



Legal Risk Management Tip
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IN THE SPOTLIGHT: CALIFORNIA AND NEW YORK CITY - NEW REGULATIONS GOVERNING SOLICITATION OF PUBLIC PENSIONS FUNDS

In response to a perception that political contributions contribute to the selection of investment advisers to oversee public pension plan assets, on July 1, 2010, the Securities Exchange Commission (the “SEC”) adopted the Pay-to-Play Rule.¹ Among other things, the Pay-to-Play Rule precludes federally registered investment advisers from receiving compensation for the management of public pension fund assets for a period of two years following a political contribution to a person who is in a position to influence the award of the management of the pension fund’s assets.² Recently, California and New York City have adopted their own regulations for asset managers that seek to solicit business from state or local pension funds, respectively.³ This month’s legal tip will focus on California’s recently implemented law and the recently issued New York City advisory opinion which may require individuals engaged in such activities to register as lobbyists.

A. California: “Placement Agents” Now Required to Register as “Lobbyists”

In September of last year, the California legislature passed AB 1743, thus extending the Political Reform Act of 1974 (“Reform Act of 1974”), which traditionally has been used to govern lobbying activities, to supervise “External Managers” and require “Placement Agents” to register as lobbyists.⁴ As adopted, AB 1743 defines an “External Manager” as a person or entity who is retained or seeking to be retained by a state public retirement system in California to manage a portfolio of assets for compensation.⁵ A “Placement Agent” is an individual or entity hired, engaged, or retained by, or serving for the benefit of or on behalf of, an external manager, or on behalf of another placement agent, who acts or has acted for compensation as a finder, solicitor, marketer, consultant, broker, or other intermediary in connection with the offer or sale of the securities, assets, or services of an external manager to a public retirement system or pension fund in California.⁶ “Placement Agents,” therefore, promote “External Management” services to California state pension funds. Both terms are broadly defined and have far reaching effects for managers interested in soliciting business from California state pension funds. Accordingly, individuals whose primary duties include marketing investment management services to state

¹ See Political Contributions by Certain Investment Advisers, Advisers Act Release No. 3043 (July 1, 2010) (Adopting Release), available at <http://www.sec.gov/rules/final/2010/ia-3043.pdf>, hereinafter the “Pay-to-Play Rule”.

² 17 C.F.R. § 275.206(4)-5 (2010).

³ California Assembly Bill 1743, available at http://www.leginfo.ca.gov/pub/09-10/bill/asm/ab_1701-1750/ab_1743_bill_20100930_chaptered.pdf (hereinafter, AB 1743); New York City Notice from the City Clerk, available at <http://www.cityclerk.nyc.gov/downloads/pdf/cc-lobbyinglawletter.pdf> (hereinafter, Notice of the City Clerk); New York City Opinion of the Corporation Counsel, available at <http://www.cityclerk.nyc.gov/downloads/pdf/placementagents.pdf> (hereinafter, Opinion of the Corporation Counsel).

⁴ AB 1743.

⁵ *Id.*

⁶ *Id.*

pension funds assuredly are “Placement Agents,” while whose interaction with state pension funds that are more ministerial in nature are probably not “Placement Agents.”

1. Exceptions to the Definition of “Placement Agent”

The following are two important exclusions from the definitions of “Placement Agent” under AB 1743 for those who would otherwise be deemed to be such:

- One-Third Rule – personnel of external managers who spend one-third or more of his or her time managing securities; and
- Registered Investment Advisor Exception – external manager personnel if the external manager is: 1) registered as an investment adviser or broker-dealer with the SEC; 2) has been selected through a competitive bidding process; and 3) has agreed to a fiduciary standard of care.⁷

Notably, the competitive bidding portion of the Registered Investment Advisor Exception must include the entire process of obtaining a contract from the state pension fund, from the time the pension system issues a Request for Proposal (“RFP”) until the contract is awarded.⁸ The California Fair Political Practices Committee (“FPPC”) considers communication with California public retirement systems prior to the issuance of an RFP to fall outside the protection of this exception. Therefore, communication before receiving the RFP may invoke “Placement Agent” status.

