Protecting America's Pensions Plans from Fraud: Will Your Savings Retire Before You do?
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Department of Labor, Washington, D.C.
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Testimony

Good morning, Chairman Enzi and Members of the Committee. Thank you for inviting me here today to share information about the Department's role in enforcing the provisions of the Employee Retirement Income Security Act of 1974 (ERISA). I am Alan D. Lebowitz, the Deputy Assistant Secretary for Program Operations of the Employee Benefits Security Administration. I am here today representing the Employee Benefits Security Administration (EBSA), and its employees, who work diligently to protect the interests of plan participants and support the growth of our private benefits system.

My testimony will discuss EBSA's investigation of Capital Consultants, LLC, its principals, Jeffrey and Barclay Grayson, and numerous related investigations. Additionally, I will describe the structure of EBSA's enforcement program and the process we follow to conduct investigations of potential pension fraud.

Background

EBSA is responsible for administering and enforcing the fiduciary, reporting and disclosure provisions of Title I of ERISA. Under ERISA, the Secretary of Labor is responsible for protecting the rights and financial security of more than 730,000 private pension plans and 6 million private health and welfare plans, which together hold approximately $4.5 trillion in assets and cover more than 150 million Americans.

EBSA headquarters are located in Washington, D.C., and its enforcement activities are conducted in 10 regional offices and 5 district offices throughout the United States. EBSA's staff has the highest average educational attainment of any agency in the Department of Labor. EBSA has a total authorized staff of 887, including the 470 investigative staff members that work out of the field offices. Our investigators have expertise in a wide variety of fields including law, accounting, banking, securities, and business. We recruit entry-level investigators and auditors who have specialized experience in such areas as accounting, finance, economics, business, insurance, securities, and banking, or who have graduated with advanced degrees. For other than entry-level investigative positions, EBSA requires specialized experience relevant to conducting complex financial investigations, such as past work experience in government, a law firm, a pension plan administration firm, or a bank trust department.

Our agency has an active training program for its employees. EBSA provides a basic training course on the fiduciary provisions of ERISA, as well as courses on investigative techniques, and criminal enforcement to all investigative staff. Individuals without an accounting background attend EBSA's Employee Benefit Plan Accounting training. These courses are all residential programs of at least two weeks in length, and offer academic and practical instruction led by EBSA staff and guests from government and the benefits field. In addition, EBSA's Office of Enforcement provides annual field office training on topics determined by enforcement priorities, regulatory and legal developments, and industry trends. Also, some of our investigators attend such courses as Financial Forensic Techniques at the Federal Law Enforcement Training Center when training slots are available. EBSA encourages on-board staff to acquire additional training, and agency funding has enabled individuals to attain the Certified Employee Benefits Specialist designation and other credentials.

DOL shares responsibility and closely coordinates with the Internal Revenue Service and the Pension Benefit Guaranty Corporation in its administration and enforcement of the provisions of ERISA, which are designed to protect participants and beneficiaries in employee benefit plans sponsored by private-sector employers.

Investigative authority is vested in the Secretary of Labor by Section 504 of ERISA, 29 U.S.C. §1134, which states in part:

"The Secretary shall have the power, in order to determine whether any person has violated or is about to violate any provision of this title or any regulation or order thereunder… to make an investigation, and in connection therewith to require the submission of reports, books, and records, and the filing of data in support of any information required to be filed with the Secretary under this title…"

In addition, the Comprehensive Crime Control Act of 1984 amended ERISA Section 506(b) to give the Secretary explicit authority to investigate criminal violations of Title 18 of the United States Code insofar as they relate to employee benefit plans.

The broad provisions in Title I protect not only retirement and health benefits, but other employee benefits as well. The core of Title I of ERISA consists of provisions that address the conduct of persons (fiduciaries) who are responsible for operating pension and welfare benefit plans (including group health plans, life insurance, disability, dental plans, etc.). Fiduciaries are required to discharge their duties solely in the interest of plan participants and beneficiaries for the exclusive purpose of providing benefits and defraying reasonable expenses of plan administration. In discharging their duties, fiduciaries must act prudently and in accordance with the documents governing the plan, to the extent such documents are consistent with ERISA. Certain transactions between an employee benefit plan and "parties in interest," including fiduciaries and others who may be in a position to exercise improper influence over the plan, are prohibited by ERISA. If a fiduciary's conduct fails to meet ERISA's standards, the fiduciary is personally liable for any resulting losses to the plan.

Subpoena Authority

Under section 504 of ERISA, the Secretary of Labor has authority to issue administrative subpoenas for testimony and for the production of documents. The Secretary does not need to show reasonable cause to believe that a violation may exist unless the Secretary is seeking to require a plan to submit books and records more than once in a 12-month period or unless the Secretary is seeking to enter a place and inspect books and records and question persons.

Typically, the subject of an EBSA subpoena complies by submitting the requested documents or testimony. In cases where the subject fails to respond adequately to the subpoena, the Department may enforce the subpoena by bringing an enforcement action in federal district court. The court may compel compliance with the subpoena by imposing appropriate sanctions, including incarceration in cases of civil contempt.

