Client Alert

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Private Equity

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California Adopts "Pay-to-Play" Restrictions

On October 11, California became the latest state to implement reforms designed to prevent placement agents from using campaign contributions, gifts, employment opportunities and other incentives to influence investment decisions by public pensions. In contrast to reforms adopted in Illinois, New Mexico and New York and proposed by the SEC, which to varying degrees prohibit the use of placement agents, Assembly Bill 1584 seeks to curb "pay-to-play" activities by requiring expanded disclosure by placement agents and asset management firms and restricting the ability of public pension employees to engage in self-interested transactions or act as lobbyists. AB 1584 goes into effect immediately but some disclosure requirements may not be fully implemented until June 30, 2010.

Required Disclosure by Placement Agents

Any placement agent, prior to acting as a placement agent in connection with any potential investment by a public pension or retirement system, must disclose to the board of such pension or system all campaign contributions and gifts that it has made to any member of the board during the prior 24-month period. Any subsequent campaign contributions or gifts made to a member of the board while the placement agent is receiving compensation in relation to investments by the pension or system must also be disclosed.

"Placement agent" is broadly defined and includes any person or entity hired, engaged, or retained by, or acting on behalf of, an asset management firm or another placement agent, as a finder, solicitor, marketer, consultant, broker, or other intermediary to raise money or investment from, or to obtain access to, a public retirement system in California, directly or indirectly, including through an investment vehicle.

Mandated Disclosure Policies for Public Pensions

Each California public pension and retirement system must develop and implement on or before June 30, 2010 a policy requiring the disclosure of payments to placement agents in connection with investments in or through asset management firms.[1] The policy must require the disclosure of the following:

- the existence of relationships between external managers and placement agents;
- a resume for each officer, partner, or principal of the placement agent detailing the person's education, professional designations, regulatory licenses, and investment and work experience;
- a description of any and all compensation of any kind provided, or agreed to be provided, to a placement agent;
- a description of the services to be performed by the placement agent;
- a statement whether the placement agent, or any of its affiliates, are registered with the Securities and Exchange Commission or the Financial Industry Regulatory Authority, or any similar regulatory agent in a country other than the United States, and the details of that registration or explanation as to why no registration is required; and
- a statement whether the placement agent, or any of its affiliates, is registered as a lobbyist with any state or national government.

Public pension and retirement systems may not enter into any agreement with an asset management firm if such firm has not agreed in writing to comply with the disclosure policy. Any asset management firm or placement agent that violates the policy will be prohibited from soliciting investments from such public pension or retirement system for five years after the violation was committed (although the board of the pension or system may reduce the length of the ban through a majority vote at a public session upon a showing of good cause).

Post-Employment Restrictions

To eliminate the conflicts of interest that result when board members and employees of public pensions and retirement systems accept lucrative positions as placement agents or managers immediately following their retirement from the public sector, AB 1584 expands existing restrictions on the employment of board members, executive officers and other designated employees of public pensions as lobbyists. Such persons are now prohibited from attempting to influence investment decisions by retirement boards or systems within two years of leaving their position. AB 1584 removes an exception to this post-employment restriction that was previously available to those who had been in their position for less than five years and expands the persons subject to these provisions.

Prohibition of Self-Interested Transactions

Members and employees of the board of a public pension or retirement system are prohibited under AB 1584 from engaging in various self-interested transactions with public pensions and retirement

[1] A retirement board is not required to take any action detailed in these sections unless the board determines the actions are consistent with its fiduciary duties as set forth in the California Constitution.

systems. Such members and employees may not sell investment products to any public retirement system in California, have a personal interest in any investment made by the board, or borrow or use funds of the retirement system.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the attorneys below.

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