



REPORT OF INVESTIGATION

NATIONWIDE FINANCIAL SERVICES CORPORATION

**ALABAMA SECURITIES COMMISSION
770 WASHINGTON STREET, SUITE 570
MONTGOMERY, AL 36130-4700
(334) 242-2984**

Case Number: S04-0239

Date: October 27, 2008

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I. TITLE OF CASE:

NATIONWIDE FINANCIAL SERVICES CORPORATION
ONE NATIONWIDE PLAZA
COLUMBUS, OHIO

II. VIOLATIONS INVOLVED:

- A. Title 8, Chapter 6, Section 3-(a), Code of Alabama 1975, Sale of Securities by Unregistered Agent or Dealer.
- B. Title 8, Chapter 6, Section 17-(a)(2), Code of Alabama 1975, Fraud in Connection With the Sale of Securities.

III. SECURITIES INVOLVED:

The securities involved in this matter are investments into 457 retirement accounts administered by Nationwide Retirement Solutions. These investments are being made by individual state employees under a group variable annuity contract.

IV. INVESTIGATION CONDUCTED BY:

Charles G. Harrison, Special Agent
Alabama Securities Commission
770 Washington Avenue, Suite 570
Montgomery, Alabama 36130-4700
(334) 242-2984

V. HISTORY OF INVESTIGATION:

A. Predication:

This investigation by the Alabama Securities Commission was preceded by a separate investigation regarding suitability of variable annuity investments being sold by Nationwide within tax deferred retirement accounts. Through the previous investigation, Nationwide's involvement regarding the state 457 plan was discovered. Further, the State Personnel Department has contacted the Commission advising of concerns, and requesting an examination, based on private litigation against ASEA, with regards to the 457 plan. This report documents the findings of this investigation as of the date of this report.

B. Period of Review:

JANUARY 2000 THROUGH PRESENT

VI. BUSINESS ENTITIES:

- A. Nationwide Financial Services Corporation
- B. Nationwide Retirement Solutions (NRS)
fka: PEBSICO of Alabama
- C. Alabama State Employees Association (ASEA)
- D. Public Employees Benefits Corporation (PEBCO)
fka: Alabama State Employees Association Benefits Corporation
- E. AON Consultants, Inc. (AON)
- F. Matrix Group, LLC (MATRIX)
- G. Keen Group, LLC (KEEN)
- H. Bartizan Research, Inc. (BARTIZAN)

VII. PRINCIPALS AND OTHER PARTICIPANTS:

- A. **EDWIN JEAN “MAC” McARTHUR, JR.** – Mr. McArthur is the Executive Director of the Alabama State Employees Association (ASEA). He is also the President and on the Board of Directors for PEBCO, which is an ASEA for-profit subsidiary. Mr. McArthur also participated in the ASEA Deferred Compensation Committee as an Ex-Officio member.
- B. **RANDY HEBSON** – Mr. Hebson is the President of the ASEA, as well as a Board member and Vice President of PEBCO. Mr. Hebson and his wife both serve on the ASEA Deferred Compensation Committee.
- C. **ROBERT WAGSTAFF** – Mr. Wagstaff is a member of the ASEA Board of Directors. He also serves as the Chairman of the ASEA Deferred Compensation Committee.
- D. **LOUIS MORENO** – Mr. Moreno a Regional Vice President for Nationwide Retirement Solutions. He is responsible for the Southeast Region, and is the direct supervisor for Mr. Patrick Cycmanick.
- E. **PATRICK ROBERT CYCMANICK** – Mr. Cycmanick is the Alabama State Director for Nationwide Retirement Solutions. He supervises the NRS sales representatives in Alabama who service the states 457 plan.
- F. **GREGORY JONES** – Mr. Jones is the former Director of Governmental Relations for ASEA. He was also listed as the Director of the Benefits Corporation (PEBCO). Mr. Jones left ASEA in late 2004 to join Matrix Group, LLC as a lobbyist.
- G. **JEFFREY MARLOW PITTS** – Mr. Pitts is the President of Matrix Group, LLC, and was retained as a lobbyist by Nationwide. He was responsible for lobbying ASEA to secure the 457 plan contract on behalf of Nationwide. Mr. Pitts is also the owner of Keen Group, LLC.

- H. THOMAS GERARD KIRKLAND** – Mr. Kirkland is the owner of Bartizan Research, LLC. He also incorporated the State Employees Association Political Action Committee (SEA-PAC). Mr. Kirkland was previously employed, or affiliated, with Matrix Group, LLC.
- I. SCOTT FISHER** – Mr. Fisher is the lead consultant to the state 457 plan. He is employed by AON Consultants, Inc., and is based in Seattle, WA. Mr. Fisher has been the consultant to the 457 plan since 2000.
- J. MICHAEL FALCONE** – Mr. Falcone is also a consultant employed by AON Consulting, Inc. Mr. Falcone was involved in the RFP process for the state 457 plan.
- K. JULIETTE DeCARTERET** – Ms. DeCarteret is a consultant employed by AON Consulting, Inc., and assisted in the RFP search for the state 457 plan provider.

VIII. GENERAL STATEMENT OF KNOWN FACTS:

Nationwide Retirement Services (NRS) is the current 457¹ plan provider for the State Employees Deferred Compensation Plan. This plan is a supplemental retirement program established in 1971 by legislative statute (36-26-14)², and is available to all state employees. State employees can elect to defer a portion of their pre-tax income into a stable value account and/or a variable annuity account.

The stable value option in the 457 plan is an interest bearing account that provides guaranteed income to the plan participant. The interest rate is determined by NRS, and has ranged between 3% and 5% during the period of review. This option offers low rates of return, but the benefits are stability, no fees, and returns guaranteed by Nationwide, on the participant's principal investment.

The variable annuity option consists of a group of mutual funds that the participant may choose to invest in. Currently, there are 25 mutual funds available that offer varying investment strategies. This plan option offers a chance to earn higher returns, but also generally carries a higher risk and account fees.

Currently, there are approximately 21,000 active and retired state employees participating in the 457 plan, with total assets of \$382 million.

Nationwide has been the 457 plan provider for the state of Alabama since 1976. The same state statute that established the plan, grants the authority to choose the plan provider to the Alabama State Employees Association (ASEA). ASEA must then present the plan provider to

¹ 457 plans are governmental deferred compensation plans established under IRS statute no. 457, and allow for governmental workers to contribute pre-tax income for retirement purposes. By statute, these plans must be one of the following: an annuity, a conservatorship, or a trust.

² Statute 36-26-14, Code of Alabama 1975, states, "The personnel board is hereby authorized and directed to adopt a plan or plans as recommended by the employees of the State of Alabama through the Alabama State Employees Association providing for tax-deferred annuity and deferred compensation programs for the salaried employees of the State of Alabama. The State of Alabama Personnel Board is hereby authorized to adopt and arrange for consolidated billing and efficient administrative services through the Alabama State Employees Association or its designated agent in order that any such plans adopted shall operate without cost to or contribution from the State of Alabama except for the incidental expense of administering the payroll salary-reductions and the remittance thereof to the trustee or custodian of the plan or plans.

the State Personnel Board (SPB) for approval. The previous contracts (1976-2000) regarding the plan were between Nationwide, SPB, and ASEA. Since 2001, the only parties listed in the contracts are Nationwide and ASEA, but one of these contracts must be submitted to the SPB for approval.