Investigative Process

Under the leadership of its Regional Director, the investigative staff in each of EBSA's field offices conducts investigations to detect and correct violations of Title I of ERISA and related criminal laws. The Regional Directors report to EBSA's Deputy Assistant Secretary for Program Operations through the Office of Enforcement in Washington, which is responsible for coordinating the agency's enforcement activities. The Solicitor's Office, a separate agency within the Department of Labor that provides legal representation for the entire Department, provides litigation and other legal support through their National and Regional offices. The Solicitor's Office has about 75 attorneys devoted to ERISA in the National Office and the Regions at this time.

In carrying out its enforcement responsibilities, EBSA conducts a wide range of activities, including civil and criminal investigations, to determine whether the provisions of ERISA and sections of Title 18 of the United States Code, as they relate to employee benefit plans, have been violated. EBSA regularly works in coordination with other federal and state enforcement agencies, including the Department's Office of Inspector General, the Internal Revenue Service, the Department of Justice, the Federal Bureau of Investigation, the Securities and Exchange Commission, the PBGC, the federal banking agencies, state insurance commissioners, and state attorneys general.

EBSA field offices manage their investigative activity within broad guidelines identified by the agency's long-term Strategic Enforcement Plan (StEP), which was published in the Federal Register on April 6, 2000. The StEP establishes a general framework by which EBSA's enforcement resources are focused to achieve the agency's policy and operational objectives as established by the Secretary and Assistant Secretary. Short-term enforcement priorities are established annually, through the Program Operating Plan (POP) Guidance issued by the national office. Preparation of the POP Guidance begins with the identification of recent enforcement trends, an analysis of particular areas of noncompliance, and a review of current policy considerations. In this manner EBSA shifts its enforcement resources to respond quickly when new and emerging issues are spotted while staying within the long-term framework established by the StEP.

It is through the POP Guidance that EBSA establishes each fiscal year's national enforcement projects, provides guidance for choosing regional enforcement projects, identifies any other specific policy priorities that will require investigative resources, integrates the agency's GPRA goals into the planning process, and provides general guidance with regard to the selection of investigations. EBSA has currently identified five national enforcement projects. Each region is required to make sufficient investigative resources available to perform necessary investigative functions in connection with these designated national projects. The national enforcement initiatives are Health Fraud/Multiple Employer Welfare Arrangements (MEWAs), Employee Contributions Project, Rapid ERISA Action Team (REACT), Orphan Plan Project, and Employee Stock Ownership Plans (ESOPs). In addition, each region is encouraged to develop regional enforcement projects to target issues within its geographic jurisdiction.

EBSA field offices open investigations based on a variety of considerations, including complaints from participants or other people, referrals from the National Office or other government agencies, computer targeting, and Form 5500 reviews (annual reports which contain detailed information on the financial condition of plans). Our goal in each investigation is to restore any money to the plan that was lost as a result of fiduciary breaches, and ensure the safety of the plan in the future.

Generally, a field investigator examines a plan to determine whether it is operated in accordance with its terms and the rules set forth in Title I of ERISA. The ERISA Enforcement Manual guides the conduct of EBSA investigations. Of particular concern in most investigations is whether the fiduciaries are carrying out their fiduciary duties appropriately, especially with regard to monitoring service providers; prudent investment of plan assets; the payment of plan expenses; proper diversification of investments; avoidance of self-dealing and prohibited transactions; the timely collection of contributions; and adherence to required claims procedures.

The type of records examined during the investigation varies depending on the nature of the case and the issues identified. Records are requested at the outset of the investigation and are generally identified in a letter sent to the Plan Administrator. All plan records relating to the maintenance of the plan are reviewed, including the plan document, trust agreement, collective bargaining agreement (if any), summary plan description, summary annual report, Form 5500, fidelity bond, and plan financial records. In addition, depending on the type of plan and the reason for the case opening, written and electronic records specific to a particular issue are requested. EBSA has broad authority to issue administrative subpoenas to compel the production of documents or testimony.

The amount of time it takes to complete an investigation varies from a few weeks to several years depending on the complexity of the issues involved, the cooperation of the parties in complying with document requests and subpoenas, and whether the investigation is resolved through voluntary compliance or through contested litigation. Procedurally, an investigation is closed when no violations are found and the Regional Director issues a no action letter. When violations are detected, the Regional Director will determine whether to pursue corrective action through voluntary compliance (VC). If so, the Regional Director will issue a VC notice letter which advises plan fiduciaries or other responsible parties of the results of the investigation and the sections of ERISA violated and invites the recipients to discuss how the violation(s) will be corrected and losses restored to the plan. In cases where VC efforts failed or that involve issues for which VC is not appropriate, the investigation may be referred to the local Regional Solicitor's Office or the Plan Benefits Security Division of the Solicitor's Office (SOL) in Washington, DC, with a recommendation that litigation be initiated. If criminal violations are found, the case is referred to the U.S. Attorney's Office for consideration of prosecution.

