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State and Local Pay-to-Play and Public Records Laws

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AGENDA

- Potential lobbyist registration requirements
- State and local pay-to-play rules (with a comparison to SEC pay-to-play rule, Advisers Act Rule 206(4)-5)
- Restrictions on use of placement agents and/or payment of contingent compensation
- Restrictions on gifts and entertainment
- Public records law considerations
- Practical guidance

POTENTIAL LOBBYIST REGISTRATION REQUIREMENTS

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LOBBYIST REGISTRATION

- Many states have adopted lobbying laws that require persons who and entities that seek to influence decision-making by public entities, including public pension plans, to register with those states as lobbyists
- In these states, third-party placement agents and their staff, as well as in-house sales and marketing personnel, are the most likely to be required to register
- California and Illinois are among the jurisdictions requiring lobbyist registration for investment management professionals and firms, in certain circumstances

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LOBBYIST REGISTRATION – EXAMPLES

- In California, a "Placement Agent," as defined in the Political Reform Act, must register as a "Lobbyist" with the Fair Political Practices Commission
  - A "Placement Agent" is a natural person, which can include, among other persons, sales or marketing personnel that seek to influence a state pension plan to invest the assets of the state pension plan, including investments through an investment contract with a manager. This can include the internal and external sales personnel of a fund sponsor
  - A "Placement Agent" does not include: (i) an individual who spends 1/3 or more of his or her time on portfolio management activities; or (ii) individuals who work for an SEC registered investment adviser or broker-dealer and the manager is participating in a competitive bidding process or has been selected and is providing services as a result of a competitive bid process and, once selected, manages the assets with a prudent person standard of care. (The competitive bidding exception applies during the competitive bidding process to all those competing, and not only to those selected)

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LOBBYIST REGISTRATION – EXAMPLES (*CONT'D*)

- In California, the following parties must register with the Secretary of State within 10 days of qualifying as such:
  - Lobbyist: an individual who is compensated to communicate directly with any state, legislative or agency official to influence legislative or administrative action on behalf of his or her employer or client. An individual who receives reimbursement only for reasonable travel expenses is not a lobbyist
  - Lobbying Firm: a business that is compensated to communicate directly with any state, legislative or agency official to influence legislative or administrative action on behalf of a client
  - Lobbyist Employer: an individual, business or other organization that employs a lobbyist or hires a lobbying firm
  - Lobbying Coalition: a group of 10 or more individuals, businesses or other organizations that pool their funds for the purpose of hiring a lobbyist or lobbying firm
- Ethics Training:
  - Every individual who registers as a lobbyist in California must periodically attend a lobbyist ethics course
  - If the course is not timely completed, the lobbyist's certification becomes void and the individual may not engage in lobbying activities until he or she takes the course and amends the certification

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LOBBYIST REGISTRATION – EXAMPLES *(CONT'D)*

- In Illinois, the term "lobbying" includes communications with an "official" for the ultimate purpose of influencing "executive actions," which include the approval by a State entity of a contractual arrangement
- Registration is made with the Illinois Office of the Secretary of State. To register, lobbyists and lobbying entities (which are the entities that have hired or retained a natural person to lobby) need to provide information such as contact information, a description of the lobbying activity and the lobbying entities' type of business. Lobbyists and lobbyist entities have a continuing duty to report any substantial change in their registration information
- Lobbyists must complete ethics training, and periodic expenditure reports are required
- Exception: Communications between an investment manager and a state agency that occur in response to a posted RFP do not trigger lobbyist registration obligations so long as there are no "lobbying expenditures" (such as payments for meals, travel, lodging, gifts or entertainment) on behalf of the staff or trustees of a plan Communications outside of these circumstances would require further analysis

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CONSEQUENCES OF STATE LOBBYIST REGISTRATION

- Consequences of Registering as a Lobbyist:
  - Ongoing reporting requirements for individual lobbyists and their employers;
  - Payment of registration fees; and
  - Prohibition on contingency fees (i.e., based on award of an advisory contract or investment in a fund) in some states
- Consequences of Not Registering as a Lobbyist:
  - Failure to comply with a state or municipal lobbying statute can result in a fine and, in some cases, rises to a misdemeanor
  - Potential termination of contract
  - Potential "Bad Actor" Disqualification:
    - A criminal conviction for failure to comply with lobbying laws could be considered a "disqualifying event," resulting in treatment as a "bad actor" for purposes of the Regulation D Rule 506 exemption