In 2003, the ASEA conducted a search of 457 plan providers, and issued a request for proposal (RFP) to eight investment services companies. The RFP was designed to evaluate several different plans and plan providers, and to select the most suitable option for the state employees. ASEA was assisted in this search by AON Consulting, Inc. (AON). Aon is a national company that has experience advising many large governmental 457 plans, with corporate headquarters in Chicago, IL.

The RFP responses were evaluated by the Deferred Compensation Committee from ASEA, along with the AON consultant. The Deferred Compensation Committee is made up of 12 ASEA Board members and Executive Officers, and was established to administer the 457 plan. After the responses were assessed, three finalists were chosen to come to Montgomery to make a presentation to the entire ASEA Board of Directors.

In September 2003, at the conclusion of the RFP process, Nationwide was again selected to be the 457 plan provider. The current contracts between Nationwide and ASEA were signed in April 2004. In 2006, these contracts were extended for 3 additional years, set to expire in 2012.

[EXHIBITS: 1 & 2](#)

457 PLAN HISTORY AND DETAILS:

Documentation received from Nationwide indicates the company has been the plan provider to Alabama State Employees deferred compensation program since 1976. The earliest agreements are contracts signed with the State Personnel Board, but it does not appear that ASEA received a significant amount of proceeds from these earlier agreements.

From roughly 1976 through 1999, Nationwide entered into agreements with the State Personnel Board to administer the 457 program. However, in 2000 the contractual relationship with the Personnel Board ended, and Nationwide began an exclusive partnership with ASEA to endorse the deferred compensation plan.

During this time (2000), Nationwide provided the state employee 457 plan, and a similar plan for AEA members, which was endorsed by the AEA. That year, Nationwide underwent a reorganization process that restructured the company's sales and marketing force. This process reduced the number of Nationwide representatives located in Alabama to service both plans. Nationwide also declined to continue to be the provider for the AEA plan, and eventually sold the account to a separate investment company.

During the company's reorganization, Nationwide terminated its current Statewide Director, Mr. Walter "Lee" Lawrence. After his departure, Mr. Lawrence established his own investment services company and began to solicit the ASEA for the 457 plan business. He reportedly met with ASEA and informed them that Nationwide had been taking advantage of ASEA by not paying them a competitive endorsement fee.

ASEA approached Nationwide and demanded to renegotiate the plan contract, claiming the plan charged excessive fees and that Nationwide's reorganization caused a reduction in the customer service level available to plan participants. In 2001, ASEA and Nationwide entered into what has been described as a "standstill agreement" by ASEA's counsel. This contract eliminated the SPB as a party to the contract, and instructed Nationwide to start paying ASEA an endorsement fee of \$1 million per year. Nationwide paid for this endorsement fee by reducing the amount of interest it paid on the fixed option of the 457 plan by 20 basis points³, or 0.2%. The 2001 contract was for a period of 3 years, and would increase the endorsement fee paid to ASEA to \$1.05 million in 2002, and \$1.1 million in 2003. [EXHIBITS: 3, 4, & 5](#)

The purpose of the "standstill agreement" was to address the endorsement fee issue, and because ASEA attorneys felt the previous contract was convoluted and confusing, due to the many amendments added since the 1986 contract. The feeling was this renegotiated contract would immediately increase the fees paid to ASEA, and give ASEA a chance to evaluate the plan and prepare for an RFP process to solicit offers from other providers.

The investigation also revealed that during this 2001 contract negotiation, McArthur instructed Nationwide to hire a lobbyist "if they wanted to participate in the competitive bid process". McArthur recommended Jeff Pitts who is a lobbyist with Matrix Group, LLC⁴ in Montgomery. Nationwide subsequently retained Pitts to lobby ASEA for the 457 plan business. It is unclear why Nationwide would need the services of a lobbyist during this time, since the RFP would not commence until 2003. To pay for the cost of this lobbyist, estimated by Nationwide at \$100,000 per year, Nationwide lowered the interest rate on the fixed account by an additional 10 basis points. [EXHIBITS: 6, 7, & 8](#)

The 2001 contract also established benchmarks for Nationwide regarding marketing activities and participant enrollments. ASEA also required Nationwide to retain an outside consultant (AON) to assess the 457 plan and provide performance reports to the Deferred Compensation Committee. The benchmarks established a set number of plan presentations Nationwide representatives must conduct with state employees, and also set goals for increased participation in the 457 plan. [EXHIBIT 1](#)

THE RFP PHASE (Jan. 2003 – Sept. 2003):

The RFP process did not commence until early 2003 when the ASEA's Deferred Compensation Committee, consisting of selected ASEA Board members, sent out requests for proposals to several investment companies for the administration of the states deferred compensation plan. The Committee was assisted by a plan consultant from AON Consulting in this due diligence process.

The RFP was sent to eight investment companies, including Nationwide, who provided governmental 457 plans. The request included a list of specific requirements, which were determined by ASEA, for the provider to administer the 457 plan. A brief summary of the initial requirements are listed below:

³ As it relates to this report, a basis point is defined as 0.01% of assets under management. For example, 100 bps is equal to 1% of assets in the 457 plan.

⁴ The investigation has determined Matrix Group, LLC is a lobbyist/consulting company located in Montgomery, AL. The president of this company is identified as Mr. Jeffrey M. Pitts.

- **Provider shall employ a state director and 8 field reps to service the plan**
- **Provider will retain an independent consultant to conduct annual participant surveys**
- **Provider shall conduct educational seminars as required by ASEA**
- **Provider shall provide the following minimum educational training experiences and opportunities:**
 1. **Provider shall arrange and pay all expenses for the Deferred Compensation Committee and appropriate staff of ASEA to visit no less than one fund house annually**
 2. **Provider shall arrange and pay all expenses for the Deferred Compensation Committee and appropriate staff of ASEA to attend the annual NAGDCA conference (National Association of Governmental Deferred Compensation Administrators)**
 3. **Provider shall provide at least one training/educational seminar for the Deferred Compensation Committee at least annually**
 4. **The appropriate representatives of the Provider shall attend the ASEA annual convention each year, as well as other ASEA sponsored events, and will continue to provide financial support to ASEA sponsored events**
- **The back cover of the *ASEA Insider* will be available for the Provider to purchase advertising, and the Provider may contribute articles for publication in the magazine**
- **A confidential agreement shall be entered into between ASEA and Provider, in the State of Alabama, and shall be subject to the laws of Alabama**
- **The venue for any disputes and/or litigation shall be in the Circuit Court for Montgomery, Alabama**

The RFP also consisted of a detailed questionnaire, which was formulated by the AON consultant, and covered areas such as marketing, products, capabilities, record keeping, pricing, and other general information that would be used to evaluate the responses. This questionnaire was primarily for the use of the consultant to gauge the capabilities of the provider to administer a large governmental 457 plan.

Nationwide responded to the initial request, and agreed to provide “all of the above listed items at no cost to the participant”. Nationwide went on to say that if ASEA “would like to impose a fee on their plan participants to recoup expenses, Nationwide would be happy to accommodate such a request and incorporate it into our (Nationwide) fee”. [EXHIBITS: 9, 10, & 76](#)

AON reportedly indicated to ASEA that the fee submissions received from the providers were inconsistent and varied greatly; some were very high, while others were very low. It is believed that most providers were only budgeting for the actual cost of the requested items. The amount of an endorsement fee to be paid to ASEA is not listed in this first request, and the other companies were not aware that ASEA would require an endorsement fee to be paid.

