Matrix Of Corruption

By Edward Jay Epstein *Mon, Jun 8, 2009*

Journalist and scholar Ed Epstein examines New York's ongoing public pension scandal, and the "placement agents" who use their political contacts, financial experience, powers of persuasion, and other means to extract pension fund money for private equity firms.

The corruption of pension funds by private interest is hardly a new phenomenon. Las Vegas, after all, was largely built with money from the Teamster's Central States Pension Fund, with the intermediary Sidney Korshak, a mob-connected lawyer, channeling a large part of it to casino owners. Korshak himself was never convicted of any wrongdoing, but Jimmy Hoffa, the president of the International Brotherhood of Teamsters, was imprisoned on corruption charges in 1971. Then, after getting a pardon from President Nixon in 1974, he literally disappeared without a trace (his body, according to the latest FBI theory, had been cremated by his associates in organized crime).

Today, pension fund financing is a far more respectable and civilized industry. It is also vastly richer, with pension funds holding over $2.7 trillion in assets, and providing private equity firms with most of the capital they use for their leveraged buy-outs, real estate acquisitions and other ventures. In return for allowing pension funds to participate in their deals, the private equity firms exact lucrative fees, taking both a percent of their total investment—typically two percent per year- and part of the profits—usually 20 percent of each successful deal. In 2008, the ten largest pension funds allocated $105 billion to such private equity deals, creating a veritable El Dorado.

To mine this mother lode, private equity firms had to first access the functionaries at the pension fund who controlled these allocations, and while there is no single powerful intermediary in the class of Sydney Korshak, there are legions of less visible intermediaries called, "placement agents," who use their political contacts, financial experience, powers of persuasion, and other means to extract pension fund money for private equity firms.

Indeed, it is now a multi-billion dollar industry. In return for inducing pension fund officials to invest in such deals, they get a cut from the private equity firm of usually between 1 and 3 percent of the total commitment. Since placement agents get nothing if they fail, they have a powerful incentive to do what is necessary to close the deal. The question currently concerning New York State Attorney General Andrew Cuomo, the SEC, and some 36 other state attorneys general law is: How do they accomplish their amazing feat of inducement?

According to Cuomo, who is spearheading the investigation, there is "a matrix of corruption, which grows more expansive and interconnected by the day." So far six people have been charged criminally and two people have pleaded guilty. Among those charged with "enterprise corruption" are Henry "Hank" Morris, and his friend David J. Loglisci. Morris, a former top aide to former New York Comptroller Alan Hevesi, who was in charge of New York's $122 billion pension, raked in at least $15 million dollars in "placement" fees from private equity firms. Former deputy comptroller Loglisci, the top investment officer of the state's pension fund, allegedly got paid from Morris and had private equity firms steer money into a curious movie venture called *Chooch*, which he and his brother produced, and whose plot, aptly enough, concerns a bag of mystery money. Both Morris and Loglisci deny any wrongdoing and are currently awaiting trial.

Cuomo's game plan, according to one lawyer knowledgeable about the investigation, is "to work his way up the food chain." This strategy, as the lawyer explained, involves making deals with less-culpable parties in return for their cooperation and testimony against other private equity firms whose real exposure comes not from their making payments to placement agents, which is perfectly legal in most states, but from their failure to disclose them or, even worse, "disguising them" as sham transactions.

Consider the recent guilty plea of placement agent Julio Ramirez Jr. to a misdemeanor securities fraud violation. According to Cuomo's office, Ramirez, who worked for the placement agent Wetherly Capital Group in Los Angeles, entered into a "corrupt arrangement" with Hank Morris to get private equity firms $50 million in investments from New York's $122 billion Common Retirement Fund. Ramirez then split his fees with Morris, but did not disclose Morris' involvement. Since that omission made him vulnerable to prosecution, he elected to cooperate with Cuomo's investigation, further tightening the prosecutorial vice on Hank Morris.

Cuomo also made a shrewd settlement with the Carlyle Group, one of the nation's largest private equity firms. It had a joint venture with Riverstone Holding, a private equity company headed by David M. Leuschen, which had paid $10 million to Hank Morris' firm for its help in getting it $730 million in investments from the New York Pension fund. Leuschen, a former Goldman Sachs oil specialist, had also invested $100,000 of his own money in *Chooch*.

"We have a case against Riverstone," Cuomo stated in a press conference. Carlyle itself had less exposure to this mess. Not only had it fully disclosed its own payments to Morris's firm, but it could also deny any knowledge of the *Chooch* investment since it had been made by Riverside's managing director, Leuschen. Unable to prove otherwise, Cuomo made a deal with Carlyle. The firm agreed to pay a $20 million fine, desist from any future use of placements agents, and fully cooperate in the ongoing investigation. In addition, Carlyle, issued statement saying that it "was victimized by Hank Morris's alleged web of deceit." It also moved to sue both him and his company for more than $15 million in damages, further ratcheting up the pressure on Morris to make a deal.

The Carlyle settlement does not bode well the 20 other investment firms ensnared in Cuomo's Matrix. The Quadrangle Group, for example, paid Morris placement multi-million dollar fees for assisting it get pension fund money in New York, New Mexico, and California and also invested money in the mysterious *Chooch* venture. But, unlike Carlyle, Quadrangle failed to disclose the fees it paid Morris' company to New York City Pension Fund and the Los Angeles Fire and Police Pensions Fund. Nor can it separate itself from its *Chooch* investment by, as Carlyle did, shifting responsibility to another party, since it had one of its own private equity holdings buy the video rights to the movie.

One possible problem for Cuomo, and for the SEC investigation, is the prominence of Quadrangle's then-chairman Steven Rattner, who in 2009 became a key member of President Obama's task force that is presently desperately working to save General Motors and the American car industry. But Cuomo has pledged that “The investigation will continue until we have unearthed all aspects of this scheme.” As he is both a tenacious and ambitious investigator, he will undoubtedly topple more dominoes as he proceeds up the food chain. Will he break the matrix of corruption? Stay tuned.

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