an exhibit booth costs and additional $17,500; and registration runs approximately $5,000 per employee.

CorPERS members are also granted “speaking priority” at these conferences and preferred status for conference presentation and article proposals. According to NCPERS website, CorPERS Membership “is designed to give your organization more visibility by increasing your involvement in NCPERS and furthering our education and research missions.”

There is broad consensus that the educational content of many public pension conferences is suspect. Even the Fund’s General Counsel acknowledged the abuses, as the Fund Administrator claimed the Board monitored conference attendance for value.

"Are some of these things junkets versus legitimate education? There are some conferences that are questionable," says Klausner.

Most public funds do have educational policies, and most must approve conferences that trustees attend. Funds do this in different ways, Klausner says. Some funds review and approve every conference prior to a trustee attending, while others publish lists of acceptable and unacceptable conferences. Others have restrictions on how many conferences trustees can attend, or limits on what can be spent. Other funds limit international travel.

For example, the Jacksonville fund has a list of conferences that meet the fund's business objectives, says Keane. Conferences are approved a long time in advance, sometimes six to seven months. "We monitor course content for its value to our ongoing program," says Keane.

Jacksonville has budgeted $70,000 for conferences for the 2005-2006 plan year for its five trustees and seven-member pension advisory committee and staff.”[60]

[60] Id.

The Fund Administrator apparently attended the Institutional Investor 18th Annual Global Hedge Fund Summit held in Bermuda in April 2012—even though the Fund is not permitted to invest in hedge funds.

A. Ethics, Compliance and Oversight Office Review of Keane and Deal Travel

According to a memorandum to the Jacksonville Ethics Commission from Carla Miller dated November 3, 2014, during 2013 and 2014, the Ethics Office received complaints concerning allegations of waste, abuse and ethics violations pertaining to the travel of John Keane (Executive Director of the Fund) and Bobby Deal (Chair of the Board).[61]

Miller noted that this review was done solely on records provided by the Fund on the specific complaints. It did not include the complete travel records of Mr. Keane and Mr. Deal.

John Keane took 31 trips from October 2010 through February 10, 2014. Two were out of the country (Scotland and Canada).[62] Hotels included Caesars Palace, Hotel Frontenac, Four Seasons, and Trump Tower.

Bobby Deal took 18 trips in the same time period as Keane.

Many of the trips taken by Keane and Deal were sponsored by Opal Financial Group and similar conference planning organizations. According to the conference agendas, Fund officials typically speak on a panel for an hour or less, and in exchange, get travel, registration and hotel expenses for several days paid by the "educational" institute.

[61] Summaries of the allegations in the complaints are contained in the Ethics Director's reports to the Jacksonville Ethics Commission on cases 2013 (5-7) and 2014 (1-3).

[62] Apparently the Bermuda trip mentioned above was not included in the records provided by the Fund.

As mentioned above, investment professionals pay tens of thousands of dollars to attend these conferences and thousands more to entertain potential public pension clients.

According to Miller, it appeared that all of the trips were approved by the Fund Board, "whose members are sometimes the ones taking the trips. The trips are listed on the agenda for their meetings and are approved. There is no other PFPF policy or procedure on trips. According to information provided to the Ethics Office by Mr. Keane, the PFPF travel policy is: Educational conferences are approved by the Board. He further indicated that "travel required to perform duties (attending a legislative or congressional hearing, court hearing, or manager meetings) does not require Board authorization.""

Miller concluded, "There is a lack of analysis and/or oversight of the many trips taken as to their value to the PFPF Fund."[63]

The Ethics Director recommendations to the Ethics Commission included additional review of Keane and Deal travel by the Council Auditor. "The requested scope of the audit should include an analysis of travel, whether members of the board are seeking out public speaking engagements, who is reimbursing such expenses (and whether there is any business relationship or potential relationship with the PFPF), and an assessment of the PFPF Board current travel policy. The Police and Fire Pension Board "PFPF" should review the usefulness and return on investment of the 50 plus trips taken by Mr. Keane and Mr. Deal."

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[63] Miller's report also noted, "In April, 2013 the Times Union reported: Jacksonville pension fund chief gets $160,000 for unused leave. "Under my contract I can sell it," said Keane, who receives six weeks of vacation time a year. "It's all perfectly legal." The move was unanimously approved by the Police and Fire Pension Fund Board, which passed it as part of its consent agenda. The magnitude of the sale was not apparent from the agenda, which described the item as a memo from the executive director to the board concerning leave payments."

Most recently, Keane's travel has emerged as an issue in connection with the estimated almost $475,000 he has already and is expected to collect for unused vacation days in the past five fiscal years.

Just because Keane hasn't used any vacation time doesn't mean he has stayed put.

An investigation by the city's ethics office last year revealed that Keane has criss-crossed the country and globe.

He's stayed in places like Caesars Palace and Trump Tower when he went on 31 trips from October 2010 through February 2014.

Two of those trips were out of country, including Scotland.

Most of the trips under review by the city's ethics commission were sponsored by a financial group which hosts pension forums. Most of the trips, according to Keane's travel summary provided by the pension fund to the ethics commission, were for two to three days.

Some of the trips, such as the one to Scotland, do not specify the length of the trip. Neither did the trips to San Francisco or Boston in 2013.

Between Sept. 26, 2012, and Feb. 19, 2013 — that's five months — Keane went to Scotland, Arizona twice, San Francisco and Las Vegas.

Accompanying him on a bulk of the 31 trips that were under review was then longtime chairman of the board of trustees Bobby Deal, an assistant police chief of the Jacksonville Sheriff Office.[64]

In summary, given that: (1) public pension trustee and staff travel to lavish conferences globally has generated controversy for decades across the nation; (2) the Board and Keane's travel has been intensely criticized locally (including an Ethics, Compliance and Oversight Office Review); and (3) the severely underfunded status of the pension, it is recommended that the Board and staff eliminate such non-essential travel.

Most important, extensive travel by the Board and staff is inconsistent with the fiduciary obligation under ERISA to manage plan assets for the exclusive benefit of the participants, in our opinion.

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[64] http://jacksonville.com/news/metro/2015-09-19/story/jacksonville-police-and-fire-pension-chief-cashing-out-unused-vacation

XIV. Communications with United States Securities and Exchange Commission

We requested from the Fund Administrator any correspondence between the SEC and the Fund for the past ten years. According to the Fund Administrator, the only such correspondence relates to the Commission's investigation of the Fund's former investment consultant, Merrill Lynch, as described below.

XV. Investment Management Fees

Unlike most other industries, the fees money managers charge institutional and retail investors for comparable investment services vary astronomically.

Passive, or index investment management services, can be purchased by institutional investors for 1 basis point (one one-hundredth of a percent) or even "for free."[65] Active traditional asset managers who attempt to beat the market by stock-picking, may charge pensions investment management fees that are 120 times greater (1.2 percent). Alternative investment managers, including real estate, hedge, venture and private equity, may charge asset-based, performance and other multiple layers of fees amounting to 8-10 percent—1,000 times greater fees than indexing.

For example, according to a Prospective Fee Analysis prepared by the Fund's investment consultant specifically for our review (discussed more fully below), Northern Trust is paid a 5 basis point investment advisory fee for the first $100 million and 2 basis points thereafter on Fund assets it manages in an S&P 500 Index Fund. The prospective fee on $131

[65] Certain index managers will manage large accounts at no cost, in exchange for securities lending income related to the portfolio.

million is 4 basis points or $52,676. At the other end of the spectrum, JP Morgan is supposedly paid a twenty times greater investment advisory fee of 1 percent, i.e., $1.27 million on the $127 million in Fund real estate assets it manages.

Paying higher fees for active traditional or alternative asset management does not guarantee and, in fact, negatively correlates to superior investment performance. Indeed, the overwhelming majority of active managers fail to outperform market indexes over time net of fees. The higher the fees, the greater the drag on investment returns.

For example, the July 31, 2015 Flash Report indicates that on a net basis the Fund's US Equity; International Equity; and Fixed Income actively managed assets—amounting to approximately 83 percent of the Fund's total assets—have underperformed their respective indices for virtually all 1, 3, 5 and 10-year periods.

A recent report by the Maryland Public Policy Institute and the Maryland Tax Education Foundation which examined the investment fees and investment performance of state pension funds concluded:

"State pension funds, including Maryland, have succumbed for years to a popular Wall Street sales pitch: "active money management beats the market." As a result, almost all state pension funds use outside managers to select, buy and sell investments for the pension funds for a fee. The actual result — a typical Wall Street manager underperforms relative to passive indexing — is costly to both taxpayers and public sector employees.

For example, **the top ten states — in terms of Wall Street fees — had a lower pension fund investment performance — over the last five fiscal years — than the bottom ten states** (emphasis added)... State pension funds should consider indexing. Indexing fees cost a state pension fund about 3 basis points yearly on invested capital vs. 39 basis points for active management fees (or 92% less)... By indexing most of their portfolios, we conclude the 46 state funds surveyed could save $6

billion in fees annually, while obtaining similar (or better) returns to those of active managers."[66]

1. Fiduciary Duty to Monitor Fees

It is well established that sponsors of public and private retirement plans have a fiduciary duty to ensure that the fees their plans pay money managers for investment advisory services are reasonable. Fees paid for such retirement plan investment services have always been an important consideration for ERISA retirement plan fiduciaries. Further, in recent years such fees have come under increased scrutiny because of class action litigation, Department of Labor regulations, and congressional hearings.[67]

According to the Department of Labor:

"Plan fees and expenses are important considerations for all types of retirement plans. As a plan fiduciary, you have an obligation under ERISA to prudently select and monitor plan investments, investment options made available to the plan's participants and beneficiaries, and the persons providing services to your plan. Understanding and evaluating plan fees and expenses associated with plan investments, investment options, and services are an important part of a fiduciary's responsibility. This responsibility is ongoing. After careful evaluation during the initial selection, you will want to monitor plan fees and expenses to determine whether they continue to be reasonable in light of the services provided."

Local government pensions are exempt from ERISA and are governed by state law. However, because ERISA and state law protections both stem

[66] Wall Street Fees, Investment Returns, Maryland and 49 Other State Pension Funds by Jeff Hooke and John J. Walters, July 2, 2013. The authors reviewed the Wall Street money management fees of all 50 states and the states five-year annualized investment returns. The information was disclosed in the state pension funds' CAFR.

[67] Revealing Excessive 401(k) Fees, The New York Times, June 3, 2011.

from common law fiduciary and trust principles, best practices for public pensions are frequently similar to those found in ERISA.

