

UPDATE ON CALIFORNIA LOBBYIST REGISTRATION REQUIREMENTS FOR PLACEMENT AGENTS AND REGISTRATION AND DISCLOSURE REQUIREMENTS FOR LOBBYING FIRMS AND LOBBYIST EMPLOYERS

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Investment Management Alert

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This is to update our November client alert [California Regulates Investment Managers' Placement Agents and Solicitors as Lobbyists](#) about the new California placement agent lobbyist law, Assembly Bill 1743 ("AB 1743"). Effective January 1, 2011, individuals who work for third party placement agents as well as certain individuals who work for hedge fund managers, hedge funds, investment advisers and other fund managers (collectively "external managers") who solicit California state pension plans may be required to register as lobbyists with the Fair Political Practices Commission (the "FPPC") pursuant to the California Political Reform Act ("Political Reform Act"). The FPPC is the agency that enforces the Political Reform Act. It is important to remember that, in addition to sales staff of third parties, any in-house personnel, such as marketing or sales staff, who act for compensation as an intermediary, either directly or indirectly, "in connection with the offer or sale of the securities, assets or services" of an external manager to a California state public retirement system may be required to register as a lobbyist with the FPPC. In addition, the external managers and the third party placement agents that employ such individuals may have to register as Lobbyist Employers or Lobbying Firms.

Lobbyists are also prohibited from accepting or agreeing to accept contingent compensation with respect to a decision by a state agency to enter into a contract to invest state public retirement system assets on behalf of a state public retirement system. In addition, placement agents, including entities as well as non-exempt individuals, who solicit a potential investment by a local public retirement system must comply with any applicable requirements that the local government agency imposes.

Our November alert provided an overview of AB 1743, which amended the Political Reform Act and other provisions of the California Government Code to require certain solicitors of state pension plans to register as lobbyists. This alert updates our November alert with respect to lobbyist and other registration requirements and pension plan disclosure policies in connection with the solicitation of state and local pension plans.

California State Pension Plan Requirements

Placement agents, as defined in the Political Reform Act, must register as lobbyists with the FPPC in connection with the solicitation of a state pension plan. The November alert sets forth the definition of "placement agents" in AB 1743, which encompasses typical third party intermediaries as well as in-house sales and marketing

personnel.^[1] AB 1743 has only been effective since January 1, 2011, and many open questions regarding its application remain. In December, the FPPC produced a Fact Sheet to resolve some of the open issues. The FPPC recently updated the Fact Sheet. In addition, the FPPC Staff intends to meet with other state agencies that regulate placement agents and affected parties to explore the adoption of regulations to clarify the application of AB 1743.

The FPPC has indicated in its Fact Sheet that an individual may not contact CalPERS or CalSTRS regarding an external manager unless the individual is registered as a lobbyist and has identified the external manager for which the solicitation is performed on the lobbying registration forms. As of January 1, 2011, the FPPC must have on file the registration forms that identify the parties engaging in the solicitation before any communications with CalPERS or CalSTRS regarding the external manager may begin. Note that some individuals may fall outside the definition of “placement agent,” and therefore would not be required to register as a lobbyist. (See the discussion below and our [November alert](#) for further information.)

Exemptions

■ Portfolio Manager Exemption

Not included in the definition of “placement agent” under the Political Reform Act, as well as the definition under other sections of the Government Code, are individuals employed by or associated with an external manager who spend one-third or more of their time managing the securities or assets of the external manager. According to a staff report on the CalPERS revised disclosure policy, CalPERS, a co-sponsor of AB 1743, has indicated that the one-third portfolio management time requirement was not intended to bring within the definition of “placement agent” personnel of an external manager that do not meet that requirement but that are not generally considered as placement agents, even if they may have some limited and intermittent role in the fundraising or engagement process. CalPERS has indicated that individuals engaged for other than solicitation or fundraising purposes that have a limited and intermittent role in the fundraising or engagement process, such as a Chief Financial Officer, generally are not placement agents and would not be required to register as a lobbyist. (The FPPC Fact Sheet does not address this issue.)