It is important to specify that AB 1743 only applies to lobbying state retirement funds, such as the California State Teachers’ Retirement System (CalSTRS) and the California Public Employees’ Retirement System (CalPERS), while local lobbying ordinances still govern the solicitation of local pension funds and whether such activities require registration as lobbyists.⁹

2. Requirements for Placement Agents and External Managers

Those who meet the above definition of “External Manager” under AB 1743 must do the following:

- Register as a lobbyist employer with the state;
- Produce a “Placement Agent” information sheet, current photograph for each “Placement Agent” and pay a fee of \$50 for each agent;
- File yearly renewal certification statements for each agent;
- File quarterly reports that itemize activity expenses for lobbying purposes (including salary paid to agents); and
- Report all contributions of \$100 or more made to elected officials or candidates running for office.

Those who satisfy the definition of “Placement Agent” under AB 1743 must comply with the following requirements:

- Register with the California Secretary of State (renewed annually);

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

- Complete an ethics course taken in California within 12 months of registration, and repeated biannually;
- Not give gifts to public officials that exceed more than \$10 per month in aggregate;
- Not make campaign contributions to elected officials or candidates seeking office in agencies that they are registered to lobby; and
- Not accept compensation contingent upon the defeat, enactment or outcome of proposed legislation or agency action.¹⁰

Failure to comply with the broadened scope of Reform Act of 1974 under AB 1743 is a misdemeanor and may subject the violator to a fine of up to the greater amount of \$10,000 or three times the amount the person failed to report properly.¹¹

B. New York City's Law Governing Placement Agents

In March, the corporate counsel of New York City issued an opinion suggesting that influencing the decisions of those in control, including their employees and staff, of the city pension funds and the investments of those funds is considered “lobbying,” and are therefore subject to the New York codes regulating lobbyists.¹² New York City has adopted a broad definition of a lobbyist in the “New York City Lobbyist Act” which includes those who influence the “disbursement of public monies,” which will now likely be determined to encompass investment managers, including their employees and staff, and require them to register as lobbyists and be subject to the requirements and restrictions of lobbyists.¹³ In an advisory opinion dated December 28, 2010 issued by the Office of the City Clerk regarding the lobbying law, New York city officials made it clear that they intended to regulate placement agents and other third parties paid to influence investments by the city’s pension funds.¹⁴ Likewise, any person that reasonably anticipated over \$2,000 in aggregate compensation from solicitation activities is considered a “Placement Agent.” Under New York City’s expanded definition of “Placement Agents,” these individuals must:

- Register as a lobbyist with the City of New York and pay a \$150 fee;
- Submit all retainer/employment agreements to the City;
- Re-file the registration statement annually;
- File bi-monthly reports due 15 days after the end of each period (bi-monthly report includes all fundraising and political consulting activity engaged in by the “Placement Agent.”);
- Disclose compensation paid or owed by the lobbyist employer;
- Both the “Placement Agent” and “External Manager” must maintain detailed records of all compensation and related expenditures of \$50 or more for at least five years; and
- Receive no compensation contingent upon legislative, executive, or administrative action.

¹⁰ *Id.*

¹¹ *Id.*

¹² Opinion of the Corporation Counsel.

¹³ Notice from the City Clerk.

¹⁴ Notice from the City Clerk.

Final Thoughts

In light of the California's and New York City's expanded definition of "lobbyist," investment advisers and others who engage in or anticipate engaging in the solicitation of public pension funds should educate their employees and associates on their obligations to register as lobbyists and on how to conform their activities to avoid running afoul of these laws.

For more information about this topic and other legal services, please contact us at (619) 298-2880, info@jackolg.com or visit www.jackolg.com. Thank you.

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