Again, in this case, the Fund has adopted ERISA fiduciary standards which include the duty to monitor the reasonableness of all fees.

At the outset, sponsors of public, as well as private retirement plans must take steps to understand the sources, amounts, and nature of the fees paid by the plan, as well as the related services performed for such fees. After all, a plan sponsor cannot determine the reasonableness of fees paid without a comprehensive understanding of the plan's services and fees.

Whether a plan's fees are reasonable depends upon the facts and circumstances relevant to that plan. The plan sponsor must obtain and consider the relevant information and then make a determination supported by that information.

2. **Lack of Board Review of Investment Fees**

We requested from the Fund Administrator any analyses that may have been prepared for the Board to scrutinize whether the fees the Fund pays its asset managers are reasonable.

Remarkably, according to the Fund's investment consultant, Summit Group, no fee analyses have been prepared for the Board by Summit or any third party for this $1.43 billion pension.

"The fees are buried in the investment performance reports," we were told. There have been no presentations to the Board specifically related

to fees. However, according to Summit, the Fund Administrator had instructed the firm to prepare the first such report for our review.[68]

In our opinion, without a comprehensive fee analysis prepared by the investment consultant or a third party, the Board cannot fulfill its fiduciary duty to monitor the reasonableness of fees the Fund pays its investment managers.

3. Lack of "Most Favored Nation" Contract Provision

Pensions seeking to ensure they pay the lowest investment advisory fees managers offer often require the managers they hire to agree to a "most favored nation" provision or "mfn." The mfn provision generally is included in the investment advisory contract between the pension and the investment manager. In other cases, the advisory contract will be silent on the issue but the manager will be required to certify quarterly or annually that the client is receiving the lowest fee.

The Fund has no mfn provision in any of its contracts with investment managers and does not require managers to certify quarterly or annually that the Fund is receiving the lowest fee they offer.

However, the current investment consultant to the Fund, Summit Strategies agrees that mfn provisions are commonplace, particularly with respect to public pensions and helpful in reducing fees.[69] Why the Fund has operated without these cost-saving provisions in its contracts with managers is puzzling.[70]

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[68] According to Dan Holmes, the fees paid to the Fund's managers are not included in the Investment Performance Reviews presented to the Board but are "buried in the Flash reports."

[69] Interview with Dan Homes, September 10, 2015.

[70] Mr. Holmes notes that his firm merely negotiates fees with managers on behalf of the Fund but does not draft the contracts between the Fund and its managers—contracts which could and should, in our opinion, include an mfn provision.

Further, as discussed below, in our opinion the fees the Fund pays could be dramatically reduced.

In brief, an mfn provision states that the manager represents the fee the client pays is the lowest the manager offers to “similarly situated” clients. The mfn does not require the manager to represent the pension is paying the lowest effective fee the manager offers to anyone—only the lowest fee offered to “similarly situated” pensions.

While mfns are common among pensions, they vary considerably in their wording and complexity. For example, one fund we advised required its managers to complete a quarterly questionnaire containing the following simply worded question which served as the fund’s mfn clause: “Do any accounts of similar size and with similar assets under management pay lower fees than this plan? If yes, please explain.”

Below is the substantially lengthier mfn of another pension fund of comparable size. (As you can see, the size of the fund does not dictate the specificity of the mfn.)

“If, at any time from and after the execution date of this Agreement, the Investment Manager enters into an agreement with any other client to provide investment management services comparable to those provided under this Agreement, and if such agreement requires the payment of fees that are in any respect lower than the fee established in this Agreement, the Investment Manager agrees that the fee required under this Agreement shall be reduced to the level specified in the agreement with such other client.

Principal variables which shall be utilized to determine whether the services are comparable include, but are not limited to, size of account, restrictions on the account, aggressiveness of investment objectives and discretionary character of the account. Such reduction in fees shall be effective as of the effective date of the agreement with such other client. The Investment Manager agrees to provide the Board with timely written notice of any event or occurrence that would require a reduction in fees provided under this Agreement. Further, the Investment Manager

represents and warrants that the fees provided under this Agreement do not exceed those currently charged to other clients receiving comparable services."

Due to the variation in the wording and complexity of mfn provisions, the issue of compliance with these clauses is a subject of intense concern among money managers. Firms differ in their understandings as to the meaning of such clauses in their clients' contracts. A single large investment advisory firm may be subject to hundreds of mfns in their contracts with pensions. Larger firms may have internal compliance professionals to review contracts for mfn compliance. However, the size of the firm does not guarantee compliance.

Smaller firms, on the other hand, may lack the resources to monitor compliance. For decades, one of the four biggest issues of concern to pensions and money managers alike has been mfn compliance.

Unfortunately the language in most mfn clauses is open to tremendous interpretation. Managers may contend a client paying a lower fee is receiving a different asset management service and therefore the mfn clause has not been violated.

Accounts paying "performance fees" are routinely considered exempt from mfn compliance by managers since performance fees typically involve low or no minimum fees and higher than usual maximum fees if the manager performs well.

Managers may believe "similar accounts" only includes other public pension funds and not corporate pensions or endowments and foundations. For example, one manager we recently interviewed candidly indicated that while he "might have a church account paying a lower fee," he was still in compliance with our client's mfn. "Wrap fee" accounts are also generally not considered "similar" by managers for mfn compliance purposes.

In summary, managers have become very skilled at distinguishing between clients and accounts in order to justify different fees for "similar accounts," yet maintain they are in compliance with mfn clauses. On the other hand, few pensions even attempt to monitor compliance with their mfn clauses. Thus, managers who fail to comply have little to fear. Managers who are questioned by clients need only develop a plausible explanation for fee differentials.

Another problem with "most favored nation" clauses is they rely upon managers coming forward in good faith to notify the client it is entitled to a fee reduction, perhaps years after the initial fee negotiation. Many managers cannot be relied upon to volunteer such information against their financial interests. Therefore, where possible funds should contact other pension clients of their managers to determine whether the fee they pay is the same or lower. Pensions should also review managers' Forms ADV on the SEC's WebIARD system for information regarding their advisory businesses, such as percentages of institutional and retail clients and participation in "wrap fee" programs.

In the investigations we have undertaken involving blatantly excessive investment advisory fees, managers generally respond that the account managed for our pension client was unique and therefore any comparisons with other accounts of the manager, with lower fees, is inappropriate. In other words, the explanation for unusually high fees is that there is something unique about the investment mandate or account. Such manager explanations are hollow to those experienced in investment management matters. Fortunately for managers, many pensions are not sophisticated, or even informed, regarding the investment advisory fees funds actually pay.

Managers charge certain funds unusually high fees because they can. In other words, either the pension's investment consultant or the fund's board itself has not effectively negotiated fees. Pensions that rely upon "most favored nation" provisions to ensure they are paying the lowest

possible investment advisory fees are missing the boat. A "most favored nation's" provision is no substitute for informed, vigorous fee negotiation. Finally, funds that fail to continuously monitor "most favored nation" compliance are likely to be unaware of fee reductions to which they may be entitled.

4. Maeva 2013 Fee Analysis

Jonathan Trichter of MAEVA Municipal Solutions, Inc., who was part of the professional team assembled by the Pew Foundation and the Laura and John Arnold Foundation briefly addressed the Fund's investments, performance and fees in his remarks to the Jacksonville Reform Task Force Committee Meeting in October, 2013.[71]

Trichter stated that "one overlooked but key contributing factor to the Fund's performance over time is the outsized amount of administrative and investment fees it pays." According to Trichter, the professional services and administrative fees the Fund paid in FY 2013 as a percentage of assets amounted to 78 basis points—more than double the all-in costs of 30 basis points paid by the Florida Retirement System.

Trichter noted that there were a number of reasons the Fund had been paying too much in expenses and fees, including that the Fund was over-emphasizing active management of its portfolio. The Fund's recommended target portfolio for FY 2012 contained only about 17 percent passively managed investments and the recommended target for equities was 83 percent active. The Fund's target for large cap equities—the most efficient market there is—was two-thirds active and one-third passive. Trichter noted that CalPERS—the nation's largest public pension—equity allocation for active and passive was almost inverted.

[71] The Jacksonville Pension Reform Task Force Committee Meeting-10-29-13, Prepared Remarks by Jonathan Trichter, MAEVA Municipal Solutions, Inc., Amended 11/5/13. .

5. Summit Strategies Prospective Fee Analysis (YE 6/30/2015)

As mentioned above, the Fund Administrator instructed Summit Group to prepare the first-ever Prospective Fee Analysis of the Fund for our review. No such analysis has ever been prepared for the Board in the past, we were told.

The Analysis prepared by Summit was based upon eVestment Alliance fee data.

According to a representative of eVestment, the firm does not provide fees "on a level as granular as client type, such as public pensions. Fee schedules provided within eVestment are meant to be a starting point for conversation and as a broad representative of what their fee schedules typically are for that vehicle type."[72]

Other pension investment consultants, such as Callan Associates, Inc., provide more meaningful fee data, segmenting the fees paid by various fund sponsor type. Most relevant here, according to Callan, public pensions pay the lowest fees regardless of account size, typically a 10-15 percent discount to their corporate plan and endowment and foundation peers.[73] Thus, the eVestment style peer fees upon which the Summit analysis is based are almost certainly materially higher than those paid by public pensions, such as the Fund.

Further, according to eVestment, the fees included in the Summit analysis are based upon "published" fee schedules, as opposed to the fees public pensions actually pay. "Published" fees are the fees managers include in their advertising materials—not the fees clients actually pay.

[72] Email from Christina Molina, Evestment September 15, 2015.

[73] See, for example, Callan Associates Inc. 2004 Investment Management Fee Survey, pg. 26.

Institutional clients routinely pay 10-15 percent less than managers "published" fees for accounts less than $75 million and larger discounts exist between "published" and "actual" fees for accounts larger than $75 million.[74] Thus, "published" fee data is of limited utility to plans seeking guidance regarding reasonable fee levels. Again, other consultants, such as Callan, provide "actual" fee data.

Even based upon the Summit analysis (which, for reasons stated above, we believe is deeply flawed) the fees paid to virtually all the U.S. Equity investment managers are **50 percent higher** than they should be, in our opinion. For example, the Fund will pay Eagle Capital Management 76 basis points or $664,412 when the median peer fee in the Summit analysis is 51 basis points or $445,855.