STATE AND LOCAL PAY-TO-PLAY RULES

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STATE AND LOCAL VARIATIONS ON SEC PAY-TO-PLAY RULE

- State and local pay-to-play rules may appear in state and local statutes and regulations
- Formal and informal positions taken by municipalities, cities and counties may also apply
- Also, specific plans may have adopted their own policies in addition to any applicable state- or local-level requirements
  - Sometimes positions appear in minutes of meetings of public officials or standardized contractual provisions or may only be clarified by direct communications with governing bodies
- Many of these laws and policies are in a state of flux and are subject to change

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STATE VARIATIONS ON CONTRIBUTION AND TIME-OUT PROVISIONS

- Some state restrictions are more expansive than the SEC Pay-to-Play Rule:
  - Connecticut looks back to the beginning of the previous election cycle – which, until the 2018 election, means a look back to January 2011 – with no *de minimis* exemption with respect to contributions to candidates for state treasurer by a principal of an investment services firm

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STATE VARIATIONS ON CONTRIBUTION AND TIME-OUT PROVISIONS (*CONT'D*)

- In New Jersey, contributions by an "investment management professional" associated with an investment manager are prohibited from making contributions in excess of $250 to a State official (which includes candidates for Governor) for whom the person is able to vote, with a two-year look-back
  - The $250 amount is below the *de minimis* amount in the SEC rule for candidates for whom a person is able to vote (which is $350); there is no *de minimis* amount permitted in New Jersey if the person is not entitled to vote for the candidate

STATE VARIATIONS ON CONTRIBUTION AND TIME-OUT PROVISIONS (*CONT'D*)

- Candidates to whom contributions are restricted may also be more restrictive than the SEC Pay-to-Play Rule:
  - For example, Connecticut restricts contributions to any exploratory, candidate or political committee established by, or supporting or authorized to support, certain candidates for state office or a party committee (which includes a state central committee as well as town committees)
  - Maryland requires persons doing business with the Maryland Government and persons employing lobbyists to file a Disclosure of Contributions. Reports are due every six months. There is also an initial report that a person doing business with the state is required to file at the time the government contract is entered into

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ADVISERS ACT CONTRIBUTION AND TIME-OUT PROVISIONS

- Advisers are prohibited from receiving compensation for providing advice to a "government entity" within two years after a "contribution" to an "official" of the government entity has been made by the adviser or by any of its "covered associates"
- An "official" for purposes of the Advisers Act rule is an elected official or candidate for political office if the office is directly or indirectly responsible for, or can influence that government entity's selection of the adviser
- The Advisers Act provides for a *de minimis* exception for contribution of up to $350 per election, to an elected official or candidate for whom the individual is entitled to vote, and up to $150, per election, to an elected official or candidate for whom the individual is not entitled to vote

RESTRICTIONS ON USE OF PLACEMENT AGENTS AND/OR PAYMENT OF CONTINGENT COMPENSATION

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SOLICITOR AND PLACEMENT AGENT RESTRICTIONS

- Certain states prohibit paying any contingency fee in connection with investments by a public investment fund with an investment manager or in the manager's funds:
  - Effective June 9, 2014, all five of the New York City Retirement Systems passed a resolution banning the use of placement agents across all investment classes
  - In February 2017, the Treasurer of the Commonwealth of Pennsylvania issued a directive prohibiting investment managers from using third-party placement agents for funds managed on behalf of the Commonwealth of Pennsylvania Treasury Department
- Prohibitions usually apply to payments of contingency fees to third-party placement agents but may also apply to contingency fees paid to employees
- Violation of contingency fee prohibition could be a felony in certain states

RESTRICTIONS ON GIFTS AND ENTERTAINMENT

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STATE VARIATIONS: RESTRICTIONS ON EXPENDITURES

- Many state statutes and/or rules contain restrictions on expenditures that are more restrictive than the SEC Pay-to-Play Rule:
  - Provision of Gifts and Entertainment:
    - Trustees, investment officers and employees in a position of investment discretion over a state retirement system are often prohibited from soliciting or accepting *anything of value*, including reimbursement of expenses
    - In many states, violation of gift statutes is a crime for both the recipient *and* donor
  - Many states have *de minimis* (*i.e.*, less than US$50; in some cases, less than US$10) exceptions to gift prohibitions; some states have no *de minimis exception*
    - In New York City, the Comptroller has implemented a policy prohibiting employees of the Comptroller's Office from accepting any gifts (including, but not limited to, meals and entertainment, loans, travel, hospitality or any other thing) whatsoever from any person or firm doing business or seeking to do business with the City
  - In California, the FPPC has audited state employees' receipt of gifts and entertainment, so keeping good records is important (especially records of what the state employee has paid for personally)