Compliance and Participant Assistance

EBSA conducts numerous educational and outreach activities to ensure fiduciaries understand and comply with their responsibilities under the law. Our newest Campaign, “Getting It Right - Know Your Fiduciary Responsibilities," includes nationwide educational seminars to help plan sponsors understand the law. The program teaches plan sponsors steps for avoiding the most common problems EBSA encounters in its enforcement activities, emphasizing the obligation of fiduciaries to:

- Understand the terms of their plans;
- Select and monitor service providers carefully;
- Make timely contributions to fund benefits;
- Avoid prohibited transactions; and
- Make timely disclosures to workers and reports to the government.

Nine seminars have been held to date and two more have been scheduled.

EBSA has established the Voluntary Fiduciary Correction Program (VFCP). The VFCP is a voluntary enforcement program that encourages plan sponsors and their advisors to self-identify and correct many types of violations of Title I of ERISA. The program allows plan officials to identify and fully correct certain transactions such as prohibited purchases, sales and exchanges, improper loans, delinquent participant contributions, and improper plan expenses. The program includes 18 specific transactions and their acceptable means of correction, eligibility requirements, and application procedures. If an eligible party documents the acceptable correction of a specified transaction, EBSA will issue a no-action letter.

EBSA also provides assistance to plan participants and beneficiaries regarding their plan benefits through Benefits Advisors. The Benefits Advisors provide direct technical assistance to plan participants and beneficiaries by responding to more than 163,000 inquiries and complaints to EBSA's toll free number and website in FY 2004 alone. They recovered over $76.4 million in benefits for participants that were improperly denied through an informal resolution process with the employer. Benefits Advisors explain how the relevant statutes apply to the participant or beneficiary and inform the employer about his or her responsibilities under the law. The Benefit Advisers facilitate resolution of complaints without formal investigation or litigation when possible. If the Benefits Advisors determine that a complaint is valid but are unable to resolve it informally, the complaint is referred for investigation. In 2004, EBSA restored over $307.97 million from 1,236 investigations opened as a result of referrals from Benefits Advisors. EBSA has a total of 111 Benefits Advisors in the national and field offices.

The agency's website hosted 1.73 million unique web visitors in FY 2004, giving them access to numerous FAQs, publications and other useful compliance and consumer information. EBSA now has 63 publications in print; over 800,000 hard copies were distributed last year, and the publications are posted on the agency's website.

EBSA's FY 2004 Enforcement Results

In FY 2004, EBSA opened 4,131 civil cases and closed 4,399 civil cases. Over 60% of the civil cases closed (or 2,642 civil cases) were closed with fiduciary results. This means that violations of ERISA's fiduciary duties and prohibited transaction provisions were found and corrected. During that year, EBSA referred 310 investigations to the SOL for litigation. Often these referrals were resolved through voluntary compliance rather than contested litigation. In FY 2004, SOL filed litigation in 125 cases, an increase of 16 filings over the prior fiscal year.

In FY 2004, EBSA opened 205 criminal cases and closed 152 criminal cases. One hundred twenty-one individuals were indicted in connection with EBSA's criminal investigations during the fiscal year. Sixty-two criminal cases were closed with convictions or guilty pleas during FY 2004.

EBSA's investigations and compliance assistance efforts have a large financial impact on plans and their participants. Total monetary results for FY 2004 were over $3 billion. These recoveries include the value of actions which EBSA obtained to correct prohibited transactions ($2.4 billion), money restored to the plan or plan participants to correct losses resulting from fiduciary breaches ($199.7 million), assets which were protected from significant risk by EBSA intervention that secured appropriate safeguards to protect the plan assets and reduce the risk of future losses ($141.6 million), and benefits recovered on behalf of individual plan participants ($76.4 million). Additionally, $264.6 million in corrections were achieved through the VFCP.

Criminal Enforcement

Under the Comprehensive Crime Control Act of 1984, the Secretary of Labor is given responsibility to investigate violations of the criminal provisions of ERISA and Title 18 of the United States Code that relate to employee benefit plans. To fulfill that responsibility, EBSA conducts criminal investigations as part of its enforcement program. Field managers consult with local U.S. Attorneys as early as possible in a criminal investigation to determine whether there is prosecutorial interest in the case and to receive any necessary direction.

EBSA's investigators evaluate the facts of every case for possible criminal violations. A civil investigation may turn into a criminal investigation when facts indicating possible criminal misconduct are uncovered and the case is referred to the appropriate U.S. Attorney for consideration of criminal prosecution. In some instances, civil and criminal investigations will be conducted at the same time using separate field investigators and supervisory oversight in order to avoid the illegal disclosure of grand jury information as well as to avoid the appearance of using the civil process to conduct a criminal investigation. In other instances, the investigation will be conducted as a criminal investigation only.