Again, the peer fee stated in the Summit analysis is based upon "published" fees. The average "actual" fee paid by public funds for an account of this size ($87 million) is likely to be approximately 30 basis points, or $262,267, based upon our data.

6. $6 Million in Excess Fees Paid Annually

In our opinion, all of the investment advisory fees the Fund pays its managers should be fully disclosed to the Board and compared against "actual" public pension fees, as well as, if need be, vigorously renegotiated. The emphasis on active management should, as noted by MAEVA above, be reexamined.

In our opinion, investment costs could easily be dramatically reduced, saving the Fund perhaps **$6 million** annually and, more importantly, improving performance.

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[74] Examining Active Investment Advisory Fees: 2003 "Actual" Fee Survey of 100 Pensions by Benchmark.

For managers that utilize performance-based fees, the prospective fee in the Summit analysis includes only the base fee and not any performance component. We note that with respect to real estate and Master Limited Partnerships, all applicable fees have not been included in the Summit analysis.

In conclusion, we do not believe that the prospective fees for YE 6/30/15 amount to only 48 basis points or almost $8 million, as indicated in the Summit analysis. Rather, we estimate total fees are **$10 million or more** annually.

XVI. Investment Performance

1. Suspect Performance Records

The Statement of Investment Policy of the Fund states that the investment performance of the pension assets will be measured by an independent performance measurement firm (the "Investment Consultant") and evaluated on a monthly basis.

According to an email from the Fund's Administrator,[75] Northern Trust (which has been the Master Custodian for the Fund for over a decade) cannot provide investment return information on a gross and net basis because the bank was not engaged to report on the Fund's performance in the past and cannot create a performance history at this time.[76]

While the custodian, Northern Trust, can and does provide performance information to pensions, the Board chose to have the former investment

[75] Email from John Keane August 25, 2015, quoting Richard F. McConville, Senior Vice President Northern Trust.

[76] Joey Greive, Treasurer of the City, independently confirmed with Northern that it could not provide a verified performance history.

consultant, Merrill Lynch and now Summit, provide it. This is highly problematic because:

a. The custodian, as holder of the Fund's assets, is always in the best position to verify values and performances of the respective investment managers;
b. The consultant and the managers are subject to a conflict of interest in calculating performance; and
c. Here, as discussed extensively below, the integrity of the former consultant to the Fund—the party calculating performance over a two decade period—was challenged by regulators.

As a result, according to the Fund Administrator, the only performance reports that exist at this time for the 20-year period when Merrill Lynch was the investment consultant were prepared by Merrill—information which has not been verified by the custodian holding the assets.

Further, the current investment consultant, once retained, undertook no analysis of Merrill's performance reports. Summit was never asked by the Board to verify the Merrill performance; rather, Summit simply accepted "a giant spreadsheet in 2007 from Merrill and uploaded it into the Fund's performance history."[77]

On September 2, 2015, we received via email an Excel spreadsheet from Summit which purported to show on a calendar year basis,[78] the total fund gross return; total fund net return and total fund market value. In the email Summit noted that returns, as requested, went back to 1988 and that Summit first began calculating investment returns in December

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[77] Interview with Dan Holmes, Summit Strategies, September 10, 2015.

[78] Note that the performance included in the Fund's independently audited financial statements is on a fiscal year basis.

2007. All returns prior to that time were received from the prior investment consultant, Merrill Lynch.

When we asked whether, in Summit's professional opinion, the Merrill performance data was accurate, the consultant responded, "Regarding Merrill Lynch's calculation of investment performance, I do not have sufficient information from which to form an opinion as to the accuracy of return calculation. **Although on the face of it, I would expect there to be a difference between gross and net returns, there may be some reason it was reported in that fashion** (emphasis added)."[79]

In other words, the Merrill gross and net annual performances reported from 1988 through 2001 were identical—there was no difference indicated between the performance before and after fees. Since we know that the Fund indeed paid investment management fees during this 13-year period, either the gross or net figures (or possibly both) must be wrong. Further, from 2002 through today, the difference between gross and net performance has inexplicably ranged from as low as 5 basis points to 55 basis points.

In conclusion, the performance of the Fund since 1988 is inaccurate, at least in part—a fact which the Board should have easily detected.

2. Estimated Long Term Underperformance of $370 Million

As mentioned earlier, according to the current consultant on a net basis—even based upon suspect long-term performance data provided by the former consultant—the Fund's US Equity; International Equity; and Fixed Income actively managed assets, amounting to approximately 83 percent of the Fund's total assets, have underperformed their respective indices for virtually all 1, 3, 5 and 10-year periods. If long-

[79] Email from Dan Holmes, September 9, 2015.

term performance is inflated (gross) then the actual (net) investment performance may be worse.

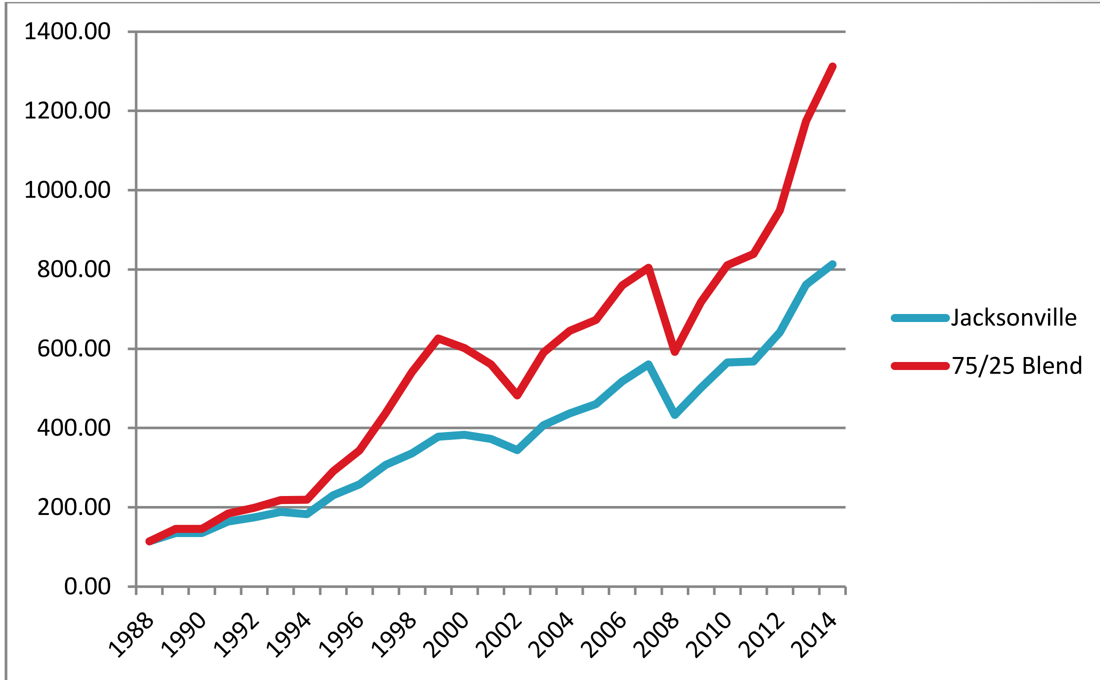
We compared the net investment performance that we were provided of the Fund from 1988 through 2014 against a 75 percent S&P 500 and 25 percent Barclays Aggregate index[80] and concluded that the performance of the Fund would have improved by approximately **$370 million** had the assets been invested in low cost, highly liquid, fully transparent index funds.

In other words, a significant factor contributing to the underfunding of the pension has been poor investment decision-making by the Board.

We note with great emphasis that due to the Board's failure to diligently scrutinize Fund performance, the performance history is so uncertain that any analysis is inherently speculative.

We understand the City Council may subpoena from the Fund's Master Custodian, the relevant records since 1988, as well as verify and report to stakeholders the true net performance.

[80] Since the Merrill Lynch data apparently did not reflect a reduction for fees, we assumed fees of 75 basis points throughout the Merrill years. The actual fees may have been more or less.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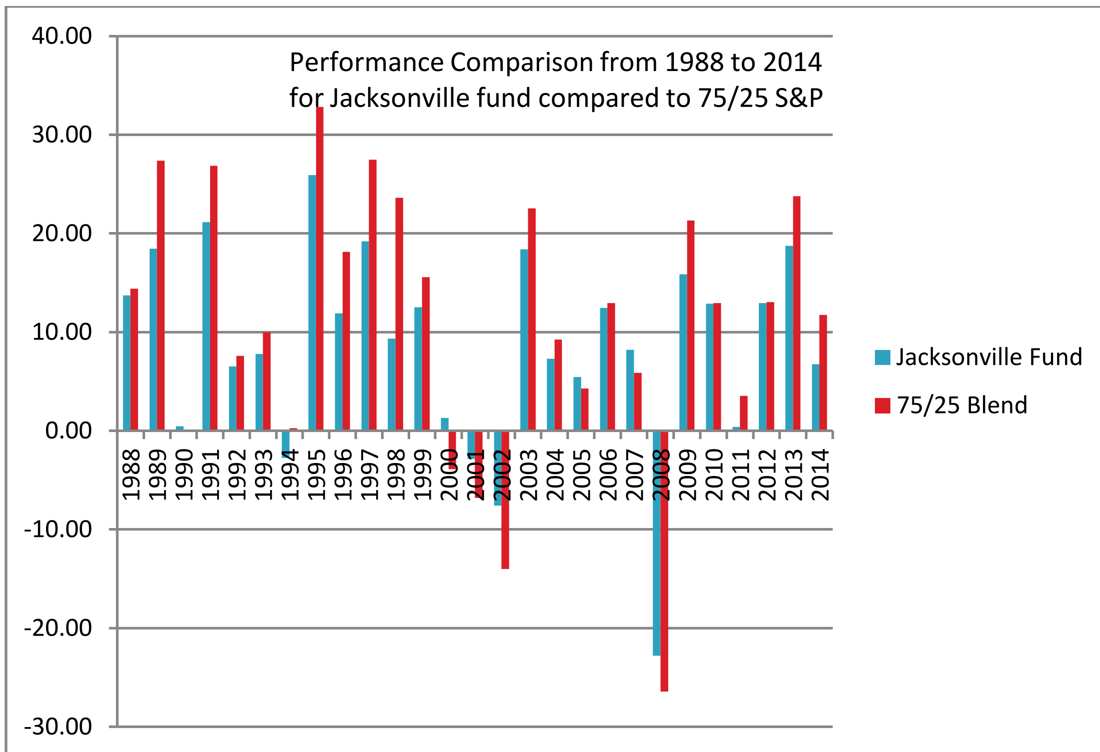
Performance Comparison from 1988 to 2014
for Jacksonville fund compared to 75/25 S&P
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30.00
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0.00
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Jacksonville Fund
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XVII. Gambling $106 Million on Energy Master Limited Partnerships

Three years ago, the Fund invested approximately $106 million or 6.75 percent of its assets with two investment managers who are paid to invest fund assets exclusively in Energy Master Limited Partnerships (MLPs). These investments are subject to regulatory, interest rate, and liability risk, and involve significant fees at the partnership level—in addition to the 75 basis point fee the Fund pays to the investment managers.