E-mail communications from AON, received by the Commission, indicate that AON was aware of the current contract between Nationwide and ASEA, and the amount of the endorsement fee being paid. These e-mails show that AON contacted McArthur to determine what details from the 2001 “standstill agreement” could be disclosed in the RFP process. It is

believed that ASEA did not want to disclose the existence or the amount of the endorsement fee currently being paid, until the provider had been selected. [EXHIBITS: 11, 12, & 13](#)

AON was apparently faced with a dilemma, because ASEA did not want to disclose the endorsement fee in the RFP, but to properly evaluate the responses, AON needed the solicited providers to account for such an expense in their fee submissions. AON e-mails illustrate this problem when they are drafting follow up questions to the RFP to address this issue. One consultant (DeCarteret) working on a draft proposal states, ***“I couldn’t think of a politically correct way to word the kick-back item – thought you might want to take a crack at that...”*** [EXHIBIT 14](#)

In June of 2003, AON sent out the list of follow up RFP questions to the providers. This letter included instructions to the providers to assume that providing the above listed requirements (listed above) would cost 50 basis points, and to adjust their fee submission accordingly. AON also included an additional bulleted item for “reimbursement (to ASEA) for sponsorship, marketing, and administration of the plan”. AON has stated this was done to be sure that all of the providers were budgeting the same amount for the items requested by ASEA. It appears this was a way to have the companies’ budget for the endorsement fee without disclosing any details. [EXHIBIT 15](#)

During this time, Nationwide contacted AON and inquired if AON was aware of the “complete deal” Nationwide had with ASEA. It is assumed the “complete deal” means the payment of the \$1 million endorsement fee. AON states that they are aware of Nationwide’s deal, and that this (follow-up questions) was a way to make an “apples to apples” comparison. [EXHIBITS: 16 & 77](#)

During this investigation, ASEA indicated the goal was to establish a plan with a high level of customer service options that would encourage plan participation, as well as provide a wide range of investment options. For this reason, some of the low cost providers were eliminated from the search because they could not provide the requested level of customer service.

The responses to the RFP were evaluated by the ASEA Deferred Compensation Committee and the plan consultant, and narrowed down to three finalists. The selected companies, Nationwide, ING, and Great West, were invited to Montgomery in Sept. of 2003 to make a final presentation to the entire ASEA Board. After the finalist presentations, Great West was eliminated, and Nationwide and ING were reportedly chosen to begin negotiations with ASEA.

Although the RFP process appears to have been thorough and exhaustive, the information received by the Commission suggests the process was pre-determined, and that Nationwide would be chosen as the plan provider. One particular e-mail gathered in the investigation recalls a lunch meeting with Pat Cycmanick (Nationwide State Director) and Robert Wagstaff (Chairman, Deferred Compensation Committee) in which Cycmanick recalls Wagstaff saying the RFP process was only conducted so ASEA could show they were “doing their due diligence”, and that ASEA was not unhappy with Nationwide’s services. [EXHIBIT 17](#)

A separate e-mail, dated June 17, 2003, Cycmanick again paraphrases a conversation he had with lobbyist Jeff Pitts, when he recalls Pitts stating that Nationwide had “nothing to worry

about”, because Alabama (ASEA) is pleased with Nationwide Retirement Solutions (NRS). [EXHIBIT 18](#)

E-mail communications provided by Nationwide indicate Jeff Pitts met routinely with McArthur during the RFP process and contract negotiations, and relayed information back to Nationwide regarding other competitor’s proposals and fee submissions. As of this date, there is no evidence to suggest that any of the other providers in the RFP process retained lobbyist. [EXHIBITS: 19 & 20](#)

In an e-mail dated Sept. 12, 2003, Cycmanick reports on a meeting with McArthur the night after Nationwide’s finalist presentation (before ING’s presentation and the ASEA Board meeting to select the provider) where McArthur stated, “if there is a clinch in our (NRS and ASEA) contract negotiations that they (ASEA) would turn around and negotiate with whoever comes in second place”. This appears to infer that contract negotiations have already commenced and that Nationwide had already been chosen as the provider. [EXHIBIT 21](#)

During the investigation, Commission staff interviewed Mr. Louis Moreno (Nationwide Regional Vice President for the Southeast). Mr. Moreno is the direct supervisor for Pat Cycmanick. Mr. Moreno stated that Nationwide’s initial response to the RFP was for zero basis points, or “at no cost to the participant”, was done to ensure that Nationwide would be chosen as a finalist and to be able to negotiate with ASEA. The zero basis point bid was later abandoned after the RFP follow-up questions instructed the providers to assume the cost of the requested items was 50 basis points. [EXHIBITS: 22, 23, & 24](#)

There would also appear to be a conflict of interest on the part of the AON consultant. The e-mail dated June 17, 2003 (discussed earlier) shows Cycmanick stating they (Nationwide) had a good relationship with Scott Fisher (AON lead consultant). AON was originally retained by Nationwide in 2001(at ASEA’s request for an independent consultant), and was paid directly by Nationwide until sometime during the RFP process when ASEA reportedly started paying the AON consultant. [EXHIBIT 18](#)

In an AON e-mail dated June 1, 2003, Juliette DeCarteret (AON consultant) is speaking in the context of who should contact the various RFP respondents, and states “I have not yet contacted Nationwide. Since they are the incumbent and Scott (Fisher) is paid directly by NRS for his services, I want to wait until Monday when Scott is back in the office to give him the opportunity to contact NRS himself”. Later in a response to this e-mail, Fisher states that “For the record, I am no longer paid by NRS, but by ASEA”. He goes on to say, “he hopes all that you have contacted are treating this confidentially...so that no one finds out through the grapevine. Awkward to say the least”. [EXHIBIT 25](#)

Although the consultant fees are technically paid by ASEA, the expense is merely passed through to Nationwide. AON submits the invoice to ASEA, who then forwards it on to Nationwide. Nationwide pays ASEA for the invoice, and only then does ASEA release the payment to AON. In that same month (June 2003) Fisher raises the issue of an unpaid invoice in an e-mail sent to Pat Cycmanick, and contacts Nationwide, not ASEA, to inquire about payment. The e-mail details the reimbursement system where Nationwide is still paying the consultant fees, although now indirectly. [EXHIBIT 26](#)

After Nationwide is selected to be the plan provider, ASEA presented a contract to the State Personnel Board for approval. AON and Nationwide representatives were both present at this meeting, as well as ASEA attorney Joe Espy. In the audio recording of the 2004 SPB meeting, Espy states that Aon chose Nationwide as the provider. This is contradictory to what was reported to the Commission and what has been documented regarding the RFP process. If in fact AON did select Nationwide, it has the appearance that AON may have recommended Nationwide to ensure they (AON) would be retained as the plan consultant. [EXHIBIT 27](#)

Other examples of how ASEA gives the appearance the RFP process was predetermined is detailed in several Aon e-mails regarding ING (who reportedly came in second place). The e-mails occur in October 2003, approximately one month after the finalist presentations, and show that ING contacted AON to inquire about “how things were progressing and what the next step in the (RFP) process is”. AON expresses confusion about this request, and indicates they (AON) assumed ASEA was negotiating with both Nationwide and ING. In a follow up e-mail, AON reports that Mac (McArthur) has not heard from ING in over a month. These e-mails seem to indicate that ASEA never had any intention of negotiating with ING, although they were reportedly selected as one of two finalists. [EXHIBITS: 28 & 29](#)

CONTRACT NEGOTIATION PHASE (Sept. 2003 – April 2004):

Although McArthur and ASEA President Randy Hebson both claim that ASEA chose two finalists, and negotiated with both, the October 2003 ASEA Board meeting minutes state the board chose Nationwide as the plan provider. The meeting minutes show the Deferred Compensation Committee report regarding the RFP was discussed in executive session, prior to Nationwide being selected. [EXHIBIT 30](#)

After the finalist presentations, it was claimed that ASEA would negotiate the best deal with either ING or Nationwide. From the previously discussed AON e-mails, there does not appear to have been any negotiations with ING.