EBSA dedicates approximately 15% of its investigative resources to criminal cases. EBSA's criminal investigations are often worked jointly with agents from the Department of Labor's OIG, the Office of Labor Management Standards in the Department's Employment Standards Administration; the FBI; the IRS; and the Postal Inspection Service. Criminal investigations cover a wide variety of pension and welfare plans, including 401(k) plans and Multiple Employer Welfare Arrangements (MEWAs), as well as service providers such as investment managers and third party administrators.

Reporting and Disclosure

ERISA section 103 requires employee benefit plans to file an annual report (Form 5500) with the Secretary of Labor. The Secretary has authority under section 502(c)(2) of ERISA to assess civil penalties of up to $1,100 per day against plan administrators who fail or refuse to file complete and timely annual reports. EBSA identifies deficient, late or non-filers by reviewing and maintaining the ERISA Form 5500 Database. Non-filers are usually identified through referrals from other EBSA offices, the Internal Revenue Service, or computer targeting.

Our primary objective is to obtain compliance with ERISA's reporting and disclosure requirements. As a result, civil monetary penalties are usually significantly abated, once compliance is achieved. In FY 2004, EBSA resolved 3,282 deficient filer cases, assessing $3,058,000 in penalties. In FY 2004, EBSA also pursued 360 non-filer cases, assessing $829,500 in related penalties and the agency closed 276 late filer cases with $172,000 in civil penalties.

EBSA's Delinquent Filer Voluntary Compliance (DFVC) program was established to assist filers in correcting situations involving the late filing or non-filing of Form 5500 annual reports. This program, which began in 1995 and was significantly revised in 2002, encourages delinquent filers to come forward and correct violations by offering significantly reduced civil monetary penalties. Participation in this program also protects plan filers from potential Internal Revenue Service late filing penalties. Since the 2002 revision, the DFVC program has received over 37,000 filings and $25.6 million in reduced civil penalty payments. The DFVC program has been enormously successful in getting these plans on our "radar screen" so they can be effectively monitored.

When Congress enacted ERISA in 1974, it included a requirement that a plan's annual report must include an audit opinion issued by an independent qualified public accountant (IQPA) stating whether the plan's financial statements (and other schedules required to be included in the annual report) are presented fairly in conformity with generally accepted accounting principles (GAAP). The audit requirement is intended to ensure the integrity of financial information that is incorporated in the annual reports. While ERISA's auditing provisions have worked to provide DOL and plan participants and beneficiaries with information about the safety of plan operations, experience has shown that IQPA audits do not consistently meet professional standards. The Department's Office of Inspector General separately identified this as a high-risk area.

In FY 2005, EBSA is placing special emphasis on reviewing the audit practices of the 37 CPA firms that audit plans holding the overwhelming majority of reported assets. This review will include examining policies and procedures that these firms employ to assure the quality and completeness of their audit work. As part of reviewing each CPA firm, a sample of plan audit engagements will be selected for more detailed review and analysis. In addition to reviewing these firms' overall employee benefit plan audit practices, our Office of the Chief Accountant will review audit workpapers of these and other firms to assess the quality of the underlying audit work. As in the past, deficient plan auditors will be referred to the AICPA's Professional Ethics Division or to the appropriate state board of accountancy.

The accounting profession has also taken steps to improve the quality of plan audits. In October 2003, the American Institute of Certified Public Accountants (AICPA) created an Employee Benefit Plan Audit Quality Center (Center) with the goal of improving the quality of employee benefit plan audits. The Center is composed of CPA firms who, through voluntary membership, made a commitment to audit quality by adhering to the Center's membership requirements affecting their management practices, including the designation of a partner-in-charge of the quality of the firm's employee benefit plan audit practice. The Center's membership requirements also include obtaining employee benefit plan specific training; establishing and maintaining quality control practices and procedures specific to the firm's employee benefit plan audit practice; self monitoring of adherence to policies and procedures; and making the results of their external peer review of their audit practice publicly available. Over 900 firms joined the Center in its first year of operation.

EBSA's First Investigation of Capital Consultants

Capital Consultants, Inc. (CCI) was an investment management firm located in Portland, Oregon, that managed more than $900 million for approximately 340 clients, many of which were employee benefit plans. More than 60 of these employee benefit plans were jointly administered union pension and welfare benefits plans located primarily in the Pacific Northwest. In addition, CCI provided investment services to numerous private trusts and individual clients.

The firm was owned and controlled by Jeffrey Grayson, who was its chief executive officer, and his son, Barclay Grayson, who was its president. Effective June 30, 1999, Capital Consultants underwent a corporate restructuring and was renamed Capital Consultants, LLC. Therefore, the company is sometimes referred to as CCI and sometimes CCL, depending on the time frame, but its ownership, officers, and line of business remained the same.

EBSA opened its first investigation of CCI in March 1992, based on information indicating that CCI engaged in prohibited transactions and self-dealing. In addition to the investigation of CCI, EBSA opened three other investigations of plans that entered into investments through CCI. They were the Oregon Laborers-Employers Pension Trust, Northern Alaska Carpenters Retirement Fund, and the Morse Brothers, Inc. Profit Sharing Plan.