For example, investing in MLPs involves brokerage commission and other front-end costs often totaling 20 percent or more. Also, the general partner in an MLP often begins with a small stake of about 2 percent in the partnership, but is given incentive distributions from net income after the quarterly required distributions. Since these distributions are usually paid in the form of increased equity claims, the general partner may attain an increased share of the partnership's ownership.

In the past year, the Fund's MLP investments have lost over 33 percent in value and over a three-year period, they have significantly underperformed (3.5 vs. 12.5 percent) the public equity market.

Note that 9 percent underperformance over 3 years amounts to **$27 million** in underperformance losses without compounding.

According to the Wall Street Journal, as the price of oil has fallen, these investments have continued to plummet in value. The Alerian MLP index fell 15.3 percent last month—the third-worst monthly loss in its nearly 20-year history. The average MLP mutual fund, according to Morningstar, lost 15.8 percent for the month.[81]

[81] http://blogs.wsj.com/moneybeat/2015/10/09/why-falling-oil-prices-startled-mlp-investors/

In our opinion, gambling on opaque, high-cost, high-risk MLP investments is imprudent, especially for a severely underfunded pension—regardless of the multi-million loss outcome.

XVIII. Custodian

The Master Custodian for the Fund currently is Northern Trust Company.[82] As Master Custodian, Northern holds and safeguards the cash, securities and other property in the Fund and collects the income and principal thereon.

The contract between the Board and Northern dated October 1, 2013, stipulates that Northern shall follow the parameters set forth in Section VIII, subsection A (excluding item #17) of the Statement of investment Policy approved by the Board on June 16, 2009.

The Statement of investment Policy dated December 20, 2012 displayed on the Fund's website is presumably current. Why Northern's contract with the Board would be governed by certain provisions of a Statement of Investment Policy that was replaced years ago is unclear.[83]

Unlike many of the contracts between the Fund and its investment managers, the contract does not require Northern to maintain any errors and omissions or other insurances. The contract does not include a provision stating that Northern acknowledges it is a fiduciary with respect to the assets of the Fund or an ERISA fiduciary. The Board does not represent in the contract that the Fund is not subject to ERISA.

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[82] It is our understanding that Northern has been the Fund's Master Custodian for over a decade.

[83] We were not provided with the Appendix to the contract relating to Section VIII, subsection A (excluding item #17) of the Statement of investment Policy approved by the Board on June 16, 2009 or any pricing information.

As mentioned earlier, certain of the practices permitted in the agreement with Northern may be inconsistent with ERISA fiduciary standards.

XIX. Commission Recapture

"Commission recapture" is a process whereby a pension plan receives a rebate in connection with brokerage transactions incurred through the plan's investment managers. This rebate represents a portion of commission (equity trade) or spread (fixed income trade) charged on these investment transactions.[84]

The plan sponsor directs its investment managers to execute a portion of their trades through a selected brokerage firm to the extent the brokerage firm is competitive in price and trade execution. The brokerage firm then rebates a portion of the commissions to the pension plan. The pension plan can be rebated in cash or have the brokerage firm pay certain administrative expenses of the pension plan.

Commission recapture programs involve responsibilities for plan sponsors, administrators, and other fiduciaries created by ERISA's fiduciary duties under Section 404 and prohibited transaction provisions under Section 406.[85]

These legal responsibilities are the bases which require plan fiduciaries to closely monitor plan expenses. Commission recapture programs are funded through use of commission dollars. Soft dollars and commission rebates generated by investment managers through trading activities are plan assets, and both plan sponsors and investment managers have

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[84] http://www.dol.gov/ebsa/publications/softdolr.htm

[85] Recall that the Fund, as a governmental plan, is not subject to ERISA but has specifically adopted in its Statement of Investment Policy ERISA's fiduciary standards.

fiduciary responsibilities regarding their prudent management and oversight as they do with other plan assets.[86]

According to industry experts, there are three parts to directed brokerage programs (such as commission recapture) -- the "good", the "bad" and the "ugly". The "good" is directed brokerage can result in significant savings to the pension plan. The savings can be used to offset legitimate plan administrative expenses and, if done correctly, do not interfere with investment managers' execution of trades. The "bad" is when plan sponsors over-direct trades by utilizing a single brokerage firm for more than a reasonable percentage, say 25 percent to 30 percent of overall trades. Another bad feature of directed brokerage programs is, if not structured properly, they can interfere with managers' execution of trades. In certain instances clients never receive promised rebates or pay five to six times greater commission dollars than the actual cost of services provided to the plan.

The "ugly" of directed brokerage programs is many arrangements are done orally with very little written evidence. Therefore, it becomes very difficult for plan sponsors to properly monitor the commission recapture program.

"A cloud of suspicions has hung over soft dollars and their offspring--directed brokerage and commission recapture programs--for several years."[87]

Worse still, commission recapture arrangements are opaque, indirect payment schemes that may compromise transparency and

[86] Id at 24.

[87] http://www.plansponsor.com/MagazineArticle.aspx?id=6442461455

accountability, as well as present conflicts of interest for all fiduciaries involved.[88]

For example, the Retirement Board of the City of Los Angeles Water and Power Employees' Retirement Plan terminated its commission recapture program with ConvergEx[89] in 2014 after the firm and two former employees admitted to and settled charges against them that included wire fraud and conspiracy to commit securities and wire fraud. The SEC and U.S. Department of Justice determined that ConvergEx routinely routed client orders through its offshore affiliate in Bermuda. This unnecessary step was taken on transactions to secure additional fees by adding a mark-up (an additional amount paid for the purchase of a security) or a mark down (a reduction of the amount received for the sale of a security) on the price of the security. The firm settled the charges with the SEC and DOJ by agreeing to pay $107 million and $43.8 million, respectively, and admitting to wrongdoing.[90]

Plan sponsors who use recaptured funds for purposes other than the best interest of the plan participants and beneficiaries may violate their fiduciary duties.

Note that even the largest public pension in Florida has been scarred by commission rebate schemes. In 1999, Barbara Jacobs, financial coordinator with the Florida State Board of Administration, who had on a number of public occasions championed the concept of soft dollars, was discovered by the state's internal auditors to have embezzled more

[88] Id.

[89] Based upon a file folder received from the Fund Administrator, it appears that the Fund has used ConvergEx for commission recapture in the past.

[90] http://retirement.ladwp.com/AgendaItems/20140326%20-%20Item%2019%20-%20Discussion%20of%20the%20Plan's%20Commission%20Recapture%20Program%20and%20Possible%20Action.pdf

than $400,000 in brokerage rebates meant to pay for manager research and other investment services on behalf of the $120 billion Florida SBA.[91]

According to a 1994 article, the Fund "started its commission recapture program in 1987, when Keane's board approved a letter of direction specifying that its money managers should place all their buy and sell orders through Lynch Jones & Ryan, a New York-based brokerage firm." From 1987 to 1994, "Keane says the fund has saved more than $600,000 in commission costs. He uses one of the fund's recent investments to illustrate the impact of those savings to his participants. "Our commitment to this idea let us buy our headquarters building," Keane says, "and to date, has paid for it more than twice over.""[92]

The article goes on to state that Keane "is firmly committed to the brokerage policy he adopted in 1987."Barring better execution elsewhere," Keane says, "this fund's policy is ABC-all brokerage recaptured.""[93]

"Any commissions recaptured for ERISA clients must directly benefit plan participants, and may not be used to reduce the expenses of the plan. In the case of Jacksonville Police & Fire, the new headquarters building is an asset of the fund.

Roughly $225 million of the fund is in equities that have an average turnover of about 20% per year, Keane says. More than 80% of its equity turnover goes through commission recapture programs. In the year ended in September 1992, $149,000, or some 80% of that year's total commissions paid, were recaptured, he adds. Savings for the first eight months of fiscal 1993 were $108,000.

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[91] http://www.plansponsor.com/MagazineArticle.aspx?id=6442461037
http://www.fraud-magazine.com/article.aspx?id=4294968469

[92] http://www.plansponsor.com/MagazineArticle.aspx?id=6442462301

[93] Keane touted the Fund's ABC policy at numerous industry conferences throughout the 1990s. Note that industry experts caution against over-directing trades more than 25-30%.

Firms like Goldman Sachs and Morgan Stanley have long contended that using soft dollar brokers-and rebates-undermines the quality of execution. And even Stanley Abel-chairman of brokers Abel Noser-who says his firm returned to Honeywell's pension fund more than $5 million in less than five years through commission recapture programs-wonders whether pension funds would be better off focusing on cutting commissions than recapturing them."

The above comment by Stanley Abel—the chairman of one of the nation's largest commission recapture firms, is important to note: A simple, transparent alternative for plan sponsors seeking to reduce plan trading costs is to simply cut or cap commissions, as opposed to recapturing them. The direct-cutting approach promotes accountability and eliminates the risk that commissions opaquely recaptured may be used for illegitimate purposes.

The article concludes:

"Like so much else in investment services, the battle over commission recapture boils down to marketing. Jacksonville Police & Fire clearly are convinced by what they have heard and seen; by contrast, AMR Investment Services, the pension arm of American Airlines, will not go near soft dollar or commission recapture programs."

Today the Fund appears to have backed-away from the aggressive ABC-all brokerage captured policy stated by Mr. Keane in the 1994 article above. The Statement of Investment Policy of the Fund states:

"The Fund has entered into commission recapture arrangements with several different brokers so as to provide a range of choices to investment advisors in their efforts and responsibilities to seek best execution. The Fund will make the listing of commission recapture brokers known to the various investment advisors; however, the Fund will not stipulate or dictate the level of commission dollars to be processed through the Fund's commission recapture arrangements. The level of commission dollars to be recaptured is solely based upon the judgment of the investment advisor."