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STATE VARIATIONS: RESTRICTIONS ON EXPENDITURES (*CONT'D*)

- In certain states, providing gifts and entertainment can trigger lobbyist registration requirements
  - In Louisiana, "lobbying" includes communicating with an executive branch official to influence an executive branch action; however, registration is only required if the person makes an expenditure (which includes payment for food, drink or refreshment)
  - As discussed earlier, responding to an RFP in Illinois generally will not trigger lobbyist registration obligations unless there is an expenditure
- Many states or localities also require reporting of expenditures
- Pre-clearance before any expenditures are made on behalf of public employees or officials is advisable to avoid unknowingly triggering registration or reporting requirements

PUBLIC RECORDS LAW CONSIDERATIONS

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FEDERAL LAW: FREEDOM OF INFORMATION ACT

- Model for state and local public disclosure laws
- General principle is that all records held by a public agency are subject to public disclosure
- Exemption from disclosure to protect the interests of government and submitters of information
  - Trade Secret: a secret, commercially valuable plan, formula or device that is used for the making, preparing, compounding or processing of trade commodities and that can be said to be the end product of either innovation or substantial effort when there is a direct relationship between the information at issue and the productive process
  - Information that is:
    - Commercial or financial in nature
    - Obtained from a person
    - Privileged and confidential
      - Confidential: the kind of information that a submitter would not customarily release to the public

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EXCEPTIONS TO PUBLIC DISCLOSURE

- Trade secrets – very narrowly interpreted
  - Public policy is for transparency
  - Law may have provisions that expressly define a trade secret in the investment context
- Courts may balance the public interest in nondisclosure against the public interest in disclosure
  - Protect privacy of medical records
  - Release salary information of public employees

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HOW IS INFORMATION DISCLOSED?

- Public records requests
- On a public website of the agency
  - Increasingly common for investment information
  - Types of information usually provided:
    - Name of manager
    - Name of fund
    - Amount invested
    - Fees paid
    - Returns on investment
- Inadvertent disclosure by employees of an agency
- At an open meeting of a pension plan's board:
  - Discussed at the meeting
  - Materials presented by state employees or by manager personnel or handouts at the meeting
  - Online:
    - Live and/or recorded meetings
    - Posted materials
    - Agenda items
    - Board minutes

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WHO MAKES PUBLIC RECORDS REQUESTS?

- "Concerned" members of the public
- Journalists
- Competitors
- Data mining companies
  - Preqin

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WHAT IS A PUBLIC RECORD?

- Request for Proposals ("RFP"), Request for Information ("RFI"), etc.
  - A response to an RFP or RFI from a public agency is a public record
  - Generally, a response is subject to public disclosure once the procurement process has completed

WHAT IS A PUBLIC RECORD? (*CONT'D*)

- Fund or IMA Documents
  - Marketing materials
  - Fund governing documents or investment management agreements
  - Amount invested by public entity
  - Ongoing reporting, including performance information

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WHAT IS A PUBLIC RECORD? (*CONT'D*)

- Board Meetings
  - Speaking at a meeting:
    - Closed or open session
  - Materials at a meeting:
    - Closed or open session
  - Materials that are online:
    - Agenda
    - Audio or video recording
    - Board minutes

PUBLIC RECORDS LAW – SELECTED EXAMPLES

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NEW YORK FREEDOM OF INFORMATION LAW ("FOIL")

- FOIL is based on a presumption of access, except records or portions of records that fall within one of eleven categories of deniable records
- One category of "deniable records" includes trade secrets submitted to an agency by a commercial enterprise or derived from information obtained from a commercial enterprise and which, if disclosed, would cause substantial injury to the competitive position of the subject enterprise
  - Information submitted by an adviser pursuant to an RFP (or certain information provided to a NY entity investor on an ongoing basis) could potentially be considered "deniable" on this basis, and therefore, not subject to disclosure

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MASSACHUSETTS PUBLIC RECORDS LAW

- Information constituting trade secrets or commercial or financial information provided to an agency upon a promise of confidentiality is generally exempt from disclosure
  - Exemption may be helpful to protect certain information provided on an ongoing basis to a MA public entity investor; *however*, information submitted in connection with a contract bid or in compliance with a filing requirement does *not* fall under this exception
- Proposals and bids are not disclosed during the bidding process; however, once a contract has been awarded, all bids are potentially subject to public disclosure
- Information provided as part of an RFP or a compliance filing in Massachusetts could become public record