■ Competitive Bidding Process Exemption

Also excluded from the definition of “placement agent” under the Political Reform Act are employees, officers or directors of external managers that are registered investment advisers or broker-dealers, or of affiliates of such external managers, that have been selected through a competitive bid process and who have agreed to a prudent person standard of care set forth in the California constitution for board members of the state pension systems; some could argue that this standard could encompass both a prudent person standard of care and a duty of loyalty based on the statutory and constitutional language. CalPERS' standard contract contains such an agreement.

There is a question about the interpretation and operation of the competitive bidding exception to the definition of placement agent. The language of two of the conditions to the competitive bidding exception is in the past tense, *i.e.*, the external manager “has been selected” through a competitive bidding process and the external manager “has agreed” to the fiduciary standard of care. Thus, it is not clear when and

how the exemption is effective; before the RFP process begins, during the process or upon selection. It also is not clear whether, if an individual registers for pre-RFP solicitation, the individual may accept contingent compensation after the RFP selection process is completed, assuming all three conditions are met by the external manager. The FPPC did not address this issue in its Fact Sheet or in a recent update of its Fact Sheet. We may seek further guidance on this issue if guidance is not otherwise forthcoming.

Other Requirements Under the Political Reform Act

If an individual solicits a state retirement system on behalf of an external manager and the solicitor is required to register as a lobbyist pursuant to the Political Reform Act, the external manager may also have to comply with requirements in the Political Reform Act. The external manager, as well as any of its subsidiaries or affiliates who directly or indirectly provide compensation to a lobbyist, may be required to provide disclosure reports to, and register with, the FPPC. In addition, if an external manager engages a third party placement agent who employs lobbyists, both the external manager and the third party placement agent are required to provide disclosure reports to, and register with, the FPPC.

The Political Reform Act distinguishes among a “Lobbyist,” a “Lobbying Firm,” a “Lobbyist Employer” and a “\$5,000 Filer.” Each category has different disclosure requirements. Lobbyists, Lobbying Firms and Lobbyist Employers must file a registration statement with the FPPC, and renew such registration every even-numbered year, as applicable. Lobbyists, Lobbying Firms, Lobbyist Employers and “\$5,000 Filers” must make quarterly disclosure filings with the FPPC, as applicable. The Political Reform Act also imposes restrictions on campaign contributions and gifts to public officials, which depend on the category in which an individual or an entity falls. In addition, Lobbyists must take an ethics course with the FPPC in California within 12 months of registration, and every two years thereafter. The ethics course currently is not offered online.

The application of these categories in connection with the solicitation of a state pension plan depends on the facts and circumstances. Multiple filings may be required in connection with one solicitation, and the types required depend on the category in which the external manager and other entities that provide compensation in connection with the solicitation fall. For example, a Lobbyist may be employed by an entity that is a third party placement agent, and that entity is under contract with an external manager to solicit an investment or engagement by the state plan on behalf of the external manager. In this case, the employer of the Lobbyist would need to register as a Lobbying Firm, and the external manager would need to register as a Lobbyist Employer unless an exemption applies.

California Local Pension Plan Requirements

AB 1743 requires persons acting as placement agents (including both entities and individuals) in connection with a potential investment by a local pension system to register, file reports and otherwise comply with local requirements. All external managers, third party placement agent firms and their respective sales and other personnel (including in-house employees of an external manager) who contact a local California plan regarding a potential new investment by that plan need to be aware that the locality may have lobbying and other registration and reporting requirements for the firms and/or such personnel. The lobbying ordinances at the local level often

track the framework of the Political Reform Act, although each ordinance has its own variations. Each locality may adopt its own definition of what constitutes lobbying and have its own lobbying registration requirements. If a locality requires a solicitor to register as a lobbyist, or a firm to register as a Lobbying Firm or some similar designation, the solicitor and/or the firm must register with that locality (rather than with the FPPC). While some localities may amend their lobbying ordinance to include placement agents in the definition of a lobbyist, similar to the amendment of the Political Reform Act by AB 1743, other localities may interpret their existing ordinances to define contact between external managers, third party placement agents or their respective personnel and the retirement system for a potential investment as lobbying activity.