The contracts between the Board and the Fund’s investment managers state that the manager “acknowledges it has been provided with and understands the provisions of the commission recapture program duly adopted by the Board together with a list of recapture agents. Subject to its continuing duty to secure best execution on behalf of the Fund, the manager agrees to utilize the recapture agents in all transactions where it is reasonable to do so.”[94]

Each of the Fund’s investment managers is also responsible for providing the Fund with a quarterly update on its investment activities as well as appropriate commentary, including but not limited to a discussion of commission recapture activities. Also, domestic equity commissions are essentially capped at three cents per share for large capitalization portfolios and four cents per share for small-mid capitalization portfolios.

Finally, the Statement of Investment Policy states:

The Commission Recapture Program established by the Fund, shall be limited to cash rebates made payable to the Fund and/or the Fund's Custodian Bank and fully reported as commission recapture revenues within the Fund's financial reporting system. Commission Recapture distributions shall not be accepted by the Fund in the form of payments on behalf of the Fund for goods and services to third parties or for services provided by the broker.[95]

[94] See page 3, DePrince, Race & Zollo agreement.

[95] Note: According to the Government Finance Officers Association, “The plan should receive all recaptured commissions in hard dollars (as opposed to soft dollars, a directed brokerage practice in which the rebate is received in the form of services such as research), which can be used to reduce overall administrative expense. An alternative to the recapture of commissions is for plans or their investment managers to negotiate a lower transaction fee directly with participating brokerage firms.” http://www.gfoa.org/commission-recapture-programs

We requested annual statements of commissions recaptured by the pension since 1987, as well as documents related to the expenditure of the recaptured amounts.[96]

Instead we were provided with statements indicating commissions recaptured since 2005 (not since 1987, as requested) by Merrill Lynch; Ticonderoga Securities; Reynders & Gray; National Financial Services; Magna Securities; Lynch, Jones & Ryan; Knight Capital; Donaldson; and Capital Institutional Services in the amount of $1.936 million.

Assuming the Fund has recaptured approximately $200,000 per year since 1987, approximately **$5.7 million** in commissions may have been recaptured.

In response to our question regarding how the commissions recaptured were spent, we were simply told, “The funds were deposited into our General Account.”

As noted above, the Fund Administrator himself has mentioned in speeches that recaptured commissions were used to buy a new headquarters building.[97]

We also asked the Fund Administrator how the Fund accounts for commission recapture rebates:

If cash is received directly by the fund, is the cash recorded as an adjustment to realized and unrealized gain loss depending on whether or not the security that the commission relates to has been sold? Where do the commissions recaptured appear in the financials?

The Fund Administrator responded:

[96] Email to Greive July 23, 2015.

[97] It is our understanding that the Fund’s office building has been named after the Fund Administrator.

Deposited into JXSF621PF, sub object 369920 – Rebate of Commissions.

In our opinion, stakeholders should be provided with a full accounting of all rebated dollars in order to determine whether they have, consistent with heightened ERISA fiduciary standards, been used for the exclusive benefit of the participants.

Note that actively managed accounts with higher portfolio turnover generate greater commission rebates. The Board's emphasis on recapturing commissions may have led to excessive reliance upon active management, contributing to the Fund's overall underperformance.

We understand that the City Council may subpoena records related to the receipt and use of rebated commission dollars since 1987.

XX. Decades of Conflicted Consultant Advice

As noted in the Report of the Retirement Reform Task Force,[98] the Board utilizes the services of an investment consultant who advises the Board on investment policies and decisions, and who assists in implementing those decisions. The investment consultant's duties and responsibilities are enunciated in the contract between the Board and the investment consultant and the Fund's Statement of Investment Policy.

The Board does not utilize an investment committee as does the Florida Retirement System. According to the Report, Task Force members indicated that they had experience with other organizations which used investment committees in addition to investment consultants, and that they believed that the use of an investment committee is a "best practice." It was the opinion of the Task Force that a volunteer investment committee consisting of knowledgeable investment and financial professionals would be helpful to assuring sound financial and investment decisions by the Board.

[98] Page 19.

1. History of Regulatory Concerns Regarding Pension Investment Consultant Conflicts

"Pension consultants" provide advice to pension plans and their trustees with respect to such matters as: (1) identifying investment objectives and restrictions; (2) allocating plan assets to various objectives; (3) selecting money managers to manage plan assets in ways designed to achieve objectives; (4) selecting mutual funds that plan participants can choose as their funding vehicles; (5) monitoring performance of money managers and mutual funds and making recommendations for changes; and (6) selecting other service providers, such as custodians, administrators and broker-dealers.

Many pension plans rely heavily on the expertise and guidance of their pension consultant in helping them to manage pension plan assets.

Public pensions, in particular, rely heavily on their pension consultants since these funds generally have lay Boards that lack investment expertise.

In late 2003, the staff of the Securities and Exchange Commission ("SEC") announced an inquiry into conflicts of interest involving investment consultants to pensions, including allegations of "pay to play" practices.

"Pay to play" in the pension context refers to the common practice of investment consultants who are retained to provide objective advice regarding investment managers, requiring or encouraging managers to direct or "pay" trading commissions and/or other compensation to them in order to be recommended to pension clients.

When consultants recommend managers based upon their willingness to pay compensation to the consultant, as opposed to on the investment merits, they engage in self-dealing and breach their fiduciary

duty to place client interests ahead of their own and. Substantial harm in the form of excessive risk and fees, as well as diminished investment returns has been found to result. The SEC staff examined the divergent sources of consultant compensation and the related conflicts; whether such amounts were properly disclosed; and whether pensions were being harmed by such practices.

On May 16, 2005 the staff of the SEC's Office of Compliance Inspections and Examinations issued a report which, in part, concluded that conflicts of interest were pervasive and disclosure practices lacking in the investment consulting industry.[99]

On June 1, 2005 the SEC and Department of Labor issued a publication entitled "Guidance Addressing Potential Conflicts of Interest Involving Pension Consultants." To encourage the disclosure and review of more and better information about potential conflicts of interest, the Department of Labor and the SEC took the unusual step of developing and issuing a set of questions to assist plan fiduciaries in evaluating the objectivity of the recommendations provided, or to be provided, by a pension consultant. That is, a form of questionnaire was provided for plan sponsors to use in their dealings with their consultants and for consultants to make available.[100]

As the DOL noted at that time:

"Findings included in a report by the staff of the U.S. Securities and Exchange Commission released in May 2005 …, raise serious questions concerning whether some pension consultants are fully disclosing potential conflicts of interest that may affect the objectivity of the advice they are providing to their pension plan clients…

[99] Staff Report Concerning Examinations Of Select Pension Consultants May 16, 2005, The Office of Compliance Inspections and Examinations, U.S. Securities and Exchange Commission.

[100] Selecting and Monitoring Pension Consultants, Tips for Plan Fiduciaries, U.S. Department of Labor, May 2005.

SEC staff examined the practices of advisers that provide pension consulting services to plan sponsors and trustees. These consulting services included assisting in determining the plan's investment objectives and restrictions, allocating plan assets, selecting money managers, choosing mutual fund options, tracking investment performance, and selecting other service providers. Many of the consultants also offered, directly or through an affiliate or subsidiary, products and services to money managers. Additionally, many of the consultants also offered, directly or through an affiliate or subsidiary, brokerage and money management services, often marketed to plans as a package of "bundled" services. The SEC examination staff concluded in its report that the business alliances among pension consultants and money managers can give rise to serious potential conflicts of interest under the Advisers Act that need to be monitored and disclosed to plan fiduciaries."

Most significantly, conflicts of interest at investment consulting firms were found to result in substantial financial harm to plans by the Government Accountability Office in a 2007 report.[101]

In its report, the GAO took the extraordinary step of quantifying the harm a conflicted adviser to a plan can cause. "Defined Benefit plans using these 13 consultants (with undisclosed conflicts of interest) had annual returns generally **1.3% lower** ... in 2006, these 13 consultants had over $4.5 trillion in U.S. assets under advisement," the report stated.

Failure to disclose conflicted sources of compensation and the amounts of such compensation among these trusted advisers to sponsors of retirement plans, as well as the potential economic harm to pensions resulting from such conflicted advice, has been well documented by the SEC, DOL and GAO.

[101] Defined Benefit Pensions: Conflicts of Interest Involving High Risk or Terminated Plans Pose Enforcement Challenges, GAO, June 28, 2007

In summary, awareness of conflicts of interest involving pension consultants has grown and for over a decade plan sponsors have acknowledged a duty to investigate such conflicts.

2. Broker-Affiliated Pension Consultants

As mentioned earlier, the SEC staff in 2005 found that many investment consultants offer, directly or through an affiliate or subsidiary, products and services to money managers that can give rise to serious potential conflicts of interest under the Advisers Act that need to be monitored and disclosed to plan fiduciaries.[102] The most common and controversial investment consultant conflict scenario relates to "broker-affiliated" consultants.

That is, securities brokerages that serve as pension gatekeepers may offer either directly or through their subsidiaries and affiliates securities trading and other services to the very money managers they recommend to pension clients. The commissions and other compensation broker-affiliated consultants earn from managers may be significantly greater than the compensation received for providing pensions with supposedly objective advice regarding these managers.

There is a risk that these payments from managers to consultants may not only undermine the integrity of the advice consultants provide to pensions but also result in underperformance if assets are allocated to investment managers based upon willingness to pay, as opposed to investment merit. Further, payments from money managers to investment consultants can result in excessive consulting, brokerage and investment management fees.

[102] Staff Report Concerning Examinations Of Select Pension Consultants May 16, 2005, The Office of Compliance Inspections and Examinations, U.S. Securities and Exchange Commission.

For example, in March 31, 2000, a KPMG Performance and Operational Review of the Metropolitan Government of Nashville and Davidson County's pension investments determined that the PaineWebber investment consulting contracted fee was excessive. The fee the $1.3 billion pension was contractually obligated to pay for consulting services was $788,747, as opposed to an average fee for similar public funds which ranged from $92,000 to $163,000. However, PaineWebber actually earned a total of $1,408,773 in commissions for the year. Similarly, investment manager fees were higher than fees paid by other similar public funds.

Benchmark's subsequent investigation of the PaineWebber compensation scheme on behalf of the Nashville pension revealed significant additional fiduciary breaches, compensation and excessive fees.

We subsequently investigated this same investment consultant after he left PaineWebber and joined Morgan Stanley on behalf of the City of Chattanooga pension fund.