KENTUCKY AND DISCLOSURE IN CONNECTION WITH LITIGATION

- Kentucky Retirement System ("KRS") received a court order in connection with litigation between KRS members and the Governor's office requiring the provisions of copies of all KRS investment management contracts
- KRS provided investment managers with notice prior to turning over documents (48 hours)
- Remedy: seek protective order limiting disclosure

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CALIFORNIA – REQUIRED DISCLOSURES FOR ALTERNATIVE INVESTMENTS

- Section 6254(a) of California's Public Records Act provides that certain records regarding alternative investments in which public investment funds invest will not be subject to disclosure pursuant to this chapter, unless the information has already been publicly released by the keeper of the information. Such information includes:
  - Due diligence materials that are proprietary to the public investment fund or the alternative investment vehicle
  - Quarterly and annual financial statements of alternative investment vehicles
  - Meeting materials of alternative investment vehicles
  - Records containing information regarding the portfolio positions in which alternative investment funds invest
  - Capital call and distribution notices
  - Alternative investment agreements and all related documents
- "Alternative investment" means an investment in a private equity fund, venture fund, hedge fund, or absolute return fund

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CALIFORNIA – REQUIRED DISCLOSURES FOR ALTERNATIVE INVESTMENTS (*CONT'D*)

- Notwithstanding the exception, certain information contained in such records regarding alternative investments will be subject to disclosure and will not be considered a trade secret exempt from disclosure:
  - The name, address, and vintage year of each alternative investment vehicle
  - The dollar amount of the commitment made to each alternative investment vehicle by the public investment fund since inception
  - The dollar amount of cash contributions made by the public investment fund to each alternative investment vehicle since inception
  - The dollar amount, on a fiscal year-end basis, of cash distributions received by the public investment fund from each alternative investment vehicle
  - The dollar amount, on a fiscal year-end basis, of cash distributions received by the public investment fund plus remaining value of partnership assets attributable to the public investment fund's investment in each alternative investment vehicle
  - The net internal rate of return of each alternative investment vehicle since inception
  - The investment multiple of each alternative investment vehicle since inception
  - The dollar amount of the total management fees and costs paid on an annual fiscal year-end basis, by the public investment fund to each alternative investment vehicle
  - The dollar amount of cash profit received by public investment funds from each alternative investment vehicle on a fiscal year-end basis
- This section was added in 2016 as a result of political pressure from litigation regarding the disclosure of information about venture capital fund investments by the UC Regents pension plan

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CALIFORNIA – REQUIRED DISCLOSURE FOR PUBLIC PENSION PLANS

- California Assembly Bill 2833 ("AB 2833," codified at Section 7514.7 of the California Government Code) became effective January 1, 2017 and applies to contracts with an alternative investment vehicle that a California public pension plan enters into (or for an existing contract, makes a new capital commitment) on or after January 1, 2017
- Requires a California plan to disclose certain fee and expense information about its investments in private funds
  - stated goal was to create greater transparency into the fees and expenses that California pension plans pay with respect to their investments in private funds
- A few other states are currently considering legislation to increase the transparency of the fees and expenses paid by the public pension plans in that state (Illinois and Rhode Island), while additional states have considered similar legislation that did not pass (Alabama, Kentucky and New Jersey)

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CALIFORNIA – REQUIRED DISCLOSURE FOR PUBLIC PENSION PLANS (*CONT'D*)

- AB 2833 requires a California pension plan to disclose the following for each alternative investment vehicle at least annually at an open meeting:
  - (1) The fees and expenses the plan paid directly to the alternative investment vehicle, the fund manager or related parties
  - (2) The plan's pro rata share of fees and expenses not covered by item (1), above, that are paid from the alternative investment vehicle to the fund manager or related parties
  - (3) The plan's pro rata share of carried interest distributed to the fund manager or related parties
  - (4) The plan's pro rata share of all fees and expenses paid by portfolio companies held within the alternative investment vehicle to the fund manager or related parties
  - (5) The gross and net rate of return of each alternative investment vehicle since inception and
  - (6) The information that is required to be disclosed in a public records request pursuant to Section 6254.26(b) of the California Public Records Act
- The alternative investment vehicle must provide the information set forth in bullets (1), (3), and (4), above, annually. A California plan may report the information set forth in items (2) and (5) above based on its own calculation or the alternative investment vehicle's calculation