In his interview with the Commission, McArthur stated he and a negotiating team consisting of Randy Hebson (ASEA President & PEBCO officer/board member), Steve Walkley (ASEA Treasurer and PEBCO officer/board member), and Robert Wagstaff (Deferred Compensation Chairman) sat down with Nationwide to negotiate a contract. McArthur also states the ASEA attorney Joe Espy took part in the negotiations.

The e-mails provided by Nationwide, along with the interviews of Nationwide staff (Cycmanick and Moreno) indicate that the contract negotiations primarily involved McArthur and lobbyist Jeff Pitts. McArthur never mentioned Jeff Pitts in his interview with the Commission.

Despite contrary statements, McArthur was the only representative from ASEA involved in the contract negotiations. The main points of contention in the contract negotiations were the underlying fund prices charged by Nationwide, and the amount of the endorsement fee paid to ASEA/PEBCO. According to interviews with Nationwide personnel, several times during the negotiations, McArthur would threaten to walk away from Nationwide and begin negotiations with ING. [EXHIBIT 20](#)

The negotiations consisted of many offers and counter offers over a period of approximately five months. Several times during the negotiation, documentation provided by Nationwide, notes that ASEA was asking for contributions to SEA-PAC. Specifically, ASEA asked for Nationwide to contribute \$10,000 every two years. Nationwide declined to contribute to SEA-PAC⁵ in the contract negotiations. ASEA did negotiate an additional five slots for ASEA staff to attend the annual Fund House and NAGDCA conference trips. [EXHIBITS: 22, 31, & 32](#)

Although not listed in the contract, McArthur requested 4 player slots for the Pro-Am golf tournament held at the Robert Trent Jones course in Prattville, and 20 guest tickets to the event. Nationwide eventually settled on 2 slots for the tournament and 10 guest tickets. Nationwide has stated to Commission staff that ASEA provided these player slots to legislators Larry Means and John Knight in 2003 and 2004. Nationwide is continuing to look for information on who these slots were provided to in later years. [EXHIBIT 78](#)

During the negotiations, at ASEA's suggestion, it was agreed to add an additional 7 basis points fee to fund a "Draw Down" account. This additional fee on assets under management was supposed to be used to pay for all of the bulleted items in ASEA's RFP, and for any additional expenses related to the 457 plan. The account is maintained by Nationwide, but pays expenses incurred by both parties. The draw down account will be discussed later in more detail.

One interesting point was noted in an e-mail between Nationwide attorneys and ASEA attorneys while discussing contract language. The e-mail was sent by Nationwide on March 5, 2004, and states "that NRS isn't certain that ASEA has signature authority for the State of Alabama Personnel Board, nor that ASEA can bind the State of Alabama Personnel Board in the contract." The e-mail goes on to ask for written confirmation from ASEA that they do in fact have this authority. Nationwide counsel is currently searching for this written confirmation, but has stated to the Commission that Nationwide was assured by ASEA attorneys that this authority is granted to the ASEA through state statute 36-26-14, Code of Alabama. [EXHIBIT 34](#)

Ultimately the two sides came to an agreement that would lower fund prices, set the administrative asset fee paid to Nationwide at 28 basis points, and pay ASEA/PEBCO an endorsement fee of 50 basis points. The amount of the endorsement fee (50bps) appears to have been selected to maximize profits paid to ASEA/PEBCO. So far, no justification had been offered as to how this number was determined, or the exact amount of the expenses ASEA incurs while administering the plan. Officially, ASEA is paid the endorsement fee for marketing, administrative and advertising support. In an internal e-mail, Nationwide made the point to be sure to note that all of the additional items were added at ASEA's request and not Nationwide's. Also of note, is that lobbyist Jeff Pitts received a bonus of approximately \$60,000 when the contracts were signed in 2004. [EXHIBITS: 35 & 36](#)

As dictated by the 2004 contract, plan participants (state employees) pay 28 basis points (not included the underlying mutual fund expenses) on their investment. The 50 bps fee paid to ASEA and the 7 bps fee for the draw down account are not paid directly by the participant; rather Nationwide pays these fees from its earnings. In addition to the 28 basis point administrative fee paid by the participant, Nationwide also generates revenues on the plan through fee sharing agreements with the mutual fund providers, and from excess earnings on the fixed fund option on

⁵ SEA-PAC is the State Employees Association Political Action Committee, and is controlled by ASEA elected representatives.

the plan. Although the participants do not directly pay the ASEA and draw down account fees, these costs are still indirectly born by the plan participants. A portion of the mutual fund expenses paid by the participant are remitted back to Nationwide through reciprocal agreements between Nationwide and the mutual fund providers. As previously stated, Nationwide lowered the amount of interest it paid to participants in the fixed fund to compensate for the expenses of the ASEA endorsement fee and the lobbyist.

Had ASEA not demanded an endorsement fee, or a lobbyist, the plan participants would pay 0 bps to Nationwide, and would earn 30 bps more on the fixed interest account.

On April 1, 2004, Nationwide and ASEA/PEBCO entered into a pair of 5 year contracts, with an option for a sixth year. The current agreements involving Nationwide, ASEA/PEBCO, and the 457 Plan are separated into two separate contracts. The "Funding Agreement" names the provider of the plan, and stipulates marketing benchmarks set forth by ASEA for the plan provider. The "Administrative Services Agreement" details the amount of the endorsement fee and benefits paid to ASEA/PEBCO, and the establishment and funding of the draw down account.

The idea to enter into two separate contracts was formulated by McArthur, and is discussed in a letter McArthur sent to Joe Espy on October 15, 2003, well before the contracts were signed in April 2004. McArthur also sent this letter to Aon consultant Scott Fisher, and the two discussed (by e-mail) the provisions that would go into each contract. In the letter McArthur states the reasoning for the separate contracts is that one must be approved by the State Personnel Board, while the other would not. This letter implies that McArthur may have withheld from the SPB, the contract that stated ASEA and PEBCO would receive compensation from Nationwide.

