

SB 398 Signed Into Law, Effective Immediately

Author: Harvey L. Leiderman, Partner, San Francisco

Author: Alexandra Poe, Partner, New York

Author: Jeffrey R. Rieger, Associate, San Francisco

Publication Date: October 14, 2011

Governor Brown Signs SB 398, Amendments to California Placement Agent Disclosures/Lobbyist Registration Laws

On Sunday, October 9, 2011, the last day of the period in which the governor could sign or veto pending legislation passed by the California Legislature, Gov. Brown signed into law Senate Bill 398 (Hernandez). The bill is the third in an annual series of acts passed by the Legislature, all designed to regulate the activities of investment managers soliciting business from California's public employee pension funds, in the wake of scandals and investigations over "pay-to-play" allegations at public funds nationwide.

The first enactment, in 2009, was AB 1584. That bill imposed disclosure requirements on "placement agents" engaged by "external" investment managers to garner a share of the investible assets of state and local pension funds. Each public employee pension fund in California was required to adopt a disclosure policy by mid-2010, including disclosure of placement agents' and managers' campaign contributions and gifts to board and staff members in the preceding 24 months.

AB 1584 was followed quickly in 2010 by AB 1743, a bill that broadened the definition of "placement agents" from outside third-party marketers to include in-house staff of investment management firms who were not engaged in asset management at least one third of their time. The bill also subjected investment managers and their placement agents to lobbyist registration, disclosure requirements, compensation and gift bans imposed at both the state and local government levels. AB 1743, however, did create a "safe harbor" not found in the original AB 1584, which exempted from *state* lobbyist requirements those managers who (a) were SEC-registered investment advisers or broker-dealers, (b) obtained the business through a competitive bidding process and (c) agreed to be subject to the California fiduciary standard imposed on public employee pension fund trustees.

This year's SB 398 attempts to clarify and ease somewhat the scope of California's placement agent/lobbyist requirements. The new enactment changes existing law in three key ways:

1. Clarifies that managers of securities and assets, whether directly or through managed funds, are all subject to disclosure and lobbyist rules regulating "external managers" and their "placement agents."

Managers subject to the placement agent disclosures, bans and lobbyist requirements include those managers of either a "portfolio of securities or other assets" or of "investment funds" - defined as "a private equity fund, public equity fund, venture capital fund, hedge fund, fixed income fund, real estate fund, infrastructure fund, or similar pooled investment entity..."

As amended, the definitions of "external manager," "investment fund" and "investment vehicle" clarify that: (a) SEC registered investment companies, like mutual funds, are not "investment funds" for purposes of the statute; (b) "external manager" includes any adviser to a portfolio of securities (i.e., a managed account not organized as a vehicle) or certain vehicles in which a covered public pension plan is a majority investor; and (c) publicly-held investment advisers are not treated as "external managers" of investment funds solely because of investment by covered public pension plans in the adviser's own shares."

2. Clarifies that selling "securities" includes sale of an "ownership interest" in an investment fund entity (e.g., an LP or LLC interest).

3. Extends the three-prong exemption from state lobbyist registration for managers of state retirement system funds to a similar exemption from *local* lobbyist registration for managers of *local* retirement system funds.

If manager is (a) an SEC-registered investment adviser or broker-dealer, (b) participates in a competitive bidding process and (c) agrees, if selected, to the California "fiduciary" standard, the manager need not comply with any local lobbyist registration requirements.

Caveat: the new law may conflict with the views of local officials about the applicability of their own regulations!

SB 398 was enacted as an "urgency" measure, meaning it takes effect immediately upon signing instead of January 1, 2012. The bill is now law.

About Reed Smith

Reed Smith is a global relationship law firm with more than 1,600 lawyers in 23 offices throughout the United States, Europe, Asia and the Middle East.

The information contained herein is intended to be a general guide only and not to be comprehensive, nor to provide legal advice. You should not rely on the information contained herein as if it were legal or other professional advice.

The business carried on from offices in the United States and Germany is carried on by Reed Smith LLP of Delaware, USA; from the other offices is carried on by Reed Smith LLP of England; but in Hong Kong, the business is carried on by Reed Smith Richards Butler. A list of all Partners and employed attorneys as well as their court admissions can be inspected at the website <http://www.reedsmith.com/>.

© Reed Smith LLP 2011. All rights reserved.