The potential for variation among the lobbying ordinances makes navigating the local pension plan requirements in California a compliance challenge. For example, some localities may not consider an individual to be a “lobbyist” until there have been at least 5 contacts in a consecutive three-month period with an employee of the locality or until the individual spends at least 30 hours in a consecutive three-month period engaged in solicitation; other localities may not have such minimum thresholds when defining a lobbyist. In addition, each locality may have a different type of penalty for a violation of its lobbying ordinance.

If you would like further information about a particular California locality, please contact one of the authors of this alert.

Pension System Placement Agent Disclosure Policies for External Managers

In addition to the requirements of AB 1743, under a previously adopted California law (AB 1584), each state and local plan was required to adopt a placement agent disclosure policy for external managers. AB 1584 requires external managers to submit extensive disclosure about their use of placement agents pursuant to a plan's disclosure policy. A placement agent for this purpose includes entities and includes individuals who would otherwise be exempt under the competitive bidding exception. Thus, the plan disclosure policy may request information about placement agents (as defined in the disclosure policy), though the placement agents would not be required to register with the FPPC if the competitive bidding exception applies, as described above, because the individuals would not be placement agents and thus lobbyists under the Political Reform Act, and the entities, the external manager or its affiliate, would not be Lobbyist Employers or Lobbying Firms under the Political Reform Act.

CalPERS adopted a policy in 2009 with more detailed requirements than AB 1584. This policy was recently amended and became codified as a new section to the California Code of Regulations in January, and compliance is now required by law. The penalties for breach of the CalPERS disclosure policy can be quite severe, and may include a penalty of up to two years of management fees and the immediate withdrawal of CalPERS from a private investment vehicle, which includes a private fund with a lock-up period, without penalty. An external manager is in breach of the CalPERS disclosure policy if, among other items, it fails to update any change in material information about its third party placement agent within 14 days from when the external manager knew or should have known about the change. These penalties are only part of the CalPERS disclosure policy and are not required by AB 1584, though some localities in California have opted to adopt a disclosure policy with these penalties.

Requirements by Other States and Localities

Compliance personnel also should keep apprised of potential regulations by other states regarding the solicitation of public pension systems by in-house sales personnel of an external manager and by third party solicitors. The pension systems of other states or their localities may have adopted lobbyist registration requirements that are similar to those in the Political Reform Act, or may adopt such requirements in the future. For example, the Massachusetts Public Employee Retirement Administration Commission is in the process of adopting regulations requiring disclosures relating to the use of third party placement agents and in-house sales personnel of an external manager. In addition, the City Clerk of New York sent letters to investment firms and solicitors that indicate that an external manager that has marketing staff or that has a third party solicit an investment by any of the five City pension systems may need to make certain annual and periodic filings with the City Clerk and comply with certain other requirements. Our alert, [New York City Regulates Investment Managers' and Placement Agents' Solicitation of City Pension Systems](#), published in February 2011, provides greater details on the requirements with respect to the five New York City pension systems.

Note:

[1] AB 1743 amended both the Political Reform Act and other provisions of the Government Code (“Pension Law”). It defined “placement agents” under the Political Reform Act as individuals, but as both individuals and entities under the Pension Law. It defined “lobbyist” as a “placement agent” as defined in the Political Reform Act. The Pension Law prohibits entities or individuals, with certain exceptions, from acting as placement agents in connection with any potential investment by a state public pension system unless the entity or individual is registered with the FPPC as a lobbyist and complies with the Political Reform Act. The FPPC in its Fact Sheet interpreting the statute states that for purposes of its fact sheet, “placement agent” means an individual who must register as a lobbyist. The FPPC appears to be taking the position that individuals should register as Lobbyists and that entities (and certain sole proprietorships) should register as Lobbyist Employers or Lobbying Firms. While this position may make sense (in spite of the statutory language), it raises a question whether entities that are placement agents under the Pension Law but which register as Lobbying Firms under the Political Reform Act are actually prohibited from accepting contingent compensation, because the prohibition with respect to state pension plan investments applies only to placement agents as defined under the Political Reform Act, which applies only to individuals.

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