

**BILL NUMBER: AB 1743 (Hernandez) as amended August 17, 2010**

**SUMMARY**

AB 1743 prohibits a person from acting as a placement agent in connection with any potential system investment made by a state or local public retirement system unless that person is registered as a lobbyist in accordance and full compliance with the California Political Reform Act of 1974 (PRA).

**PURPOSE OF THE BILL**

To enhance transparency in government and increase confidence that public retirement systems' investment decisions are made in an impartial manner, free from any potential bias caused by the financial interests of placement agents, retirement system officials and third parties who have supported these officials.

**BOARD POSITION**

**Support.** This measure would augment CalSTRS current policy on Ethical and Fiduciary Conduct and is in alignment with CalSTRS Corporate Governance policy. While the Teachers' Retirement Board supports AB 1743, the Board has expressed concerns that there may be unintended consequences to emerging managers and minority-owned firms and their ability to work with large investors like CalSTRS.

**LEGISLATIVE HISTORY**

Chapter 301, Statutes of 2009 (AB 1584—Hernandez) made numerous changes aimed at increasing disclosure and accountability of investment placement agents, board members, and others associated with public pension funds in California. Specifically, required all public pension systems to adopt a policy requiring the disclosure of fees paid to investment placement agents, and specifies that placement agents disclose campaign contributions and gifts made by the agents to public retirement board members, as specified. Prohibited public retirement board members from selling investment products to other public retirement systems. Lengthened post-employment restrictions on influencing retirement board actions for former system executives and board members that currently apply to CalSTRS and CalPERS. Extended those expanded provisions to all public retirement systems in California.

Chapter 921, Statutes of 2001 (AB 1325—Negrete-McLeod) required individuals that lobby the California Public Utilities Commission to adhere to the same governing laws as lobbyists of other governmental entities under the Political Reform Act.

Proposition 208—Campaign Contributions and Spending Limits (approved November 4, 1996) made a number of changes to current state law regarding campaign contributions and spending. Specifically, the measure: 1) limited the amount of campaign contributions that an individual or group can make to a candidate for state and local elective office and prohibited lobbyists from making contributions; 2) established voluntary campaign spending limits; 3) limited when campaign fund-raising may occur; and 4) established penalties for violations of the measure and increased penalties for existing campaign law violations.

Proposition 9 – Political Reform Act of 1974 (approved June 4, 1974) created the Fair Political Practices Commission and required reports of receipts and expenditures in campaigns for state and local offices and ballot measures. Limited expenditures for statewide candidates and measures. Prohibited public officials from participating in governmental decisions affecting their "financial interests." Required disclosure of certain assets and income by certain public officials. Required "lobbyists" to register and file reports showing receipts and expenditures in lobbying activities.

## **PROGRAM BACKGROUND:**

CalSTRS is committed to protecting assets through the pursuit of good governance and operational accountability, and has robust policies and standards in place to insure transparency and to avoid conflicts of interest. In 2006, as part of its policy governing ethical and fiduciary conduct, the Board adopted a policy for the disclosure of third party relationships and payments. The policy requires a person or entity involved with any investment transaction or investment management contract to disclose all third party relationships with persons or entities that assisted with the solicitation of CalSTRS as a potential client or the retention of CalSTRS as an existing client. The policy also requires the disclosure of any fees paid or payable to the third party for assisting with the solicitation, which includes placement agent fees. CalSTRS also has regulations in place to add transparency and eliminate potential conflicts of interest in investments and to prevent "pay-for-play" activities.

In April 2009, the California State Treasurer sent CalSTRS and CalPERS a letter in which he applauded CalSTRS current disclosure policy. The Treasurer further suggested enhancement of CalSTRS policy for third party placement agents (i.e. possibly via a formal registration process) and requested a thorough review of CalSTRS contracting entities' relationships with its placement agents.

In response to heightened scrutiny of public pension funds and their relationships with third party placement agents and fees paid to these agents, along with investigations into pension fund corruption and increasing controversy, Chapter 301, Statutes 2009 (AB 1584 – Hernandez) was enacted. Chapter 301 required increased disclosure of placement agent payments and activities and expanded post-employment restrictions for specified employees and board members of state and county retirement systems. AB 1743 (Hernandez) is intended to further build upon Chapter 301 in limiting opportunities for "pay-for-play" practices and conflict of interest activities, and in increasing transparency and accountability within pension systems and the financial industry.

CalSTRS has a comprehensive policy with respect to the disclosure of payments to placement agents in connection with system investments (Board policy 600 J), and it should be noted that CalSTRS does not engage in or make payments to placement agents. Any placement agent fee arising out of a CalSTRS investment is the result of an arrangement between an outside investment manager and the placement agent. CalSTRS is committed to the highest ethical standards and strict adherence to federal, state, and foreign security laws and regulations and has also adopted a policy on Insider Trading.