In June 2005 the Atlanta District Office of the SEC concluded an examination of the Nashville Branch Office of Morgan Stanley. The SEC review of the pension consulting arrangement between Morgan Stanley and the City of Chattanooga public pension fund revealed that Morgan Stanley failed to fully and fairly disclose all material facts concerning its conflicts of interest, including its compensation agreements in violation of Section 206 of the Investment Advisers Act of 1940.

The SEC concluded that the disclosures made by Morgan Stanley were not sufficiently detailed in order to allow its client to evaluate investment manager recommendations and to give its informed consent to Morgan Stanley's conflicts of interest. Further, determined that Morgan Stanley had failed to disclose to the pension the conflicts of

interest related to the firm's financial adviser (broker) compensation program, including indirect "perks."

On July 20, 2009, the SEC instituted public administrative and cease-and-desist proceedings against the pension consultant, who, according to the SEC, was a member of Morgan Stanley's Chairman's Club, comprised of the firm's top 175 financial advisers, and ranked among the firm's top 25 financial advisers in revenue.[103]

PaineWebber and Morgan Stanley both entered into settlements with the public pension funds of the cities of Nashville ($10 million) and Chattanooga ($6 million) in matters involving pension consultant conflicts of interest and pay-to-play.[104]

Callan Associates, another pension consulting firm, entered into a $4.5 million settlement with the City of San Diego regarding consultant conflicts. In addition, the SEC investigated and took action with respect to Callan Associates, CSG, and Merrill Lynch regarding pension consulting conflicts. Callan and Yanni Partners, were sanctioned by the SEC.[105]

3. 20 Years of Conflicted Advice Cost Fund $300-$500 Million

For almost twenty years, from 1988 through December 31, 2007, Merrill Lynch, a broker-affiliated investment consultant, served as the investment consultant to the Board. If, as the GAO study found, pension consultant conflicts cost plans 1.3 percent, then over a 20-year period,

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[103] https://www.sec.gov/litigation/admin/2010/34-61278.pdf

[104] Morgan Stanley Settles Chattanooga Suit, fundfire.com, March 24, 2006.

[105] Adviser Firm on Pensions Is Rebuked, by Mary Williams Walsh, The New York Times, September 21, 2007.

with compounding, such conflicts may have cost the Fund **almost 30 percent** of its value—perhaps **$300-$500 million**.

Merrill Lynch provided Consulting Services to the Board through its "Callaway Team," a group headed by Merrill Lynch Financial Advisors Michael and Mellissa Callaway, and whose employees all operated out of the same Merrill Lynch office in Duval County, Florida.

In its capacity as investment consultant to the Board, Merrill Lynch provided a package of services intended to assist the Board in among other things, (i) developing the Fund's investment policies and asset allocation strategies, (ii) selecting the Fund's' investment managers, and (iii) monitoring and analyzing of the performance of the Fund's investments.

The contracts between the Board and Merrill stated that the information needed to provide investment evaluations were generally contained in the records and reports of the custodian bank and that Merrill was entitled to reasonably rely upon such information.

In its contracts with the Board,[106] Merrill certified that it was "professionally qualified as an independent consultant to evaluate the performance of the professional money managers investing the assets of the Fund."

Under Florida Statutes Chapter 185 applicable to Municipal Police Pensions, a professionally qualified independent consultant must, at a minimum, provide services on a flat-fee basis and not be associated in any manner with the money managers for the pension fund.[107]

[106] We have only reviewed those contracts provided by the Fund Administrator.

[107] 185.06 (5) (b). As detailed below, Merrill was not paid on a flat-fee basis and was associated, via brokerage arrangements, with money managers for the pension.

The contracts between the Board and Merrill generally provided that the firm would be paid an annual hard-dollar fee, e.g. $68,200 in 2000 and $91,395.00 for 2008, for its services.

However, the initial contract (1988) stated that the Board could pay the fee in directed commissions for which the cost would be approximately twice the hard-dollar fee.

Beginning in 2004 and through 2006, the contracts provided that in addition to any hard-dollar fee, "the Board, in recognition of the increased level of services provided by the Consultant to the Board, authorizes additional compensation for the Consultant in the form of a rebate of 5 percent of the revenue received by Broadcort Capital (an affiliate of Merrill) from the Fund's commission recapture account."

Apparently throughout the consulting relationship Merrill Lynch's trading desk was receiving trading commissions from investment managers that Merrill Lynch Consulting Services recommended to the Fund, in addition to the hard dollar annual fee.

Fund General Counsel in a 2005 article stated trades by the Fund's managers with Merrill's brokerage arm were "separate" and "never make their way back to the consulting arm."

"Merrill Lynch's consulting arm, however, is separate from its brokerage arm, so conflicts are less inherent, says Robert D Klausner, a partner in the Plantation, Florida, law firm of Klausner & Kaufman, PA, who has looked into Merrill Lynch on behalf of a client pension fund in Florida. Klausner, who also is general- counsel for the National Conference on Public Employee Retirement Systems (NCPERS), admits that some trades of consulting clients are executed by Merrill Lynch. It would be hard to not do so since it is one of the biggest brokerage houses in the country,[108] he

[108] In a 2003 email from Board member Jaffe to the Fund Administrator, Jaffe observes that "If Merrill is the "biggest" (trading firm) in the industry and we are hurting ourselves to eliminate the (trading) services, then it would say that maybe we shouldn't use Merrill as our consultant."

adds, and, even if trades are made through Merrill Lynch's brokerage arm, those fees never make their way back to the consulting arm.

In interviewing consultants, the first question boards should ask is how the consultant will make his money. All fees should be disclosed, particularly with brokerage-based consultants, says Klausner. "The biggest issue is a failure to disclose," says Klausner. "If it's disclosed, then the trustees can decide if the business model works or if there is an appearance of impropriety."[109]

As discussed extensively below, by the year 2000, concerns regarding the integrity of Merrill Lynch's pension consulting advice and related conflicts of interest were widely known. In 2003, Board members and Fund General Counsel were questioning Merrill regarding conflicts and business practices. In 2005, the Board was made aware in published reports of the SEC staff investigation into certain specific business practices of Merrill and subsequently Merrill informed the Fund that it was under investigation by the SEC for alleged violation of federal securities laws. In early 2006, the SEC contacted the Fund requesting voluntary cooperation in an investigation of Merrill and by late 2007 an SEC enforcement action against Merrill appeared imminent.

These issues resulted in the Board finally terminating its relationship with Merrill at the beginning of 2008.

On November 5, 2007, Fund General Counsel sent a letter to the Board stating:

"Nearly two years ago, Merrill informed the Fund that it was under investigation by the SEC for alleged violation of federal securities laws, but only after public disclosure of the investigation, rather than as required under our contract. SEC investigators have questioned trustees and administrators from a number of Florida clients of Merrill, including staff of the Fund. The initial allegations against Merrill involved whether Merrill had received undisclosed compensation and related

[109] http://www.plansponsor.com/MagazineArticle.aspx?Id=4294991588

conduct. The charges referred to in Merrill's letter to the Board have not been released and at this juncture, it is not useful to speculate on unknown details.

…there were related issues discovered and investigated directly by the Fund and this office and brought to Merrill's attention. That investigation and follow up, which was previously reported to the Board, resulted in restitution to the Fund…[110]

Merrill was invited to attend the November 5 meeting of the Board and initially agreed. It has now refused to attend. Instead Merrill is requesting a list of questions which it may or may not choose to answer. This is an inadequate response from a fiduciary to the Fund, particularly when serious concerns about alleged federal securities laws violations are present. In our view, Merrill's refusal to attend the November 5 meeting is a breach of its fiduciary duty.'

Fund General Counsel recommended terminating the agreement with Merrill effective December 31, 2007, as well as tasking the new consultant with an in depth review of Merrill's reports and practices to determine if any previously undisclosed concerns were present and authorizing discussion with the Fund's securities counsel to determine if the Fund had suffered a recoverable loss.[111]

On that same day, the Fund finally terminated its two-decade relationship with Merrill effective December 31, 2007. At that time, the Fund issued a public Statement stating the Fund,

"… retained Merrill Lynch Consulting Services (MLCS) to provide independent fiduciary guidance to the Board on issues relating to Investment Manager Performance Measurement; review of and updating the Fund Asset Allocation Plan; Fund Investment Policy and other related invested related monitoring services needed by the Board. For over 20 years MLCS provided the required services to the Board…

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[110] A $10,000.00 transition management credit was provided by Merrill to the Fund on March 31, 2004.

[111] We requested from the Fund Administrator any documents related to any in depth review undertaken by the consultant or others of the Merrill relationship. According to a September 2, 2015 email from the consultant who replaced Merrill, the new consultant did no such evaluation or review.

Nearly 2 years ago, the Board was made aware in published reports of the SEC staff investigation into certain specific business practices of MLCS and also those of Mr. Michael Callaway (the Consultant), a representative of MLCS who has a fiduciary relationship with the Board as the Investment Consultant Performance Measurement Consultant to the Board. The staff of the Board has cooperated fully with the SEC staff during the investigation.

On October 29, 2007 the Board was informed by MLCS "the SEC staff has indicated that it believe that some practices engaged in by Merrill Lynch and Mike Callaway violate certain regulatory prohibitions." Also, … we were informed by the Consultant the SEC "has taken issue with some of Merrill Lynch's and my practices." The Board has no detailed knowledge of the particular practices the SEC staff believes to violate regulatory prohibitions, nor does the Board by its actions today express a view of the SEC staff recommendations."

4. Repeated Warnings Regarding Merrill Lynch Consulting in Florida

In early 1996, questions surrounding conflicts related to pension consultants with affiliated brokerages began to attract national attention.[112]

By 2000, the dangers related to broker-affiliated consultants were being discussed with Florida public pensions and their attorneys. Independent conflict-free consultants were challenging broker-affiliated consultants that had long dominated the Florida public pension marketplace by drawing attention to the conflicts and dangers related to broker-affiliated consultants.[113]

In 2002, Edward Siedle was invited to give a speech specifically focused upon pension consultant conflicts at the annual Florida Police and Firefighters Pension Trustee Educational Seminar hosted by The Florida

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[112] http://www.benchmarkalert.com/article7.html

[113] Florida-based Independent consultant The Bogdahn Group voiced concerns in 2002 regarding broker-affiliated consultant conflicts and later wrote an extensive White Paper which was distributed to members of the Florida Public Pension Trustees Association in 2004.

Department of Management Services' Division of Retirement Security in Tallahassee.

