



Government Law Alert

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California Extends “Pay-to-Play” Laws to Certain Placement Agents

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Recently the Fair Political Practices Commission (FPPC) provided guidance regarding the new California law regulating placement agents as lobbyists. Specifically, the FPPC provided guidance on the limitations to the registration exceptions carved out under the new law, including what activities and communications constitute “the competitive bidding process” and are therefore exempted by the Registered Investment Advisor Exception, whether it is possible to be systematically exempt from registering as a lobbyist for subsequent lobbying under the Registered Investment Advisor Exception, and whether local placement agents qualify for exemption from the law under either the One-Third Exception or the Registered Investment Advisor Exception.

What Is the New California Law Regulating Placement Agents As Lobbyists?

In the wake of accusations involving influence peddling and pay-to-play at the California Public Employees’ Retirement System, California recently enacted Assembly Bill 1743 (AB 1743) which extended the reach of the Political Reform Act of 1974 by including “placement agents” in the definition of “lobbyist.” Specifically, AB 1743 requires “placement agents” to register as lobbyists with the state if they sell, or are seeking to sell, the securities, assets, or services of an “external manager” to California state public retirement systems.¹

Who Is a Placement Agent?

The term “placement agent” is broadly defined in AB 1743 as “any person 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 board or an investment vehicle, either directly or indirectly.” This definition includes an investment manager’s employees, officers, directors, and affiliates that deal with a retirement system and third-party placement agents.

As a result, a placement agent or an external manager’s employee must register as a lobbyist if the investment firm hiring the placement agent is an “external manager.” Under AB 1743 an “external manager” means either of the following: (1) “a person who is seeking to be, or is, retained by a state public retirement system in California to manage a portfolio of securities or other assets for compensation,” or (2) “a person who is engaged, or proposes to be engaged, in the business of investing, reinvesting, owning, holding, or trading securities or other assets and who offers or sells, or has offered or sold, securities to a state public retirement system in California. Like “placement agent,”

the term “external manager” is broadly defined. Early this month the Fair Political Practices Commission, however, indicated that “external manager” does not include entities providing “custodial banking services” even where the tasks undertaken include holding or managing a retirement system’s funds because “the tasks that a custodial banking service undertakes are primarily akin to safeguarding funds, providing reporting and currency exchange, and (among other services, rather than being ‘in the business of investing, reinvesting, owning, holding, or trading securities.’”²

Two Exceptions Limiting the Reach of the AB 1743 to Employees of External Managers

AB 1743 carves out two exceptions to the term placement agent. First, the so-called One-Third Exception provides that an external manager employee who spends one-third or more of his or her time managing securities held by the external manager is not considered a “placement agent” and is therefore not subject to the strictures imposed by AB 1743. Second, if the individual employee does not satisfy the One-Third Exception, that individual can still be exempt if the external manager can satisfy the so-called Registered Investment Advisor Exception. Under this exception, an employee is not a placement agent if the external manager (1) “is registered as an investment adviser or a broker-dealer with the Securities and Exchange Commission or, if exempt from or not subject to registration with the Securities and Exchange Commission, any appropriate state securities regulator”; (2) “has been selected through a competitive bidding process” that is statutorily defined; and (3) “has agreed to a fiduciary standard of care” as applied to the retirement fund board. An individual falling under either of these exceptions is not considered a “placement agent” and thus would not be a “lobbyist” under the Political Reform Act of 1974.

Unfortunately, there also appear to be some limitations to the Registered Investment Advisor Exception. According to recent guidance provided by the FPPC, the competitive bidding process described in the Registered Investment Advisor exception “must include the entire process of obtaining a contract, from the time the public pension system issues an RFP until the contract award.”³ However, according to the FPPC, communications with the California state public retirement systems prior to the issuance of an RFP “do not fall into the exception and may result in an individual qualifying as a placement agent. Additionally, for the exception to apply the retirement system must have actually released an RFP and any activity before such action would not be included within the exception.”⁴ For example, if an individual pitches the securities, assets, or services of an external manager to a retirement system prior to the release of an RFP, that individual must register as a lobbyist pursuant to AB 1743. In addition, the exemption does not “systematically exempt a placement agent” in that it does not apply to subsequent efforts by the placement agent to obtain contracts for additional services from the same retirement system or fund.⁵ Lastly, the exemption does not apply to RFQs or RFIs—only to the RFP process.⁶

Local Placement Agents

According to new guidance by the FPPC, the exceptions in Section 82047.3 of AB 1743 do not apply to local placement agents in Section 7513.8(d). The AB 1743 exceptions are limited to placement agents that are working in connection with a state public retirement system—not local systems.⁷

Requirements and Restrictions on Placement Agent Lobbyists

Individuals who are deemed to be “placement agents” by AB 1743 are now subject to a variety of new requirements and restrictions in their new role as lobbyists. Among other things, placement agents must:

- Register as a lobbyist with the California Secretary of State and renew the registration biennially;

- File quarterly reports detailing any fees, gifts, or compensation paid to or received from public officials, including campaign contributions of \$100 or more to state candidates or elected officers;
- Complete an in-person ethics course biennially; and
- Register and file reports with local government agencies and to comply with any applicable requirements imposed by any local government agency on lobbyists.⁸

Perhaps more significantly, pursuant to AB 1743, placement agent lobbyists are prohibited from:

- Accepting or agreeing to accept any payment that is in any way contingent on “the defeat, enactment or outcome of any” proposed investment action;
- Making campaign contributions to public officials or candidates for positions related to a state pension or retirement fund; and
- Making gifts aggregating to more than \$10 in a calendar month to certain public officials, including board members or CalPERS and CalSTRS;

Senate Bill 398 Aims to Clarify AB 1743

Recently California State Senator Ed Hernandez, who authored AB 1743, introduced a second bill, Senate Bill 398 (SB 398), designed to refine some of the terms in AB 1743 and clarify that AB 1743 does not apply to broker-dealers engaged in general secondary and primary securities transactions with state retirement systems. The current version of SB 398, last amended on March 24, 2011, is still in the committee process. A hearing before the Senate Elections and Constitutional Amendments Committee has been scheduled for May 3, 2011. To date, there has been no opposition to SB 398 and the bill has the support of the California State Treasurer, the California State Comptroller, the CalPERS Board of Administration, and the Security Industry and Financial Markets Association (SIFMA).

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Endnotes

- 1 The California state public retirement system currently consists of the California Public Employees' Retirement System (CalPERS) and the California State Teachers Retirement System (CalSTRS).
 - 2 Letter from John W. Wallace, Asst. General Counsel, Fair Political Practices Commission at 7 (Apr. 7, 2011).
 - 3 Letter from John W. Wallace, Asst. General Counsel, Fair Political Practices Commission at 4 (Apr. 7, 2011).
 - 4 *Id.*
 - 5 *Id.* at 5.
 - 6 *Id.* At 4.
 - 7 Letter from John W. Wallace, Asst. General Counsel, Fair Political Practices Commission at 2 (Mar. 23, 2011).
 - 8 For example, the City of Los Angeles requires that lobbyists register with and report lobbying activities to its City Ethics Commission.
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