

## New Disclosure Requirements for Massachusetts Pension Investments

The Commonwealth of Massachusetts has started implementing pension reform legislation enacted in 2011 that imposes demanding contracting and disclosure requirements on state and local pension fund boards. The new pension fund rules – particularly those requiring disclosure of service provider compensation – are sweeping in their scope and may present compliance challenges to investment managers and other investment service providers that accept mandates to provide services to any of the more than 100 public pension plans in the Commonwealth, the assets of which total more than \$50 billion.

The 2011 legislation added Section 23B to Massachusetts General Law Chapter 32, which describes the processes which Massachusetts public pension plans must use in procuring services from third-party vendors and governs the terms of the relationship between such pension plans and their investment service providers, including investment managers. Over the past year, the Massachusetts Public Employee Retirement Administration Commission (“PERAC”) has released a number of explanatory memoranda describing and interpreting the statutory changes. While the new requirements have some similarities to service provider fee disclosure requirements for nongovernmental retirement plans imposed recently under the federal law known as ERISA, the PERAC rules in some respects reach well beyond the ERISA requirements.

The Massachusetts legislation imposes compensation and conflict-of-interest disclosure requirements not only on public pension plans but also on investment vehicles in which such plans invest and on other investment service providers, such as investment managers and third-party placement agents whom such managers may retain. The reason investment vehicles are pulled into the disclosure regime is that where a plan invests in an investment partnership or similar entity, including single-investor funds and separate accounts, PERAC treats the general partner or investment manager as a contractor engaged by the plan. For example, if an investment partnership accepts an investment from a Massachusetts public pension plan, the general partner is required to complete disclosure forms identifying, on an annual basis, any compensation paid or received by the general partner and its affiliates in connection with the investment, and must also complete a conflict of interest disclosure form. Certain service providers, including investment managers, must also complete a placement agent disclosure form. The legislation also requires investment service providers to acknowledge their status as fiduciaries under Massachusetts law with respect to a Massachusetts plan’s investment in the fund. (Massachusetts law defines a fiduciary, for this purpose, as one who exercises discretionary authority or control respecting management of a plan or exercises authority or control respecting management or disposition of plan assets, and imposes on fiduciaries a standard of care similar to that which is imposed under ERISA.) In addition to this fiduciary status acknowledgement, investment service providers must also agree that they will not be entitled to indemnification.

### Required Contractual Terms

Effective February 16, 2012, the legislation makes certain contractual terms mandatory for any contract or amendment to an existing contract entered into by a Massachusetts public retirement board that invests pension plan assets in an investment partnership or similar vehicle for the procurement of services from an investment service provider. The investment service provider, or “contractor,” is not the investment partnership or similar entity, but rather, the entity’s general partner or investment manager.

The mandatory contractual terms include:

1. An agreement that the retirement board will not indemnify the contractor (although the fund can be indemnified where the retirement board makes inaccurate representations or fails to meet its contractual obligations);
2. An acknowledgment of the contractor's fiduciary status with respect to funds which the manager invests on behalf of the retirement board; and
3. Contractual language requiring the contractor to make annual disclosures to the retirement board regarding (a) indirect compensation the contractor or any related party may receive in connection with services provided to the fund, (b) any compensation the contractor or a related party pays in connection with services provided to the investment vehicle, and (c) any potential conflict of interest which the contractor may have.

## Compensation Disclosures

An investment service provider to a Massachusetts public pension plan, including a fund manager, is required to complete two compensation-related disclosure forms on an annual basis, on or before January 1 of each year.

- The first form requires the service provider to inform the commission and the retirement board of any arrangements for compensation or any other benefit received by the service provider or a related person in connection with the provider's services *to the retirement board or any other client* investing in the same product or receiving the same services. Disclosure must be made with respect to both oral and written arrangements, and must disclose not only benefits actually received but also benefits expected to be received.
- The second form requires the service provider to disclose to the commission and the retirement board all compensation, in whatever form, paid by the contractor or a related person to others, whether directly or indirectly, in relation to such provider's services *to the retirement board or any other client* investing in the same product or receiving the same services. This form likewise requires disclosure not only of compensation paid, but also of compensation expected to be paid.

The scope of these required disclosures, while not entirely clear, appears to be very expansive. Notably, each form appears to extend the disclosure requirement beyond amounts paid or received in connection with investment services provided to the particular Massachusetts pension plan, to mandate similar disclosures with respect to investments made *by other clients* in the same product in which that pension plan is investing or for the same service. The forms also appear to require disclosure beyond compensation paid or received by the investment service providers and to require similar disclosures for persons related to the service providers. PERAC has interpreted the related-persons requirement in a manner generally consistent with the definitions included in the SEC ADV Glossary of Terms, which, in conjunction with the application of Section 23B, results in a "related person" being any affiliate or any person that is under common control with the investment service provider.

## Conflict of Interest Disclosures

In addition, an investment service provider must disclose to PERAC and the applicable retirement board on an annual basis any conflict of interest the contractor may have that could reasonably be expected to impair the contractor's ability to render unbiased and objective services to the retirement board. In particular, the investment service provider must disclose any beneficial ownership of securities involved with respect to the relationship.

## Placement Agent Disclosures

Effective January 1, 2012, additional disclosure requirements may apply to a manager, such as a general partner, investment manager, or fund sponsor, as the case may be, who uses a placement agent in connection with responding to an RFP or solicitation or when entering into discussions related to a proposal to amend an agreement.

## Consequences of Noncompliance

The consequences of noncompliance vary depending upon the type of failure, whether it is the provision of inaccurate information, a failure to provide timely information or a failure to provide any information at all. PERAC guidance indicates that immediate termination of the investment management contract, or penalty-free withdrawal from the investment fund, may be required. PERAC has also suggested that a material violation of the disclosure requirements may result in an investment service provider being prohibited from soliciting new investments from any Massachusetts public pension plan for a period of time, or even being barred from doing business with Massachusetts public pension funds altogether.

For more information about the PERAC disclosure rules or other requirements under the Massachusetts pension laws, please contact a member of Ropes & Gray's [employee benefits](#) practice group.