ASEA AND PEBCO CORPORATE STRUCTURE AND OPERATIONS:

ASEA incorporated a for-profit company titled Alabama State Employees Association Benefits Corporation in December of 2000. ASEA used the services of attorney Ken Wallis in the incorporation process. At the time, Mr. Wallis worked at the law firm of Capell & Howard, and was outside counsel for AEA. In July of 2003, the name was changed to Public Employees Benefits Corporation (PEBCO), and for the purposes of this memo will only be referred to as PEBCO. Presumably, PEBCO was incorporated by ASEA as a for-profit subsidiary to generate revenues through endorsement agreements with vendors, who provide benefits to the association's members. Unlike most corporation/subsidiary relationships, the organizational distinction between ASEA and PEBCO is very unclear. The ASEA Executive Officers also serve as the Executive Officers and Board of Directors for PEBCO. PEBCO Board members are reportedly paid \$1,000 per diem for board meetings, which are reportedly held once a year.

PEBCO has no full-time employees, and no dedicated offices. The only listed employee is the Executive Director, Mr. Mac McArthur, who receives a 1099 from PEBCO. Select employees of ASEA reportedly split their time and efforts working for both companies. A percentage of those employee's salaries and benefits are reimbursed to ASEA by PEBCO. These employee's positions mainly involve member benefits functions. The ASEA Executive Director and Comptroller determine each position and percentage of salary that is to be reimbursed by PEBCO. The employees whose salaries are partially reimbursed by PEBCO are not aware of this fact. They receive paychecks and W-2s from ASEA. [EXHIBIT 38](#)

The employees of ASEA participate in the state retirement plan through the Teachers Retirement Systems. The reimbursement of salaries by PEBCO allows those employees who perform functions for the for-profit subsidiary to remain in the state retirement system. A portion of their state retirement is paid for by the for-profit corporation. Some of the ASEA employees whose salary is partially reimbursed by PEBCO could not differentiate between the two companies, and could not adequately describe what functions PEBCO was supposed to provide versus those provided by ASEA. [EXHIBIT 38](#)

It appears that only the PEBCO Board and officers know the full extent of the company's relationship with ASEA and the 457 plan. The PEBCO Board Meeting minutes do not offer any substantive information as to what business the board discussed. Additionally, during the RFP, McArthur instructs all vendors to limit communication to himself and Randy Hebson. Randy Hebson also reiterates this statement to Board members in the Sept. 2002 Board meeting.

At this time, it is not known if PEBCO's financial information and business dealings are currently presented to the ASEA Board members. The Feb. 2003 ASEA Board minutes indicate at least one Board member asked to see the financial statements from PEBCO, but ASEA Executive Director Mac McArthur stated there were legalities that could affect the ASEA's non-profit status if that information was disclosed, because PEBCO is a for-profit subsidiary. It appears that McArthur restricted contact between PEBCO vendors and the ASEA Board by directing all communications go through himself, or Randy Hebson. [EXHIBITS: 30, 40, & 41](#)

Robert Wagstaff is the chairman of the ASEA Deferred Compensation Committee, and is also an ASEA Board member. In his interview with the Commission, Wagstaff stated he did not know that PEBCO also paid McArthur compensation, or that PEBCO Board members are paid a per diem to attend board meetings. He claimed he was aware that PEBCO paid an endorsement fee to ASEA, but he was unaware of exactly where that money came from, or how the amount of the endorsement was determined.

The Board and Executive Officers of PEBCO have essentially remained the same individuals since the company's incorporation, and the Board meeting minutes indicate the majority of PEBCO business is conducted and discussed in Executive Session. The PEBCO business that is discussed in the Board minutes is vague and non-descriptive. All of the PEBCO Board members are on the ASEA Deferred Compensation Committee and attend the conferences and fund house trips described later in this report. [EXHIBITS: 39 & 74](#)

PEBCO REVENUE SHARING WITH ASEA:

The main source of revenue for PEBCO is fees generated from the endorsement and sponsorship of the State of Alabama Employees 457 Deferred Compensation Plan. Approximately 90% of annual PEBCO revenues come from an agreement with Nationwide Retirement Services to provide the State's deferred compensation plan to all state employees. The remaining 10% comes from similar agreements with insurance companies to provide discounted insurance products to ASEA members. [EXHIBITS: 42, 43, 44, & 45](#)

The most recent audited financial report provided by PEBCO is for the year ending December 31, 2006. According to the Income Statement, PEBCO generated total revenues of \$1.77 million. Of this amount, approximately \$1.65 million came from Nationwide through

revenue sharing fees. The most recent tax returns show those fees have increased to approximately \$1.8 million last year. [EXHIBITS: 42, 43, 44, & 45](#)

The 2006 income statement also listed expenses of \$1.6 million during the year. By far, the largest PEBCO expense was \$1.2 million paid to ASEA as an endorsement fee. Some of the remaining major expenses were salary and wages, employee benefits, contract labor, and bonuses. After all remaining expenses are deducted, PEBCO shows a pre-tax profit of roughly \$160,000, on which they paid approximately \$67,000 in state and federal taxes. [EXHIBIT 45](#)

The PEBCO payment to ASEA is listed as an “endorsement fee”, and is carried as an expense on the subsidiary’s financial sheet. This process allows PEBCO to drastically reduce its pre-tax profits, and avoid paying income tax on the majority of revenues. [EXHIBIT 46](#)

The Consolidated Notes to the PEBCO financial statement offer a description of the endorsement fee paid to ASEA. It explains that PEBCO reimburses ASEA for costs and expenses in providing: advertising, marketing, administrative support, due diligence, educational/informational services, and overall sponsorship for the Alabama Public Employees 457 Deferred Compensation Plan. However, it appears all legitimate expenses incurred by the ASEA are paid out of the 7 bps in the draw down account, and that the 50 bps endorsement fee is mostly profit for PEBCO. The only expense associated with the plan that is not paid from the draw down account is the expense for the Nationwide advertisement in the *ASEA Insider*. This expense is paid to ASEA by PEBCO from the 50 bps fee. [EXHIBITS: 45 & 46](#)

The majority of the endorsement fee is passed through PEBCO to ASEA. The amount paid to ASEA each year is determined after ASEA calculates their annual budget. The annual ASEA budget is approximately \$3 million per year, but membership fees only provide for approximately \$1.5 million in revenues. The difference between ASEA membership revenues and budgeted expenses dictates the amount of the endorsement fee paid by PEBCO to ASEA. As previously stated, PEBCO also reimburses ASEA for a portion of employee salaries and benefits. ASEA is largely dependent on the revenues generated by the 457 plan to fund its annual operating expenses. [EXHIBIT 38](#)

DRAW DOWN ACCOUNT: [EXHIBITS: 47, 48, 49, & 50](#)

Also as a result of the negotiations, Nationwide agreed to establish a “Draw Down” account to reimburse expenses associated with the state 457 plan. This draw down account is funded by an additional 7 basis points fee on assets under management. The most recent accounting of the draw down account shows the 7bps to equate to approximately \$250,000 per year at current asset levels. This money is placed in an account administered by Nationwide to reimburse expenses submitted and approved by ASEA.

The account pays for plan expenses such as: 17 members of the ASEA Board and the Deferred Compensation Committee to take annual due diligence trips to a Fund House and the annual NAGDCA Conference (National Association of Government Defined Contribution Administrators), plan surveys, the plan consultant fees (AON Consultant), and any other fees ASEA deems associated with the 457 plan. The draw down account also reimburses Nationwide field representatives for providing sponsorships and food at ASEA events and marketing presentations.