The investigations were completed in March 1993 and referred to SOL. The investigations revealed that CCI and Jeffrey Grayson violated ERISA by entering into a fee arrangement with the Oregon Laborers-Employers Pension Trust (Oregon Laborers Trust) that enabled them to increase their own compensation. Investment managers usually charge their clients a fee based on a percentage of assets under management. Under CCI's fee arrangement with the Oregon Laborers Trust, CCI and Grayson charged the usual fee based on assets under management and charged an extra fee for real estate related investments. This extra fee, which they called an "acquisition fee," was charged each time CCI made a real estate related investment for a plan. This was a one-time fee based on a percentage of the gross asset value of the transaction.

As investment manager, CCI and Jeffrey Grayson had the discretion to determine the amount and frequency of the Oregon Laborers Trust's real estate-related investments. Therefore, this fee arrangement placed them in the position of being able to affect their own compensation. Each time CCI and Jeffrey Grayson invested the Oregon Laborers Trust's assets in another real estate-related investment; CCI and Jeffrey Grayson would receive an additional fee.

The investigation did not, however, establish any evidence that CCI and Jeffrey Grayson increased the Trust's real estate investments with the motive of increasing their fees, and a number of trustees stated that they specifically authorized the real estate related investments. Nevertheless, under ERISA, a fiduciary cannot set its own compensation, regardless of whether that fee is reasonable. To the extent CCI set its fees, rather than a fiduciary independent of CCI, it violated ERISA.

The investigations also revealed that CCI invested more than $100 million of its clients' assets, including almost $90 million in loans and $13 million in stock purchases, in Crown Pacific, Ltd. (Crown), from which CCI received $5.2 million in fees as its consultant. This allegation related not only to the Oregon Laborers Trust but also to the other two plans under investigation, the Northern Alaska Carpenters Retirement Fund and the Morse Brothers Profit Sharing Plan. The timing of the transactions suggested that CCI and Jeffrey Grayson might have invested their client plans' assets in Crown in return for consulting fees from Crown. If true, this too would violate the self-dealing provisions of ERISA. However, there was no direct evidence of a relationship between CCI's consulting agreements with Crown and the investments that CCI caused the Plans to make in Crown. Neither was there direct evidence that CCI had invested plan assets in Crown specifically because CCI was being paid the consulting fees. Jeffrey Grayson actually performed consulting services for Crown, and there was only one instance of a simultaneous correlation between CCI's loans to Crown and Crown's payment of consulting fees to Jeffrey Grayson. Moreover, the loans, which were secured by land, personal guaranties, and stock did not appear to cause any losses to the plans. Therefore, the decision was made to proceed solely on the fee arrangement issue.

As is its usual practice, pursuant to Executive Order 12778, SOL engaged in settlement negotiations before filing the complaint and reached agreement on a consent order, which was filed simultaneously with the complaint in December 1995 in the U. S. District Court for the District of Oregon. The consent order provided that CCI would pay the Oregon Laborers Trust $2 million, and permanently enjoined CCI and Jeffrey Grayson from operating and collecting fees under any fee arrangement which would permit them to use their discretion over the assets of ERISA-covered plans to affect the amount of their fees from such plans. In February 1996, the Secretary of Labor assessed a 502(l) civil penalty of $182,000 against Jeffrey Grayson and CCI. All of the payments required by the consent order and civil penalty assessment were made.

EBSA's Second Investigation of Capital Consultants

EBSA's Seattle District Office opened its second investigation of CCL in October 1997, based upon the receipt of a complaint filed against Jeffrey Grayson and CCL by one of its plan clients, the A.G.C. International Union of Operating Engineers Local 701 Pension Trust Fund. The complaint's principal allegation was that CCL made imprudent real estate investments for the plan, contrary to the Plan's investment guidelines and without the approval of the trustees. Although the Operating Engineers Fund settled its lawsuit in March 1998, EBSA's investigations continued. The breadth of the fiduciary misconduct which was uncovered in EBSA's second investigation was astonishing, ultimately causing EBSA to open 58 investigations, devote over 13 civil and criminal investigative staff years to date, collect and review hundreds of thousands of pages of documents covering dozens of private loans and equity investments, and institute 19 separate lawsuits against plan trustees.

This second investigation of CCL involved CCL's investment of plan assets in loans called "collateralized notes," which were loans for which the collateral consisted largely of the borrower's potential revenues. These loans were unlike the loans to Crown, which were secured by land, personal guaranties and stock. The bulk of the loans were first made to Wilshire Credit Corporation (WCC) beginning in July 1995, more than two years after EBSA's first investigation had ended. Subsequent loans were made largely to shell corporations and entities that did not exist at the time of the first investigation. Thus, EBSA's second CCL investigation did not involve the same loans, the same borrowers, or the same type of collateral as the first case.