This measure does not affect the current practice of CalSTRS in a substantive manner, but rather enhances and strengthens current CalSTRS Investment Policy. The measure augments CalSTRS policies governing placement agents and external managers and is consistent with CalSTRS current business practices aimed at mitigating conflict of interest issues when making investment decisions. The bill increases transparency and accountability and further limits "pay-for-play"

opportunities. The administrative cost to produce a report on the use of placement agents would be minor and absorbable.

Other public pension plans in the United States have banned contracting entities from utilizing placement agents. However, some pension systems assert that placement agents do serve a legitimate business purpose. Many placement agents work independently, and their fees are contingent upon the outcome of investment actions and the services they provide in connection with finding, soliciting, or marketing investment actions. Subjecting placement agents to the same restrictions and rules governing lobbyists would change the fee structure for placement agent compensation. Prohibiting placement agents from compensation paid contingent upon the outcome of a proposed investment action could reduce the desire of some managers from using placement agent services in connection with investment actions.

## **ANALYSIS:**

### **Existing Law:**

Existing law regulates investments made by public pensions and retirement systems and defines the term “placement agent” to mean a person or entity hired, engaged, or retained by an external manager, as defined, to raise money or investment from a public retirement system in California.

In addition, the PRA provides for the comprehensive regulation of the lobbying industry, including defining the term “lobbyist” and regulating the conduct of lobbyists. Current law makes a knowing or willful violation of the Political Reform Act of 1974 a misdemeanor and subjects offenders to criminal penalties.

### **This Bill:**

AB 1743 provides additional regulation of placement agent fees and activities to prevent “pay-for-play” activities with public pension investments and increases transparency and accountability by prohibiting a person from acting as a placement agent in connection with any potential system investment made by a state or local public retirement system unless that person is a registered lobbyist according to the PRA. The measure:

- Prohibits a person from acting as a placement agent in connection with any potential system investment made by a *state* public retirement system unless that person is registered as a lobbyist pursuant to the PRA.
- Requires a person acting as a placement agent in connection with any potential system investment made by a *local* public retirement system to file any applicable reports with a local government agency that requires lobbyists to register and file reports and to comply with any applicable requirements imposed by a local government agency pursuant to the PRA.
- Excludes “an individual who is an employee, officer, director, equityholder, partner, member, or trustee of an external manager and who spends one-third or more of his or her time, during a calendar year, managing the securities or assets owned, controlled, invested, or held by the external manager” from the definition of placement agent.
- Excludes from the definition of placement agent an affiliate of an external manager, registered with the SEC or any appropriate state securities regulator if operating under an exemption from the SEC, who is selected by a competitive bidding process and agrees to

a fiduciary standard of care, as defined, when managing a portfolio of assets of a state public retirement system in California.

- Specifies that a placement agent registered with the SEC and regulated by the Financial Industry Regulatory Authority is permitted to receive a payment of fees for contractual services provided to an investment manager, except to the extent that payment of fees is prohibited by the proscription on contingency payments to placement agents.
- Requires the CalPERS and CalSTRS to each provide a report, as specified, on the use of placement agents in connection with investments made by the retirement systems, to the Assembly Committee on Public Employees, Retirement, and Social Security and the Senate Committee on Public Employment and Retirement, no later than August 1, 2012.
- Revises various definitions in relation to public pension or retirement systems and the PRA.

The bill defines “external manager” and “placement agent” in the PRA, consistent with definitions established in the Government Code via Chapter 301, Statutes 2009 (AB 1584 – Hernandez) and the provisions of AB 1743. The bill revises the PRA definition of “lobbyist” to include “a placement agent” and defines “investment vehicle” in the Government Code for purposes of this measure.

## **FISCAL IMPACT**

Benefit Program Cost – None.

Administrative Costs/Savings – The administrative cost is minor and absorbable.

## **SUPPORT**

California Public Employees’ Retirement System (Co-sponsor)  
State Controller John Chiang (Co-sponsor)  
State Treasurer Bill Lockyer (Co-sponsor)  
American Association of Retired Persons  
California Common Cause  
California Professional Firefighters  
California Retired Teachers Association  
California State Employees Association  
California State Teachers’ Retirement System  
Cartica Management, LLC  
Faculty Association of California Community Colleges  
Fair Political Practices Commission  
NAACP  
Secretary of State Debra Bowen  
Service Employees International Union

## **OPPOSITION**

Investment Company Institute  
Securities Industry and Financial Markets Association  
Third Party Marketers Association

## ARGUMENTS

### Pro:

- Enhances current law and CalSTRS policy regarding disclosure of placement agent payments and activities.
- Further limits opportunities for “pay-for-play” practices and conflict of interest activities.
- Increases transparency and accountability within pension systems and the financial industry

### Con:

- Increases the role of government in business activities.
- Creates a one-size fits all approach that may not work for all businesses.
- Could limit access to public pension funds for small and emerging managers.

## LEGISLATIVE STAFF CONTACT

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