CALIFORNIA – REQUIRED DISCLOSURE FOR PUBLIC PENSION PLANS (*CONT'D*)

- AB 2833 specifies that the disclosures should encompass payments made to related parties, including individuals such as operating partners, senior advisors and venture partners
- For purposes of the disclosures, "carried interest" is defined as any profit that is distributed from an alternative investment vehicle to the fund manager, general partner or related parties, including allocations of profit received by a fund manager in consideration for waiving fees
- The term "related parties" is defined broadly to include:
  - Any current or former employee, manager, or partner of any related entity that is involved in the investment activities or accounting and valuation functions of the relevant entity or any of their respective family members
  - Any operational partner, senior advisor, or other consultant or employee whose primary activity for a relevant entity is to provide operational or back office support to any portfolio company of any alternative investment vehicle, account or fund managed by a related party
  - Any entity where at least 10% of the ownership is held directly or indirectly by a related party or operational person and
  - Any consulting, legal or other service provider regularly engaged by portfolio companies of an alternative investment vehicle, account or fund managed by a related person that also provides advice or services to any related person or relevant entity

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WAYS TO CONTROL DISCLOSURE – GENERAL

- *Do not provide* sensitive materials to a public agency
  - View in office only and do not allow copies of the materials
  - Issue: what constitutes possession of a record
- Understand the laws and policies of the agency
  - Separate account versus a fund
- Understand how the agency responds to public records requests
- Have a strategy in place to address public records requests quickly
- This is a *political* process

WAYS TO CONTROL DISCLOSURE – RFPs, RFIs ETC.

- Generally, selectively mark any information that is a trade secret/confidential
  - Do not over-designate information as confidential
- Have a process in place to review information that is included in a response

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WAYS TO CONTROL DISCLOSURE – BOARD MEETINGS

- Understand the Board's process
- Have the meeting in a closed session
- Have materials presented under separate cover and marked as confidential
- Understand what information will be posted online

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WAYS TO CONTROL DISCLOSURE – CONTRACTUAL

- Non-disclosure agreements before an investment
- Expressly state what is disclosable; everything else is confidential
- Request prompt notification upon a public records request
- Request prior notification of board discussions
- Agency agrees to cooperate in good faith to challenge a request

PRACTICAL GUIDANCE

PRACTICAL GUIDANCE

- An inventory of prospects
- Advance approval of all gifts and entertainment and political contributions
- Recordkeeping; review of expense reports
- Consideration of lobbyist registration, FOIA issues and restrictions on use of placement agents *before* responding to RFPs/RFIs
- Educate compliance, distribution and RFP teams about real life examples (not just dry policies)
- When in doubt, ask somebody – internal/external counsel, the plan's FOIA officer, other plan representatives

QUESTIONS?

SPEAKER BIOGRAPHIES

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Ms. Meer has been structuring private funds as limited liability companies, limited partnerships, offshore corporations, common trust funds and business trusts, and preparing disclosure documents and organizational documents for such entities since the mid-1990s. Her clients include hedge fund and private equity fund sponsors, as well as sponsors of funds-of-funds and funds-of-one. Some of these manager are stand-alone entities and some are part of large financial institutions. She also advises investment advisers, private fund managers, and investment companies on compliance issues, including under the Investment Advisers Act of 1940, whether their commodity interest-related trading or advice would require them to register as commodity pool operators or commodity trading advisors and regarding lobbyist registration and related matters. She also advises institutional investors in connection with their investment in third-party private funds.

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Ms. Delaney focuses her practice on advising domestic and offshore private fund advisers on organizational, regulatory, and compliance issues. In particular, she assists clients with:

- Forming hedge funds and preparing all necessary organizational and offering documents.
- Negotiating advisory and subadvisory agreements.
- Structuring private funds to comply with ERISA or to avoid “plan asset” status.
- Compliance with “pay-to-play” and lobbying requirements under federal, state, and local rules.

Ms. Delaney also assists institutional clients with collective investment fund matters.

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Eric J. Smith is the Managing Director and Deputy General Counsel of PineBridge Investments. He heads a five-person legal team responsible for the firm's private equity and alternative investments businesses that are managed from the Americas (approximately $10.7 billion in AUM). He also works closely with legal colleagues in Europe, the Middle East and Asia on cross-border strategies and to provide support for regional alternative investment initiatives.

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