WCC was an Oregon S-Corporation, which acquired and serviced performing and non-performing consumer loans. CCL and Jeffrey and Barclay Grayson invested $160 million of their clients' assets in a series of loans to WCC from July 1995 through October 1998. The loans were "interest only" with a stipulated maturity date but no periodic payments of principal. The collateral for the loans was cash amounting to only 15% of the loan amount and WCC's expected revenues from loan servicing contracts with third parties, primarily Wilshire Financial Services Group ("WFSG"), a publicly traded corporation managed by the principals of WCC. WCC's expected revenues were not guaranteed, and if WCC's business volume declined, the fees from third parties would not sufficiently collateralize the loan. The WCC loan agreements were amended several times to allow for increased principal, reduced collateral, extended maturity dates and lower interest rates. This made the terms of the loans even less favorable to the investors and increased the risk of nonperformance.

Shortly after the final loan was made to WCC, WFSG experienced severe financial problems. As a result, WFSG was no longer an income source for WCC, and WCC defaulted on the loans. In fact, WFSG filed for Chapter 11 bankruptcy in March 1999, and its Reorganization Plan indicated that the $160 million in loans from CCL clients to WCC, consolidated into “the Wilshire Loan,” was valued at only $6.45 million on a liquidation basis.

Rather than report or acknowledge investors’ losses on the WCC investment, CCL and Jeffrey and Barclay Grayson engaged in a series of transactions with other companies (Sterling Capital, LLC; Oxbow Capital Partners, LLC; Brooks Financial, LLC and Beacon Financial Group, LLC) to facilitate “paper sales” of all or a portion of the Wilshire Loan at an inflated price. This concealment is what some have referred to as the “ponzi scheme.” Essentially, CCL was able to continue to make interest payments on the loans.

First, in November 1998, Daniel Dyer, a prior recipient of CCL loans, created Sterling Capital LLC (Sterling). Sterling was a shell company with no assets or revenues, yet it entered into an agreement with CCL to purchase the Wilshire Loan for $160 million plus interest. Sterling retained the right to terminate payments under the agreement at any time and without further liability.

Subsequently, in January 1999, Dyer created Oxbow Fund I, a venture capital fund which was to raise funds from investors through a private offering and use the funds to pay for Sterling’s purchase of the Wilshire Loan. Oxbow Fund I was to be marketed by Dyer through his ownership of a broker/dealer firm, CJM Planning Corporation. Dyer’s purchase of CJM Planning had been funded in 1998 through loans from CCL’s clients. Also, CCL assured its clients by letter that the Wilshire Loan was being sold to Sterling for $160 million plus interest at prime + 3.75%. CCL continued to value the Wilshire Loan at $160 million and charged its clients a fee of 3% per annum on the face value.

The Oxbow Fund I offering failed to attract any significant investors. As a consequence, Dyer told CCL that Sterling could not make the Wilshire Loan payments and he wanted to terminate the agreement. Instead, Sterling entered into an agreement with CCL and another company, Brooks Financial LLC (Brooks), whereby Brooks agreed to take over two thirds of Sterling’s loan obligation.

Brooks was a shell company formed by the owner of Florida Automobile Finance Corporation, a sub-prime automobile finance company. Brooks’ agreement to purchase two-thirds of the Wilshire Loan was specifically conditioned on receiving a $50 million loan from CCL. On that same day, CCL entered into a loan agreement with Brooks, committing CCL’s clients to loan Brooks up to $50 million. Pursuant to the agreement, CCL loaned $38.1 million to Brooks. CCL used $7.843 million from its clients’ escrow account to make “interest payments” on the Wilshire Loan. CCL reported to its clients throughout this period that Brooks was making timely interest payments and the clients’ investment in the Wilshire Loan was still worth a total of $160 million.

Then, in January 2000, CCL entered into a second loan agreement committing its clients’ funds to loaning up to another $50 million to Beacon Financial LLC (Beacon), a newly created shell company under common ownership with Brooks. CCL loaned approximately $33.88 million to Beacon. Again, CCL retained another $7.37 million in escrow and used this money to make monthly interest payments on the Wilshire Loan. CCL repeatedly assured its clients that both Brooks and Beacon were performing on their respective loans and were making the interest payments on the Wilshire Loan. As a consequence, CCL continued to report the Wilshire Loan at its original value of $160 million.

Throughout this period, CCL billed its clients 3% per annum for investment management fees on the Wilshire Loan and the Brooks and Beacon loans.
This not only caused their clients to pay fees in excess of those amounts to which CCL and Jeffrey and Barclay Grayson were entitled, but also concealed from their clients the declining value of their investments. A diagram of the scheme is attached as Appendix A to the written statement.

In February 2000, after completing its investigation of CCL and its principals, EBSA referred the case to SOL for litigation. In July 2000, per the SEC’s request, a copy of the EBSA Report of Investigation, along with voluminous exhibits, was provided to the SEC in Los Angeles. The SEC and the Department decided to proceed against CCL jointly. This litigation strategy was advantageous because the Department had an in-depth knowledge of the underlying facts and the SEC could more readily have a receiver appointed over the entire business of CCL, which included non-ERISA clients as well as the ERISA plans.

