

Klausner Subpoena Questions
January 26, 2016

The Finance Subcommittee on PFPF Subpoenas has the following questions related to the subpoena issued to Robert D. Klausner, Esq. for the Police and Fire Pension Fund ("PFPF") Board of Trustees.

1. In connection with securities litigation cases in which the PFPF is a party, please provide:
 - a. The name of each case that has been settled or is in active litigation
 - b. The settlement amounts received by the PFPF, as applicable
 - c. The date(s) such settlements were received, as applicable
 - d. The bank account(s) in which such settlements were deposited, as applicable
 - e. The general ledger account to which such settlements were recorded, as applicable
 - f. Evidence of PFPF Board of Trustees approval for all settlement decisions, including an indication of the PFPF Board of Trustees' advance approval of the fees received by Mr. Klausner, as applicable

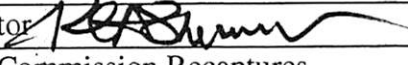
2. With regard to the PFPF Securities Litigation Policy and in reference to the securities litigation cases noted in item #1 above, please provide:
 - a. Evidence of the PFPF Board of Trustees' approval of securities litigation counsel
 - b. Evidence of the PFPF Board of Trustees' regular monitoring of the status of the securities litigation during the course of the cases, i.e. reports from the "Monitoring Legal Firm(s)"

3. With regard to the PFPF Securities Litigation Policy, please provide:
 - a. An explanation of the PFPF Board of Trustees' consideration of the ERISA provisions regarding parties-in-interest and prohibited transactions, i.e. the evaluation of the role of the "General Counsel" in the Securities Litigation Policy and how such roles and responsibilities comply with and/or consider parties-in-interest and prohibited transaction laws [NOTE: While the PFPF is a public pension plan not legally subject to the provisions of ERISA, the PFPF Statement of Investment Policy adopted by the PFPF Board of Trustees and dated December 20, 2012 adopts the fiduciary provisions of ERISA]

OFFICE OF THE COUNCIL AUDITOR
Suite 200, St. James Building



MEMORANDUM

Date:	February 26, 2016
To:	Finance Subcommittee on the PFPF Subpoenas Anna Lopez Brosche, Chair Danny Becton John R. Crescimbeni
From:	Kirk A. Sherman, Council Auditor 
Subject:	Police and Fire Pension Fund – Commission Recaptures

Subcommittee Request

The subcommittee directed the Council Auditor's Office to gain an understanding of the commission recapture arrangements of the Police and Fire Pension Fund (Fund). Specifically, we were requested to perform a detailed review of the transactions with one of the Brokers in which the Fund has a recapture agreement. This includes checks written directly to the Fund and other transactions that may be payments on behalf of the Fund. Please note that this is not an audit. Thus it is not an audit or attestation conducted in accordance with Government Auditing Standards.

Separately the subcommittee requested the Fund to provide contracts for all Brokers that the Fund has entered into recapture agreements with since 1997. We have a listing of these firms at the end of this memorandum.

Background on the Commission Recaptures Program

The Police and Fire Pension Fund's (Fund) Financial Custodian is Northern Trust. This is the party responsible for maintaining security over the Fund's stocks and other financial assets.

The Fund engages with several Money Managers who are tasked with investing assets of the Fund. The Money Managers are selected and directly contracted by/with the Fund. These Money Managers utilize Brokers who actually execute the trades. These Brokers charge a commission/fee to the Money Managers to process the trades. In general the Money Managers are to select Brokers based on best price/execution. Included in the commission (in addition to the actual cost of processing the trade) can be research and other similar costs.

The commission recaptures that are being discussed by the subcommittee stem from the fact that the Fund can enter into contracts directly with Brokers whereby the Broker will rebate part of the commission back to the Fund directly in exchange for the Fund requesting the Money Managers to execute trades through the Broker.

What the Council Auditor's Office Did

Due to previous requests of the Fund, the Fund had already contacted the current recapture Brokers for a detailed listing of all commission recaptures. The Fund provided us with this detail listing of the commission recapture remittances for three applicable Brokers. To verify that one of these three firms was the appropriate Broker to review, we tied the remittance detail provided by the Fund to the City's general ledger for the period 10/1/12 to 9/30/15. (Please note that the information in the City's general ledger is input by the Police and Fire Pension Fund.) During this process we noted a few issues:

- 1) There were adjustments that appear to have overstated recapture revenue by a net amount of \$2,394.45 over two fiscal years. This appears to have resulted in a net understatement to another revenue subobject.
- 2) We do not always agree with the fiscal year the funds were credited, but in total we tied the individual remittances.
- 3) We found a \$10,582.87 deposit that was recorded in the recapture revenue line. After going through the bank statement detail as explained below, we were able to determine the check was from National Financial Services LLC. The Fund states that this is associated with a recapture account with Reynders, Gray & Co. and based on the account number listed on the check and other detail provided by the Fund we agree with the assertion. We do still have questions surrounding why the funds had been sitting in this account since at least December 2010 until October 2013 when the funds were remitted to the Fund.

We then determined what percentage of the revenue was from each firm to assist in determining which Broker to select for further research as requested by the subcommittee. Based on this we were able to determine that Convergenx accounted for 89% of the dollar value of the deposits and that no other firm had revenue deposited with the Fund since August 2014. Below is the activity for period of 10/1/12 through 9/30/15 with a brief explanation of the activity:

- Convergenx (\$268,285.58) – Activity almost every month during selected period.
- CAPIS (\$21,277.07) – Last activity in August 2014.
- KCG (\$0) – No activity since May 2012.
- Reynders, Gray, & Co (\$10,582.87) – This was the firm not included in the data originally provided. As stated above, the revenue appears to be associated with periods prior to our review period.

Based on the facts identified above, we selected Convergenx as the recapture Broker to contact to verify the amounts credited/paid related to the Police and Fire Pension Fund account. We were able to tie the amounts provided directly to us from Convergenx to the amounts previously provided by the Fund without exception.

Next, we tied the support provided by Fund for the three recapture firms to the Police and Fire Pension Fund bank statements. During this review we also identified the \$10,582.87 deposit identified above, but did not find evidence of any other recapture deposits. The remaining deposits were mainly office and parking rental revenues plus replenishment checks from the Northern Trust account.

Lastly, we tied the amounts included in the City's general ledger to the amounts included in the funds financial statements for FY 2012/13, FY 2013/14 and FY 2014/15.

What We Found

Based on work performed, it appears that the monies credited/paid to the Police and Fire Pension Fund as indicated by Convergenx for the period 10/1/12 through 9/30/15 were deposited into the Fund's bank account and were subsequently reported in the Fund's audited financial statements.

Listing of Recapture Brokers Approved by Board Since 1997:

- 1) Abel Noser Brokerage
- 2) Andes Capital Group
- 3) CAPIS (Other names: Capital Institutional Services)
- 4) Cheevers & Co
- 5) Convergenx (Other names: Lynch, Jones, & Ryan Inc.)
- 6) Dominick & Dominick (Other Names: Ticonderoga Securities; Reynders, Gray & Co)
- 7) First Honolulu Securities Inc.
- 8) KCG (Other names: Knight Transmission Management, Knight Capital Group; Knight Equity Market LP; Donaldson & Co.)
- 9) MAGNA Securities Corp.
- 10) Merrill Lynch/Citation Group