Siedle explained the breach of fiduciary duty that results when a pension gatekeeper, the investment consultant, receives brokerage compensation from the managers it recommends, provided details regarding the first-ever investigation of broker-consultant conflicts for a public pension in Nashville that resulted in a $10 million recovery for the single public pension, and warned attendees of the potential damages to plans.

Around this time, he met with and discussed conflicts of interest involving Merrill Lynch specifically with the Fund Administrator, General Counsel and attorneys from BLBG accompanying the Fund Administrator. In light of the potential harm to the Fund and other Florida public pensions, he urged them to take immediate action.

In December, 2004, The New York Times wrote an article, How Consultants Can Retire on Your Pension, which mentioned that the potential for conflicts was greatest at firms with brokerage or trading operations. It was also stated that Merrill Lynch Consulting Services in Jacksonville had almost 100 pension funds in Florida as its clients but that some Florida funds had already fired the firm and replaced it with an independent consultant.

Next securities regulators from the State of Florida asked to meet with Benchmark at our offices and reviewed files regarding the broker-affiliated consultant abuses we had uncovered**.**

In September 2005 Money Management Letter wrote an article about how Florida regulators were looking into brokers serving as consultants to public pensions.

December 2, 2005, The New York Times ran an article entitled, "Merrill Unit Subpoenaed on Pensions." It was now widely known that the SEC was investigating Merrill's pension consulting operation in Florida.

The Wall Street Journal reported on March 12, 2007 that Merrill had begun issuing refunds to public pension clients in Florida. Apparently some Florida public pensions took the money, no questions asked—i.e., no investigation as to whether the damages may have exceeded the compensation offered.

On Sunday, November 4, 2007, the New York Times ran an article regarding the SEC investigation of Merrill and the letters the firm had sent to clients.

On May 2008, Merrill announced it was closing down its Florida pension advisory practice.

In January, 2009, the SEC finally took action against Merrill and Michael Callaway. Merrill Lynch agreed to settle the SEC's charges and pay a $1 million penalty.

The SEC stated that investment advisers, such as Merrill Lynch, owe fiduciary duties to their clients and, therefore, must, among other things, disclose all actual or potential conflicts of interest. In addition, investment professionals who advise pension funds must be aware of the important role that pension plans play in the financial security of the beneficiaries.

"During the relevant time period, Merrill Lynch charged for the advisory services provided through Merrill Lynch Consulting Services on a fixed-fee basis. Clients could pay in cash (referred to as "hard dollars") or through "directed brokerage." Directed brokerage was an arrangement whereby the clients directed their money managers to execute trades through Merrill Lynch's institutional trading desk, consistent with the managers' best execution obligations. In return, in addition to execution services, these clients received credit for a portion of the commissions generated by

these trades against the hard dollar fee owed for the advisory services provided by Merrill Lynch Consulting Services. Even after the hard dollar fee had been satisfied, Merrill Lynch Consulting Services, and its investment adviser representatives, continued to receive a portion of the commissions generated through the directed brokerage relationship.

Under Merrill Lynch's standard directed brokerage relationship, Merrill Lynch Consulting Services and, consequently, its investment adviser representatives potentially could receive and, in fact, often did receive significantly more revenues through directed brokerage commissions than they would have received if clients had paid brokerage commissions for trade executions elsewhere and paid Merrill Lynch only the hard-dollar annual Consulting Services fee. For example, in one instance in the Ponte Vedra South office a client who was obligated to pay a $7500 annual hard dollar fee for the advisory services it received through Merrill Lynch Consulting Services generated almost $175,000 in production credits by executing trades at Merrill Lynch."[114]

5. Florida Public Pension Class Action Settlement with Merrill Lynch

On July 15, 2010, 76 Florida local public pensions filed a detailed putative class action complaint against Merrill Lynch.[115] The Plaintiffs alleged that Merrill Lynch breached its fiduciary duties to the plans by, among other things, (a) entering into fee arrangements with the plans – and with certain third parties (such as mutual fund companies) who provided services to the plans – that placed Merrill Lynch's financial interests ahead of the plans' interests and that compromised Merrill Lynch's role as an "independent" advisor to the plans, selecting money managers from a "short list" of money managers that Merrill Lynch's Callaway Team created and maintained in its Florida office. Plaintiffs further alleged in the complaint that the plans suffered damages as a result of Merrill Lynch's breaches of its fiduciary duties, and demanded

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[114] https://www.sec.gov/litigation/admin/2009/ia-2834.pdf

[115] Both the City's General Employees' Pension and the Fund were plaintiffs in the suit.

that Merrill Lynch disgorge all benefits, compensation, or other value it received, from any source, in connection with the provision of Consulting Services to the Plans or the investment of the plans' assets.

On March 23, 2012, the parties entered into a Stipulation and Settlement Agreement resolving the matter for $8.5 million. Attorneys for the plaintiffs including BLBG and the General Counsel's firm, shared in $2.125 million in legal fees.

In response to our request for information, we were provided with a check dated February 28, 2013 made out to the Fund in the amount of $273,696.64 and a letter indicating that the check represented the Fund's pro rata share of the net settlement fund from the class action case brought against Merrill Lynch. It appears that, aside from a transaction management credit of $10,000, this is the total compensation the Fund received in damages from Merrill Lynch.

Since, based upon the GAO study, pension consultant conflicts may have cost the Fund almost 30 percent we requested any evaluation or review of the damage caused to the Fund by Merrill over the decades.

The Fund Administrator provided no such analysis and the new consultant indicated it undertook no such review.

In our opinion, the Board failed to heed credible warnings and adequately investigate conflicts of interest related to the Fund's consultant for years. Based upon the documents we were provided, it appears the Board did not question the receipt of compensation by the General Counsel's firm—an obvious potential conflict of interest noted in The New York Times—from the consultant during the period. Even after terminating Merrill, the Board failed to conduct or commission any review of the potential (massive) harm to the Fund caused by Merrill. The Board did not investigate the fact that the gross and net investment

performance of the Fund as reported by Merrill were inexplicably the same for many years.

XXI. Current Consultant - Summit Strategies

At least since the termination of Merrill Lynch, the investment consultant to the Board has been Summit Strategies Group. The current Statement of Investment Policy of the Fund[116] enumerates the specific duties of the Investment Consultant, as well as includes the most elaborate discussion of the fiduciary obligations applicable to any Fund service provider.

The Statement of Investment Policy with respect to the Consultant states:

"The Consultant is acknowledged to be a fiduciary, as it relates to its services and advice provided to the Fund. In discharging its contractual responsibilities, the Consultant recognizes that its fundamental obligations are to the Board and the members of the Fund, and that it will place the interests of the Board and the members of the Fund above all others. Consistent with this focus, the Consultant will not enter into any agreement or take any action contrary to its fundamental responsibilities and obligations. One of the fundamental roles of the Consultant is to provide an independent, unbiased perspective on the Fund's goals, structure, policies, performance and managers. In preserving and maintaining this independent advisory role, the Consultant shall ensure that through words, deeds, and financial relationships, it is insulated from conflicts of interest. In this regard, the Consultant has an affirmative duty of full and fair disclosure of all material facts to the Fund regarding all issues and relationships that relate to the subject of independence and conflict of interest. The Consultant additionally maintains an obligation to the Board to disclose all forms of pertinent information on Investment Managers employed by the Board, various sources of the Consultant's compensation, and other aspects of the Fund's investment program that a reasonable person in like posture would deem pertinent to the Board's area of interest and concerns. In an effort to avoid any appearance of conflicts of interest and to maintain the highest degree of objectivity

[116] We have only reviewed the current Statement of Investment Policy of the Fund.

and independence, the brokerage affiliate(s) of the Investment Consultant shall not be eligible to participate in the Fund's Transition Management Programs authorized from time to time by the Trustees.

Unless otherwise approved on an exception basis and fully disclosed to the Board in advance, investment managers shall not: custody assets under their control, execute trades through brokers affiliated with the Investment Manager or the Fund's Investment Consultant or Custodian Bank, or otherwise pay any fees, compensation or gratuities to the Fund's Investment Consultant or Custodian."[117]

The 2013 contract between Summit and the Board states that the consultant originally commenced providing services to the Board on December 3, 2007.

While the list of duties or obligations required of the Consultant in the contract and Statement of Investment Policy is extensive, conspicuously absent is any specific obligation to advise and assist the Board in negotiating and evaluating the investment advisory fees the Fund pays.

The Board's contract with Summit provides that information needed to provide the investment evaluations required of the Fund and its investment managers is generally contained in the records and reports of the custodian bank and that the consultant is entitled to reasonably rely upon such information.

While the custodian bank could provide such performance information, the Board under Merrill Lynch and now under Summit, continues to rely upon the consultant for performance analyses.[118] As mentioned earlier, Summit has represented that it did not undertake any evaluation or review of Merrill Lynch.

[117] Page 38.

[118] It is our understanding that the General Employees' Fund relies upon its custodian for investment performance data.

The contract provides for a hard dollar quarterly fee of $61,466.00 or an annual fee of approximately $246,000. Recall that the highest annual hard dollar fee paid to Merrill Lynch was substantially less—approximately $90,000.

A review of the firm's Form ADV filing with the SEC indicates that the firm has no affiliated broker-dealer or any other financial industry affiliation. While the firm does manage private investment funds which represents a potential conflict of interest, the Fund has not invested in any such Summit fund.

We recommend the contract between the Fund and its Master Custodian be amended to include calculating investment performance and that the Fund rely upon any investment consultant only for advice and analysis of such verified investment performance. We also recommend that the contract between the Fund and any investment consultant be amended to include a duty to advise the Board on the reasonableness of the investment advisory fees the Fund pays.

XXII. Plaintiff Class Action Law Firms

The Fund has entered into agreements with multiple securities class action law firms to monitor its investment portfolio in order to determine whether the Fund has suffered any loss due to violations of federal and/or state securities laws, calculate losses, identify breaches of fiduciary duty and other corporate misconduct.[119]

It appears that the General Counsel of the Fund recommends which class action law firms should be used for monitoring.[120]

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[119] According to the Board Workshop Minutes dated November 19, 2013, the Fund recovers about $500,000 a year in securities litigation proceeds. These cases are all done on a contingency basis.

[120] See November 18, 2008 memo re: securities monitoring services from Bob Klausner, General Counsel to the Board.

As mentioned above, the Board has delegated to the General Counsel and Fund Administrator the duty to review whether the Fund should proceed as lead plaintiff in any class action litigation and the General Counsel may receive compensation related to any such cases brought by the firms he has recommended to monitor the Fund's portfolio (or any other class action law firm).