There does not appear to be any oversight on what expenses are paid from this draw down account. Many of the expenses appear to benefit the ASEA membership rather than the 457 plan. For instance, a \$125 bonus is paid from this account to ASEA chapters who recruit 10 or more members at a meeting. The account also sponsors “Mac’s Tour”, which McArthur undertakes in July each year in ASEA’s annual membership campaign.

While the Fund House⁶ and NAGDCA trips taken by the ASEA Board members and Deferred Comp. Committee members may be educational and beneficial to the 457 plan, the expenses associated with these trips appear exorbitant and lavish in some areas. McArthur, Randy Hebson (ASEA Pres.) and Paige Hebson (wife) all fly first class during these trips. Randy and Paige Hebson are also on the Deferred Compensation Committee. All expenses incurred on these trips, including travel, lodging, entertainment and souvenirs, are paid for by the draw down account. Some of the entertainment events listed included a tour of a vineyard in Napa Valley, CA, tickets to a Broadway show in NYC, a Chicago Cubs baseball game, a dinner cruise, and expensive lunches and dinners during each trip.

Nationwide sponsorships for ASEA functions are also paid by the draw down account. For example, approximately \$15,000 - \$20,000 is paid for a reception at the annual ASEA Convention, sponsorship of a SEA-PAC reception suite at the convention, “Mac’s Tour”, the ASEA Leadership Conference, and the ASEA golf tournament. While some of these activities provide marketing opportunities, the majority of the benefit is received by ASEA, since most of these functions are exclusive to the ASEA members, and are not open all state employees.

Other questionable expenses paid from the draw down are for surveys conducted by the Keen Group, LLC. A records search indicates the Keen Group is owned by lobbyist Jeff Pitts. At this time, it is unknown what these surveys consist of, or if they even exist. The Commission has asked ASEA & Nationwide for these surveys several times, but to date we have only been supplied with two surveys; one from Anzalone-Liszt Research and the other from Eurekafacts, Inc. These payments to Keen Group show that Pitts is receiving payments from both Nationwide and ASEA for services. [EXHIBIT 51](#)

Although the Commission has not been provided with a copy, e-mails indicate that Pitts has presented at least one customer satisfaction survey to the ASEA Board of Directors. It is apparent that the Board does not know the full extent of what services Pitts/Matrix provides. In one e-mail, Robert Wagstaff describes Pitts as an independent consultant who provides surveys for the 457 plan, and would infer that Wagstaff did not know that Pitts was a hired lobbyist for Nationwide. Through the documents uncovered in this investigation, it is clear that Pitts is not independent, and would have a financial incentive to ensure that the surveys show plan participants are happy with the services provided by Nationwide. [EXHIBITS: 52, 53, & 54](#)

Another survey firm is kept on retainer, paid from the draw down account, is Bartizan Research, LLC. Bartizan is owned by Mr. Thomas Kirkland. A search of the Secretary of States website indicated that Kirkland has incorporated several ASEA related entities, including SEA-PAC. An AIS database search (similar to Lexis-Nexus) conducted by the Commission, revealed

⁶ The ASEA Deferred Compensation Committee and other ASEA staff visit one mutual fund company per year to conduct due diligence activities. Throughout the context of this investigation these trips are referred to as “Fund House” trips.

that Kirkland was also previously employed/affiliated in some capacity with Matrix Group, LLC. [EXHIBITS: 55 & 56](#)

These surveys are reportedly required to be for the benefit of the 457 plan, but key personnel from Nationwide could not recall reviewing the survey results, and were not familiar with the subject matter of the surveys. Had the surveys been pertaining to the 457 plan, the information generated by these surveys would be very beneficial to Nationwide in evaluating the services they are providing to the state's 457 plan participants.

Thus far, there is no information that suggests Pitts, Kirkland, Bartizan or Matrix, LLC, have any specific knowledge of, or professional expertise regarding deferred compensation plans. The Commission is currently gathering additional information to determine the specific services Pitts, Kirkland, Bartizan and Matrix provided to Nationwide during the RFP, contract negotiations, and servicing the 457 plan. The Commission recently issued subpoenas for documentation to Matrix Group, Keen Group, and Bartizan Research, and is currently waiting for those documents to be produced.

The ASEA expenses that are submitted for reimbursement from the draw down account are reviewed and approved by McArthur. They are then submitted to Nationwide's State Director Pat Cycmanick for processing. Mr. Cycmanick stated he had not reviewed any surveys regarding the plan and had never questioned any expense submitted by McArthur.

Mr. Cycmanick also informed the Commission that his position with Nationwide, the Nationwide office in Montgomery, and other staff members jobs, were dependent on Nationwide keeping the State Employees 457 Plan. Without the revenues generated from the plan, Nationwide would restructure its operations in Alabama, eliminating his position. This situation would put Cycmanick in a precarious position to challenge the expenses submitted by ASEA for the draw down account.

AON Consultants, Inc. also continues to be kept on retainer (\$40K per year paid from the draw down account). They provide periodic reviews of the selected funds in the plan, and make recommendations to add or replace underperforming funds. [EXHIBITS: 47, 48, 49, & 50](#)

While the RFP indicated that the amount of plan expenses would equate to 50 basis points, the addition of the draw down account increases that amount to roughly 57 bps. With the addition of the 28 bps administrative fee charged by Nationwide, the plan participants pay fees equating to 85 bps on assets, plus expense fees imposed by the underlying mutual funds.

LOBBYIST AND OUTSIDE INFLUENCE ON THE STATE 457 PLAN:

As discussed in the previous section, there is evidence to suggest that lobbyists are being paid from proceeds generated by the 457 plan. The aforementioned Jeff Pitts (Matrix/Keen Group) and Thomas Kirkland (Bartizan/Matrix) have received multiple payments from the draw down account for reportedly conducting surveys. Pitts receives payments through a company he incorporated in June 2003, called Keen Group, LLC. Kirkland's company Bartizan Research is paid a \$1,000 per month retained from the draw down account. [EXHIBITS: 47, 48, 49, 50, & 51](#)

The investigation has also discovered 2 other lobbyist associated with ASEA and/or the 457 plan. The first is John Anzalone, who conducted one of the surveys for ASEA that was

provided to the Commission. The second is Gregory Jones, who formerly worked for ASEA as the Director of Governmental Relations. There is not evidence that either of these individuals received any payments from the draw account.