On September 20, 2000, SOL and SEC attorneys jointly met with counsel for CCL and its principals in Oregon. Counsel for CCL and its principals represented that their clients agreed to the receivership. SOL and SEC attorneys negotiated the language of their respective consent orders. The consent orders were presented to the United States District Court and were entered by the Court on September 21, 2000. The court orders appointed a receiver to make an accounting and to protect the interests of CCL's ERISA plan clients and other investors. Through the consent orders, the SEC was able to freeze the defendants’ personal assets and EBSA was able to enjoin them from doing business with ERISA plans.

CCL has been in receivership since the suit was filed in September 2000. Settlements totaling more than $101 million have been reached in private litigation, resolving claims brought by the court-appointed receiver, trustees of ERISA plans and other investors against plan fiduciaries and other parties who provided services to or had business relationships with CCL. These settlement amounts were made a part of the receivership estate. To date, the receiver has marshaled estate assets of more than $189 million in part by collecting on outstanding loans and selling CCL's assets. The receiver estimates that the total amount of settlements and marshaled assets accumulated in the receivership to date is $291 million of which about $193 million was already distributed to CCL's private placement clients, including the ERISA plans.

Barclay Grayson settled with the receiver and private plaintiffs for $500,000, but the Department did not agree to the settlement. The Department is currently in settlement negotiations with him to obtain injunctive relief. Barclay Grayson is bankrupt and the Bankruptcy Court has discharged all of his debts. Jeffrey Grayson suffered a stroke and is currently in a nursing home. The receiver has sold Jeffrey Grayson's property. His remaining assets have been frozen and he is currently drawing a monthly stipend to cover his living and medical expenses.

The receiver has approximately $76.36 million remaining for distribution. It will be distributed in accordance with the court-approved distribution plan, minus the remaining receivership fees and expenses, which are approximately $1 million. The total cost of the receivership is $8.5 million. Overall, the employee benefit plans recovered well over 70% of their losses through the receivership, and many plans have recovered additional losses through settlements of litigation resulting in at least $42 million.

Related Litigation Against Trustees

In addition to the investigation of CCL, EBSA’s Seattle, San Francisco, Cincinnati, Detroit, Kansas City, and Los Angeles offices opened investigations of plans that invested in private placements through CCL. In total, EBSA opened 58 related investigations and filed 19 lawsuits against trustees of 34 plans in Oregon, Idaho, California, Nevada, Utah, Arizona, Colorado, Minnesota and Ohio. In these lawsuits, the Department alleged that the trustees imprudently authorized CCL to invest in high-risk investments (the collateralized notes), failed adequately to investigate the merits of the investments, and failed adequately to monitor the investments. In some cases, the complaints also alleged that the investments violated the plans' own investment guidelines, and that a number of trustees violated ERISA's self-dealing provisions by accepting gratuities from CCL, including free hunting trips, rifles, and tickets to football games.

In April 2002, the Department entered into consent orders with 10 plans and their trustees in the District of Oregon. The consent orders provided for the resignation of a number of trustees and permanently enjoined others from serving as ERISA fiduciaries or service providers. The consent orders also provided for significant plan reforms, including internal controls and procedures relating to plan investments, contracts with service providers, written investment guidelines, communication procedures, quarterly meetings, reviewing and monitoring plan fiduciaries, the pursuit of litigation, and the retention of experts to serve as investment monitors, managers, auditors, and attorneys. The plan reforms are binding on the plans’ current trustees as well as successor trustees.

Contemporaneously with the filing of the consent orders, private plaintiffs settled their class action lawsuits against the same plan fiduciaries as a result of court-ordered mediation in which the Department participated. In the mediation, the private litigants obtained settlements totaling $15.8 million. Of that amount, $9.5 million was to be paid by Legion Insurance Company, which is currently in liquidation in Pennsylvania. It is expected, however, that much or all of that money eventually will be recovered as a result of private negotiated settlements with the state insurance guaranty funds and through the liquidation of Legion by the Pennsylvania State Insurance Commission.

After the April 2002 settlements, the Department continued to monitor the receivership and to pursue cases against other trustees. In March 2004, the Department obtained consent orders providing for restitution of $4.875 million to 12 employee benefit plans in California, Nevada and Utah. The consent orders also required payment of $975,000 in civil penalties to the government. In addition, the consent orders provided for plan reforms, including internal controls and procedures relating to plan investments similar to those contained in the earlier settlements. The consent orders resolved five lawsuits and covered more than 17,000 participants and beneficiaries.

In January 2005, the Department obtained additional consent orders providing for restitution of $4.31 million to 10 employee benefit plans in Arizona, Colorado, Minnesota and Ohio that invested plan assets through CCL. The consent orders also required payment of $862, 413 in civil penalties to the government. In addition, the consent orders provided for plan reforms similar to those in the other cases. The consent orders resolved eight lawsuits and covered more than 25,000 participants and beneficiaries.