As explained by Forbes:

"Bernstein Litowitz, like other firms in the class action field, offers free "portfolio monitoring" to pension-fund clients, tapping into their portfolios electronically and alerting them to potential lawsuits.

One lawyer who works for pension funds in Florida receives e-mails every week from big class action firms prowling for clients, with queries sometimes arriving within minutes of each other after new cases are filed. Florida lawyers get their cut: up to 18%, he says. Such fees are typically described as compensation for work as local liaison rather than purely for referring a client, which violates legal ethics in most states."[121]

Some have severely criticized these "portfolio monitoring" arrangements between pensions and class action firms. One highly regarded federal judge, Judge Rakoff, noted in 2009, that such an arrangement was "about as obvious an instance of conflict of interest as I've ever encountered in my life." He said he was shocked that persons with a fiduciary duty to monitor pension investments would choose "to save a few bucks" by hiring a law firm to monitor those investments that could only profit by recommending litigation.[122]

In response to plaintiffs' counsel's suggestion that his law firm analyzed and evaluated the merits of the case before recommending that the

[121] http://www.forbes.com/forbes/2004/0920/150.htm

[122] http://www.dandodiary.com/2009/04/articles/securities-litigation/judge-calls-plaintiffs-firms-monitoring-services-shocking-conflict-of-interest/

fund become involved in litigation, Judge Rakoff said that arrangement "makes crystal clear that the Iron Workers (the pension involved) *are being led by counsel rather than the other way around* (emphasis added)."[123]

For years we have urged public pension officials to scrutinize the arrangements they enter into with class action law firms, just as they vet investment consultants, money managers, brokers and anyone else doing business with their funds. Nevertheless, scrutiny of lawyers by public pensions remains severely limited–and not just among pension officials.

For example, in 2009 New York Attorney General Andrew Cuomo who was investigating investment consultants for bribing their way into doing business with the state's giant pension fund, stated that he would not subject class action law firms (from which he reportedly received large campaign contributions) to similar scrutiny for similar behavior.

We were provided with and reviewed portfolio monitoring agreements between the Fund and Bernstein Liebhard; Cohen Milstein; Berman DeValerio; and Spector Roseman.

While the Fund General Counsel in an email[124] referred to BLBG as the Fund's "primary securities litigation council" and in a 2004 letter to the Board stated that the Board entered into an agreement with BLBG to monitor the Fund's portfolio, no contract or agreement with the firm was provided to us.

The relationship between BLBG, the Fund and the Fund Administrator is longstanding and widely known.

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[123] Id.

[124] September 25, 2010 email from Klausner to Keane.

“At the Jacksonville [Fla.] Police & Fire Pension Fund, a Bernstein Litowitz client, suing big business for fraud seemed a fitting step. “Every day our members put people in jail for auto theft and armed robbery. It was logical to leap from enforcing local laws to going after boardroom bandits,” says John Keane, a former cop who is the administrator of the $900 million fund.

The Jacksonville fund is the lead plaintiff in a class action accusing Nextcard of underreporting loan losses; it also leads a case pending against El Paso Corp. Keane has parlayed this into regular speaking gigs, traveling to Bernstein Litowitz investor forums that also have featured Carl McCall, the ex-comptroller for New York, and New York Attorney General Eliot Spitzer, Wall Street slayer.”[125]

The Fund Administrator noted in his response to our request for all contracts and monitoring agreements between the Fund and class action litigation firms that “all law firms are not under this type of contract.”

Accordingly, on September 4, 2015 we specifically asked for *any* type or contract between the Fund and BLBG:

Please provide a copy of any contracts or agreements between the Fund and Bernstein Litowitz and any contracts or agreements between BLBG and the Klausner firm related to the Fund.

The Fund Administrator responded:

We do not have a monitoring agreement with BLBG. When we first retained BLBG we did so by letter/email asking them to represent the Fund.

On September 8, 2015, we again asked:

Please provide any agreements the Fund has had with BLBG over the past 15 years.

[125] http://www.forbes.com/forbes/2004/0920/150.htm

And again we were told:

As I responded to your inquiry on Friday afternoon, we do not have a monitoring agreement with BLBG. When we first retained BLBG we did so by letter/email asking them to represent the Fund.

In conclusion, despite repeated requests we have never been provided with any contract, agreement or letter between the Fund and its "primary" securities litigation counsel—despite the fact that General Counsel to the Fund has stated in a letter to the Board that such an agreement exists.

The agreements Bernstein Liebhard and Berman DeValerio are relatively new (2011 and 2012, respectively) and seem quite broad, indicating that these firms will proactively identify instances of abuse by corporate management and breaches of fiduciary duties under federal securities, state securities, corporate and related areas of law.

Based upon information provided by the Fund Administrator, it appears that no law firm monitoring the Fund's investments over the period from 1988 through 2008 notified the Fund of fiduciary breaches related to Merrill Lynch Consulting Services early on—breaches for which the SEC later took action against the firm.

Whether any firm monitoring the Fund's investments during this period represented that it would notify the Fund of any such fiduciary breaches should, in our opinion, be reviewed—if for no other reason than determining whether the Fund should continue to rely upon any such firm to identify key fiduciary breaches related to its investments.

In our opinion, it is important for public fund boards to keep in mind the narrow services the class action securities law firms actually provide, as opposed to the expansive capabilities these firms often claim. Further,

the contract between monitoring firms and public funds should reflect the actual services being provided "for free" and firms which are not performing pursuant to their contracts should be terminated.

XXIII. Placement Agent Contingent Fees

Placement agents are intermediaries or middlemen paid by external investment managers to market and sell their investment products. Placement agent fees are paid directly by money managers and indirectly by investors through higher asset-based fees than would be available absent the compensation arrangement between the manager and the intermediary.

Under the economic theory of disintermediation, removal of the intermediary from the process, i.e., "cutting out the middleman," reduces the cost of the service to the customer. Disintermediation initiated by customers is often the result of high market transparency. Markets lacking transparency often are plagued by undisclosed and dispensable intermediaries.

The federal securities laws generally require that registered investment advisers, when employing the services of third party marketers, provide the client with a written disclosure document, commonly referred to as a "solicitation agreement," describing the terms of any compensation arrangement between the solicitor (or marketer) and the investment adviser, as well as "the amount, if any, for the cost of obtaining his account the client will be charged in addition to the advisory fee, and the differential, if any, among clients with respect to the amount or level of advisory fees charged by the investment adviser if such differential is attributable to the existence of any arrangement pursuant to which the investment adviser has agreed to compensate the solicitor for soliciting clients for, or referring clients to, the investment adviser.

In summary, the disclosure requirements related to investment advisor third party solicitation arrangements reflect the belief that the investment advisory client should be advised of the existence of the intermediary, the fees paid to the intermediary and whether he is paying a higher fee as a result of the intermediary.

In our experience, the SEC has required registered investment managers utilizing undisclosed solicitors to offer the public pension investors rescission of the investment and return of all fees paid. Thus, failure to disclose marketing intermediaries can have severe consequences for investment managers.

The contracts drafted by the Board which we were provided in response to our request[126] between the Board and the Fund's investment managers generally include a provision stating that the manager warrants that it had not employed or retained any company or person, other than a bone fide employee working solely for the manager to solicit or secure the contract and that it has not paid or agreed to pay any person, company, corporation, individual or firm other than a bona fide employee working solely for the manager any fee, commission, percentage, gift or other consideration contingent upon or resulting from the award or making of this contract.

In response to our specific question the Fund Administrator represented in an email on August 31st that that no placement agent has ever directly or indirectly received compensation related to the Fund.

We note however, the following:

1. We were only provided with the most recent contracts to review. Whether older contracts contained such provisions is unknown.

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2. Certain of the Fund's investments, e.g., Eaton Vance Institutional Senior Loan Fund and Silchester International Value Equity Group Trust, were made pursuant to subscription agreements and, as a result, there apparently were no representations regarding placement agents with respect to these investments.

3. Illiquid investments, such as those mentioned in item 2 above, commonly involve the use of placement agents.

4. Since placement agent fees are paid by the investment manager, the Fund Administrator may not be aware of any fee that may have been paid.

5. Whether compliance with the placement agent prohibition has been monitored or enforced is unclear.

XXIV. Conclusion

In our opinion, the Board has failed to provide oversight, consistent with its fiduciary duties, with respect to matters as fundamental as verifying, evaluating and reporting investment performance of the Fund over time; investment manager and other vendor compliance with state and federal heightened ERISA fiduciary standards adopted by the Fund; monitoring conflicts of interest and establishing corresponding safeguards; and reviewing, as well as assessing, the reasonableness of investment management and other fees paid by the Fund.

While the Board, staff and others related to the Fund will, no doubt, dispute some or all of these findings, we believe that providing all the relevant information related to the issues identified in this report to the public, regulators and law enforcement can only benefit all stakeholders in the Fund, as well as the nation.

About Benchmark Financial Services, Inc.

Benchmark Financial Services, Inc. was founded by Edward "Ted" Siedle, a leading expert in forensic investigations of pensions, focusing upon excessive and hidden investment fees and risks, conflicts of interest and wrongdoing. A former SEC lawyer and industry executive with over 30 years experience, he has investigated over $1 trillion in retirement plans. Prior investigations include the state of Rhode Island, state of North Carolina, the Alabama State Employees Pension, Wal-Mart, Cities of Nashville and Chattanooga, Town of Longboat Key, Caterpillar, Boeing, Northrup Grumman, John Deere, Bechtel, ABB, Edison, Shelby County, Tennessee, Fidelity Investments, JP Morgan, Sanford Bernstein, Banco Santander and the US Airways Pilots Pension.

Siedle is a nationally recognized authority on investment management and securities matter and has trained Department of Labor pension investigators around the country. He has testified before the Senate Banking Committee regarding the mutual fund scandals and the Louisiana State Legislature regarding pension consultant conflicts of interest. He was a testifying expert in various Madoff litigations. Articles about him have appeared in publications including Time, BusinessWeek, Wall Street Journal, The New York Times, Barron's, Forbes, USA Today, Boston Globe, and Institutional Investor. He widely lectures and has appeared on CNBC, Wall Street Week, and Bloomberg News.

He writes about his groundbreaking findings as a contributor for Forbes.

Siedle was recently named as one of the 40 most influential people in the U.S. pension debate by Institutional Investor for 2014.