From the Commission interviews with Nationwide's Pat Cycmanick and Louis Moreno, it was determined that McArthur instructed Nationwide to hire a lobbyist and recommended Jeff Pitts from Matrix Group, LLC. McArthur and Pitts appear to have a broader relationship than would be expected. Several times in the contract negotiations, McArthur stated he wanted Pitts to be "taken care of" regarding future contracts between Pitts and Nationwide. In e-mails and documentation provided by Nationwide, McArthur recommended Nationwide keep Pitts as their lobbyist and was concerned when Nationwide had not reach an ongoing agreement with Pitts. ASEA also made concessions in the negotiations so Nationwide would have the revenue to continue retaining Pitts/Matrix. [EXHIBITS: 41, 57, 58, 59, 60, & 61](#)

While in discussions to assume the 401(a) accounts, Nationwide stated that they did not have to compensate Pitts if the contract extension was only for two years. They went on to say that if ASEA wanted to see Pitts be a part of an extension, it would give weight to Nationwide's demand for a 3 year extension. The contract was eventually extended for 3 years, and Pitts received a bonus of \$45,000. [EXHIBIT 62](#)

Earlier in this report, it was stated that ASEA had requested Nationwide make contributions to SEA-PAC. Nationwide declined to contribute to SEA-PAC, but instead elected to directly contribute to the political candidates of ASEA's choosing, through the Nationwide Alabama Political Action Committee. E-mails received from Nationwide show that lists of all candidates running for election are provided to ASEA, and ASEA is asked to indicate which candidates should receive \$500 contributions from Nationwide's PAC. Documentation shows that McArthur gives this list to Jeff Pitts, and lets Pitts decide who should receive the contributions. [EXHIBITS: 63, 64, & 65](#)

Thomas G. Kirkland incorporated Bartizan Research, LLC in 2002. Bartizan receives a \$1,000 monthly retainer, which is paid out of the draw down account. It is unclear at this time what services, if any, Bartizan provides to the 457 plan. A search of corporation filing shows Kirkland had incorporated a myriad of companies seemingly related to ASEA. The names of these companies include: Alabama State Employees Association, LLP., Alabama State Employees Association, LLC., Alabama State Employees Association, Inc., Alabama State Employees Insurance Agency, and State Employees Association Political Action Committee (SEA-PAC). Kirkland has also incorporated a company called APEAL, Inc. (Alabama Public Employees Action League, Inc.), but it is unknown if this company is at all related to this investigation. On the initial incorporation documents for SEA-PAC, Kirkland is listed as a Director. An AIS database search also listed Kirkland as being affiliated with Matrix Group, LLC. [EXHIBITS: 55, 56, & 75](#)

Gregory Jones is a former employee of ASEA, and served in the position of Director of Governmental Relations. E-mails provided by Nationwide show Jones was at least peripherally involved in the contract negotiations, and participated in some of the Fund House and NAGDCA trips taken by the Deferred Compensation Committee. On more than one occasion, Jones is listed as the Director of the Benefits Corporation for ASEA. In September 2004, Jones left ASEA and went to work for Matrix Group, LLC. On hearing this news, Nationwide stated "Great news for Greg....Do we (get) Two for the price of One", apparently referring to Pitts and Jones. Jones has

since started a lobbying group called The Jones Group, LLC. At this point in the investigation there has not been any evidence that suggests Jones was being paid anything other than his salary from ASEA. [EXHIBIT 66](#)

As previously stated, the commission received a copy of a November 2005 survey conducted by Anzalone-Liszt. The survey was prepared and analyzed by John Anzalone who is listed as a lobbyist on the Alabama Ethics Commission's Registered Lobbyist List. There is no record of this company receiving any payment from the draw down account for this survey. However, the accounts documents show that Keen Group received a \$30,000 payment on November 2, 2005 for a member survey. One possible explanation is that Keen Group is subcontracting with Anzalone to produce the survey. [EXHIBITS: 47, 48, 49, & 50](#)

The investigation has concluded that the relationship between ASEA and Matrix is undeniable. To further add to this relationship, Joe Perkins, Jr (founder of Matrix) represented Matrix at the 2004 ASEA annual convention and spoke about "The Power of SEA-PAC".

The investigation also uncovered some outside influence on the 457 plan. E-mails from Nationwide indicate that ASEA would like to add Kemper Funds as a second Terminal Fund Provider to the 457 plan. The e-mail states, "Mac is getting political pressure to add Kemper". The source of this political pressure is not clear, nor is it clear this would be detrimental to the 457 plan, but it shows that the plan administered by ASEA is subject to outside influences. Additional e-mails also show that Jeff Pitts was involved in discussions to add Millennium Capital Management as a secondary terminal fund provider. [EXHIBITS: 67 & 68](#)

401(a) ACCOUNTS FOR LEGISLATIVE APPROPRIATIONS:

The current Funding and Administrative Services Agreements between NRS and ASEA/PEBCO were signed in March of 2004. Both contracts were amended in April of 2006. The amendments extended the current contracts by 3 years, and were reached when Nationwide agreed to take over the 401(a) legislative matching funds accounts in 2006. The 401(a) accounts receive any funds that are appropriated by the legislature as employer matching contributions. These matching contributions are made available to both 457 plan and RSA-1 participants. These accounts were previously managed by Prudential, but there were apparent problems in the administration of the accounts. [EXHIBIT 69](#)

In 2006, ASEA and the 401(a) Board of Control set out to find a new provider for the 401(a) business. These accounts have a very small profit margin because of the high number of accounts the provider must maintain, and because they are not regularly funded by the legislature. Nationwide was approached with the offer to administer the 401(a) accounts, but demanded a contract extension on the 457 plan in return. This 3 year contract extension on the 457 plan also earned Nationwide's lobbyist, Jeff Pitts, a \$45,000 bonus. [EXHIBITS: 61 & 62](#)

While the profits margin on the 401(a) accounts is small, Nationwide charges the same 28 basis points fee on the assets. Another advantage of Nationwide maintaining the 401(a) accounts is detailed in a December 2003, Nationwide states, "Immediately it would give us access to information on people currently deferring with RSA-1 for potential rollovers." It is important to note that the assets in the 401(a) accounts are NOT counted in the calculation of the endorsement fee paid to ASEA/PEBCO. [EXHIBITS: 62 & 70](#)

457 PLAN MARKETING:

Currently, the plan is marketed by the Nationwide and ASEA field reps, who often conduct joint presentations. It is also marketed through advertising in the *ASEA Insider*. Nationwide employs a staff of 8 salaried field representatives with separate coverage areas in the state. In addition to the joint presentations, these representatives also conduct individual presentations to state employees at state offices. However, they are also responsible for all Nationwide deferred compensation plans with counties and cities across the state, and are not exclusive to the state 457 plan. The state employees plan is not the only client they must serve. ASEA representatives can only briefly describe the 457 plan in meetings they conduct without a Nationwide representative present.

While they are only contractually obligated to spend at a minimum 10% of their time on the state plan, the number of presentations they must conduct dictates they spend a majority of their time marketing the state 457 plan. The contract stipulates that Nationwide must conduct 1250 presentations to 5 or more state employees each year. This breaks down to approximately 150 presentations per field rep each year (250 working days). [EXHIBIT 1](#)

The state 457 plan is also marketed by the Nationwide representatives at ASEA events, such as: membership meetings, the annual convention, the annual golf tournament, and other events which are in part sponsored from the draw down account by Nationwide.

It appears the state 457 plan is being primarily marketed to ASEA members through the ASEA and Nationwide field representatives, and advertising in the ASEA publication. No advertising is done on television, or in any of the statewide newspapers and publications. The only independent marketing done by Nationwide is the independent presentations to state employees done by its field representatives. The *ASEA Insider* is only mailed to all state employees once a year, during ASEA's annual membership drive. If a state employee has an aversion to the ASEA, he or she may not be inclined to attend a meeting with an ASEA field representative and may not read the ASEA's publication. Personnel from Nationwide have indicated some state agencies will not allow ASEA to conduct presentations at their offices.

Nationwide also claimed the plan is advertised with a message on the ASEA phone system, and a link to Nationwide on the ASEA webpage.

