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Highlights

Highlights of GAO-09-503T, a testimony before the Subcommittee on Health, Employment, Labor and Pensions, Education and Labor Committee, House of Representatives

PRIVATE PENSIONS

Conflicts of Interest Can Affect Defined Benefit and Defined Contribution Plans

Why GAO Did This Study

Conflicts of interest typically exist when someone in a position of trust, such as a pension consultant, has competing professional or personal issues. Such competing interests can make it difficult for pension plan fiduciaries and others, in general, to fulfill their duties impartially and could cause them to breach their duty to act solely in the interest of plan participants and beneficiaries. The proliferation of consulting work and the complexity of business arrangements among investment advisors, plan consultants, and others have increased the likelihood of conflicts of interests for both defined benefit (DB) plans, where investment risk is largely borne by the plan sponsor and defined contribution (DC) plans, where such risk is largely borne by the participant. Given the potential financial harm conflicts of interest may pose to DB and DC plans, GAO was asked to report on (1) the effects undisclosed conflicts of interest may have on the financial performance of DB plans, and (2) the vulnerabilities that conflicts of interest may pose for DC plan participants. GAO interviewed a variety of experts, reviewed the Department of Labor's (Labor) legal and regulatory authority and analyzed government and industry data associated with terminated plans.

What GAO Recommends

GAO is not making recommendations at this time but has ongoing work.

View GAO-09-503T or key components.
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What GAO Found

GAO's analysis of available data on pension consultants and plans revealed a statistical association between inadequate disclosure and lower investment returns for ongoing plans, suggesting the possible adverse financial effect of such nondisclosure. Specifically, our econometric analysis using ongoing defined benefit (DB) plans and Securities and Exchange Commission (SEC) study data on pension consultants registered as investment advisers, who adequately disclosed their conflicts of interest and those who did not, detected lower annual rates of return for those ongoing plans associated with consultants that had failed to disclose significant conflicts of interest. These lower rates generally ranged from a statistically significant 1.2 to 1.3 percentage points over the 2000 to 2004 period. Since the average return for the ongoing plans that used consultants who did not have significant disclosure violations was about 4.5 percent, the model implies that the average returns for ongoing plans that used consultants who failed to disclose significant conflicts was 3.2 to 3.3 percent for the period. Because many factors can affect returns, and data as well as modeling limitations limit the ability to generalize and interpret the results, this finding should not be considered as proof of causality between conflicts and lower rates of return, although it suggests the importance of detecting the presence of conflicts among pension plan consultants. GAO's analysis of data from a 2005 SEC staff report examining 24 registered pension consultants, including 13 that failed to disclose significant conflicts in conjunction with other sources of data also showed that, in 2006, these 13 consultants had over $4.5 trillion in U.S. assets under advisement, which included private DB and DC plan assets.

Conflicts of interest can have adverse effects on both DB and DC plans. Our study focused exclusively on DB plans and less information exists on the extent or nature of conflicts of interest in the DC plan environment. However, because the risk of investment is largely borne by the individual participant in DC plans, participants are vulnerable to any decision, including those involving conflicts of interest, that could result in higher fees or other outcomes that can lower investment returns for participants. Given the multiplicity of parties involved in today's 401(k) plan arena, many opportunities exist for business arrangements to go undisclosed. Problems may occur when pension consultants or other companies providing services to a plan also receive compensation from other service providers. Without disclosing these arrangements, service providers may be steering plan sponsors toward investment products or services that may not be in the best interest of participants. Labor has published proposed regulations to improve the information disclosed about the various business arrangements among service providers. However, those proposed regulations are currently awaiting review and approval by the new Secretary of Labor. We are currently conducting a review of Labor's revisions to the Form 5500 Schedule C, which could provide some information to Labor about previously undisclosed business arrangements.