In total, the Department filed 19 lawsuits against plan trustees, covering 34 employee benefit plans. The consent orders issued in these cases called for the retirement or resignation of 51 plan trustees, and permanent injunctions barring 31 plan trustees and one investment advisor and his firm from serving as ERISA fiduciaries or service providers. The orders also imposed significant internal reforms on the 34 affected plans to help prevent future fiduciary breaches. In addition to the money collected by the Receiver, and the $15.8 million recovery from the Oregon mediation (subject to Legion's insolvency proceedings), the Department obtained $9.2 million to date in these cases against trustees, and assessed and received a total of $1,837,427.86 in civil penalties

Criminal Investigations of CCL and Related Entities

In December 1999, in coordination with the United States Attorney's Office for the District of Oregon in Portland, Oregon, EBSA and other law enforcement agencies began the criminal investigation of the CCL matter. By the summer of 2000, under the direction of the United States Attorney's Office, the investigation had developed into a task force which included EBSA, the Internal Revenue Service, the Department of Labor's Office of Inspector General and the Office of Labor Management Standards, as well as the Federal Bureau of Investigation.

The criminal investigations of Jeffrey and Barclay Grayson led to other investigations surrounding the CCL debacle. By December 2000, under the direction of the United States Attorney's Office, the task force opened an investigation of Lawrence Mendelsohn and Andrew Wiederhorn, owners of Wilshire Credit Corporation. In June 2001, the investigations into CCL and its officers and employees expanded to Dean Kirkland, the principal salesperson for CCL. These investigations revealed that CCL had engaged in a practice of paying gratuities to trustees of union sponsored employee benefit plans which invested funds through CCL.

From May 2002 to July 2002, the task force conducted a number of criminal cases on various trustees of union sponsored benefit plans. As a result of a task force investigation guilty verdicts and pleas were obtained from Barclay Grayson and Dean Kirkland of CCL; plan trustees John Abbott, Robert Mayhew, John Lontine, and Dennis Talbot; and Andrew Wiederhorn and Larry Mendelsohn of Wilshire. Two other trustees Gary Kirkland and Robert Legino were acquitted of gratuities charges after a lengthy trial. The charges against Jeffrey Grayson were dismissed due to Grayson's mental and physical impairment. An attorney from the Department of Justice's Criminal Division participated in the prosecution of the plan trustees and Dean Kirkland.

Conclusion

CCL owed a duty of undivided loyalty to its benefit plan investors under ERISA. It breached that duty on an almost unprecedented scale causing hundreds of millions of dollars in losses to both ERISA plans and non-ERISA investors. It took an extraordinary effort to uncover CCL's misconduct and to remedy the violation because the transactions were extraordinarily complex and CCL consistently misled its investors about the nature of the transactions and the existence and magnitude of the resulting losses. There simply were no easy shortcuts available to the agency to uncover and remedy CCL's violations.

As a result of EBSA's efforts, in tandem with the work of the SEC and private litigants, the participants of the ERISA-covered plans will recover well over 70% of their losses. The Department and the SEC had a receiver appointed to marshal CCL's assets and protect the interest of CCL's investors. The Department also enjoined Jeffrey and Barclay Grayson from doing business with ERISA plans. In total, the Department filed 19 lawsuits against the plan trustees of 34 employee benefit plans and obtained consent orders calling for the resignation and retirement of 51 trustees and permanent injunctions barring 31 additional trustees (as well as one investment manager) from ever serving as ERISA fiduciaries or service providers. The additional injunctive relief obtained by the Department included significant plan reforms, including internal controls and procedures relating to plan investments that will provide long-term protections for plan participants and beneficiaries. In addition to the money collected by the receiver and through the mediation in the third party litigation, the Department obtained restitution of $9.2 million to date in cases against plan trustees. A total of $1,837,427.86 in civil penalties were assessed and paid. A chart that describes the results of the civil investigations is attached as Appendix B to the written statement.

EBSA's work also resulted in the Justice Department indicting 11 individuals for various crimes resulting from their participation in the CCL debacle. Seven of these individuals pleaded guilty. One case was dismissed, while two individuals were acquitted in a bench trial and one was convicted. Four defendants served prison time ranging from 15 to 24 months, for a total of 81 months served, while others served probation. A chart that describes the results of the criminal investigations is attached as Appendix C to the written statement.

The scheme was of great sophistication and had a veneer of respectability provided by the cooperation of so many professionals including attorneys, accountants, and investment advisors. EBSA’s investigation uncovered a complex scheme to defraud investors through the unprecedented use of newly created shell companies, paper transactions, and false reports.

Finally, ERISA places the ultimate responsibility for the governance of plans on individual plan fiduciaries. CCL was able to find fiduciaries that failed to responsibly oversee the retirement assets of the plans' participants and beneficiaries. These fiduciaries, as well as CCL, failed to prudently discharge their obligations to the plans' participants. All too often, the trustees (and their advisors) failed to understand the nature of CCL’s investments, to review the investments, or even adhere to the plans’ own investment guidelines.

Mr. Chairman and Members of the Committee, thank you again for the opportunity to appear before you to discuss EBSA’s enforcement program and this very important case. This concludes my testimony. I would be pleased to answer any questions you may have.