X. CONCLUSIONS AND RECOMMENDATIONS:

A. CONCLUSIONS:

The current state employees 457 plan appears to be a better plan for state employees than it was before 2000. Many of the fees Nationwide previously charged (contingency deferred sales charges, Account Maintenance fees, sales commissions, fund prices) have been completely eliminated, or reduced. Many underperforming and high expense ratio funds have been replaced or eliminated. The ASEA Deferred Compensation Committee and the AON consultant appear to regularly monitor and ensure the plan provides a mix of funds to cover all asset classes. The fees paid by participants have decreased, and the number of participants and total assets in the plan has substantially increased.

Although the current plan is better for the state employees than the previous plan, the involvement of the ASEA has cost approximately \$10 million since 2000 from participant's retirement accounts. The funds paid to ASEA/PEBCO do not appear to be justified, and are in fact mostly profits to the association. It is also certain that it is not disclosed to state employees who participate in the plan, the fact that funds they believe are going into a retirement account are being used to subsidize the ASEA. [EXHIBIT 73](#)

At this point it is not clear if the ASEA Deferred Compensation Committee had full knowledge of the 50 bps fee being paid to PEBCO, and exactly what was the justification for the amount of the fee. It appears it was presented to the Committee as a way to reimburse ASEA for the due diligence functions, and other expenses ASEA would incur while administering the 457 plan. However, it is evident that the Committee did not know about the additional 7 bps fee imposed on participants to fund the draw down account, or that the draw down account would be used to pay the same expenses that were used to justify the 50 bps endorsement fee. Most of the justifiable expenses are paid from the draw down account, which leaves the majority of the 50 bps endorsement fee as profit received by ASEA via PEBCO.

So far, the only justifiable expense paid for from the 50 basis point endorsement fee is for advertising. Since 2003 PEBCO has reimbursed ASEA a total of \$78,500 for advertising in the *ASEA Insider*. PEBCO has received approximately \$9.1 million from Nationwide since the renegotiated contract in 2000. Of this amount, PEBCO has paid ASEA approximately \$6.7 million through an untaxed endorsement fee. ASEA has also transferred some of its regular operating expenses to PEBCO through salary and benefits reimbursements.

It is clear the ASEA intended to profit from the State Employees 457 plan because of the incorporation of the for-profit company PEBCO. Had the intent been to only recoup expenses, that function could be accomplished with out the need for a for-profit corporation to pass the revenues through. It is also apparent that the ASEA is using the profits, and benefits associated with the 457 plan, to pay operational expenses, conduct lobbying activities, and to increase membership in the ASEA.

Fees paid by plan participants are being used to pay lobbyist (Pitts/Kirkland) and to support the ASEA's PAC (SEA-PAC reception suite at the annual convention). McArthur also requested and received 2 slots to play in Nationwide's Pro-Am golf tournament held at the RTJ Trail in Prattville, and 10 tickets to the Nationwide sponsored professional golf tournament.

Mac McArthur is also personally benefiting from the ASEA's control of the 457 plan. He currently receives salaries from both ASEA and PEBCO. His compensation agreement with PEBCO provides him with an annual salary of \$36,000, \$2,000 per month in benefits, plus 3% of the first \$1 million in PEBCO revenues, and 3.5% of all additional revenues. PEBCO also agreed to pay for McArthur's spouse to travel with him to all events in which his attendance is deemed necessary. It appears McArthur's PEBCO compensation agreement raises a conflict of interest with the 457 plan participants. Because a portion of his compensation is derived from fees paid by the participants, he has a financial incentive to increase the amount of fees Nationwide pays to PEBCO. His annual compensation from ASEA and PEBCO combined has risen from approximately \$142,000 in 1998, to approximately \$375,000 in 2007. [EXHIBITS: 71 & 72](#)

Attached is a spreadsheet that details the years and amounts of payments ASEA and PEBCO have received from Nationwide. The first list shows the total amount Nationwide has

sent to both PEBCO and ASEA (before PEBCO began operating). The second list is the amount of funds PEBCO has transferred to ASEA. The last list on the spreadsheet details McArthur's salary as it is listed in the ASEA tax returns, but these figures vary substantially from what he has reported to the Commission. [EXHIBIT 73](#)

B. ONGOING INVESTIGATIVE ACTIONS:

The Commission currently has outstanding subpoenas issued to Matrix Group, LLC, Keen Group, LLC, and Bartizan Research, Inc. The Commission anticipates reviewing any documentation supplied by these entities and amending this report as necessary. Previous interview transcripts are being produced to reference information included in this report, but are not available at this time for exhibit purposes. The Commission also continues to interview key personnel involved in this matter and will include any pertinent information provided by these individuals.

C. RECOMMENDATIONS:

As requested by the Attorney General of the State of Alabama, a copy of this Report of Investigation, with the accompanying exhibits and appendices, is being submitted to the Attorney General, for such action, as he deems proper and advisable.

Prepared by:

Charles G. Harrison
Special Agent
Alabama Securities Commission

XIV. LIST OF EXHIBITS:

EXHIBIT

- 1 – 2004 FUNDING AGREEMENT
- 2 – 2004 ADMINISTRATIVE SERVICES AGREEMENT
- 3 – 2001 STANDSTILL AGREEMENT
- 4 – 8698
- 5 – 6921
- 6 – 8409
- 7 – 8460
- 8 – 8459
- 9 – 3168
- 10 – 5095
- 11 – 0182
- 12 – 1275
- 13 – 1276
- 14 – 00107
- 15 – 3058
- 16 – 5839
- 17 – 8509
- 18 – 8470
- 19 – 4843
- 20 – 4842
- 21 – 4885
- 22 – 4850
- 23 – 4919
- 24 – 5263
- 25 – 00184
- 26 – 00284
- 27 – 2004 PERSONNEL BOARD MEETING (AUDIO FILE)
- 28 – 1446
- 29 – 1438
- 30 – ASEA BOARD MEETING MINUTES
- 31 – 4827
- 32 – 8545
- 34 – 4667
- 35 – 8489
- 36 – 5732
- 37 – 01168
- 38 – 1712
- 39 – PEBCO BOARD MEETING MINUTES
- 40 – 8691
- 41 – 4646
- 42 – ASEA TAX RETURNS
- 43 – ASEA FINANCIAL STATEMENTS
- 44 – PEBCO TAX RETURNS
- 45 – PEBCO FINANCIAL STATEMENTS
- 46 – 1664
- 47 – 2004 DRAW DOWN ACCOUNT REGISTER

48 – 2005 DRAW DOWN ACCOUNT REGISTER
49 – 2006 DRAW DOWN ACCOUNT REGISTER
50 – 2007 DRAW DOWN ACCOUNT REGISTER
51 – KEEN GROUP, LLC
52 – 6305
53 – 6312
54 – 5412
55 – BARTIZAN RESEARCH, LLC
56 – AIS REPORT THOMAS G. KIRKLAND
57 – 8662
58 – 6968
59 – 8690
60 – 8404
61 – 8415
62 – 6262
63 – 8542
64 – 8551
65 – 8516
66 – 8452
67 – 4647
68 – 4648
69 – 6264
70 – 6764
71 – McARTHUR/PEBCO COMPENSATION AGREEMENT
72 – McARTHUR SALARY RECAP
73 – ASEA/PEBCO PAYMENTS SPREADSHEET
74 – PEBCO DIRECTORS & OFFICERS
75 – SEA-PAC INCORPORATION DOCUMENTS
76 – 4874
77 – 4998
78 - 7690