VISTA360

Perspective

Industry Focused News

PAY-TO-PLAY PRACTICES IN THE MANAGEMENT OF PUBLIC PENSION PLANS

Vista360's Perspective mailings are intended to provide advisers and funds with snapshots of current industry topics and news we believe to be noteworthy. This issue of Vista360's Perspective focuses on recent developments governing "pay-to-play" arrangements where placement agents are paid to help investment advisers secure public pension plan business. Advisers in New York, Illinois, New Mexico and California should pay particular attention to these developments, especially if they manage assets for a public pension plan.

- ***Quick History***

In early 2009, New York State Attorney General Andrew Cuomo uncovered a pay-to-play scheme that involved the use of placement agents to direct public pension plan money into certain investment funds in exchange for political kickbacks. As a result, Cuomo indicted two key political advisers on 123 charges, including larceny, bribery and money laundering, and formed a task force to investigate pay-to-play practices with respect to other public pension plans.

This scandal has generated public scrutiny of the use of placement agents in the pension plan arena, and fiduciaries of public and private pension plans nationwide have begun to review their policies addressing the use of placement agents. Fiduciaries of public pension plans and state legislators in four states in particular have either banned the use of, or are forcing disclosure regarding the fees paid to, placement agents.

- ***New York***

In April, the ***New York State Comptroller announced a blanket prohibition on the use of placement agents, paid intermediaries and registered lobbyists by investment managers of the New York State Common Retirement Fund*** (the "CRF"). The State Comptroller is the sole trustee of the CRF and therefore must abide by a fiduciary duty to avoid the conflicts that may arise by engaging a placement agent. Following this move, the New York State Teachers' Retirement System announced a similar ban on the use of placement agents or other paid intermediaries for the purpose of engaging an investment manager. The New York City Comptroller also called for a similar ban with respect to the New York City pension funds for which he serves as trustee.

- ***Illinois***

Similar to the bans imposed by New York officials, ***Illinois recently passed legislation that prohibits the use of placement agents by investment advisers to the Illinois Public Employees Retirement System***. The bill states that "[n]o person or entity shall retain a person or entity to attempt to influence the outcome of an investment decision of or the procurement of investment advice or services of a retirement system, pension fund, or investment board of this Code for compensation, contingent in whole or in part upon the decision or procurement."

- ***New Mexico***

In July, New Mexico's State Investment Council ("SIC") revised a blanket prohibition against the use of placement agents with respect to the SIC. ***The new policy allows advisers to use third party agents as long as that agent is not involved in obtaining commitments from pension funds in New Mexico or the Southwest.*** The original policy disallowed the SIC from doing business with a firm that used a placement agent in *any* investment deal. The policy also prohibits advisers to the plan from making any campaign contributions to any individual who may have influence over the SIC during the term of the investment contract and for two years afterward.

- ***California***

Engaging placement agents is still allowed with respect to the California Public Employees' Retirement System ("CalPERS"); however, a new policy is now in place with regard to investment managers who hire placement agents to seek CalPERS business***. The new policy requires investment advisers to disclose fees and other payments made to placement agents, which will then be posted on CalPERS website.*** Investment managers must also provide copies of agreements with placement agents, resumes of their key personnel and any registrations of the agent or its affiliate. This new policy applies to all arrangements entered into after May 11, 2009, or any existing arrangement amended after that date.

In addition to CalPERS, the Los Angeles City Employees Retirement System has also adopted policies requiring advisers to disclose whether they engage the use of placement agents. The new policy is aimed at increasing transparency in the selection process of advisers to the plan.

- ***Definition of "Placement Agent"***

Although each jurisdiction may have a different definition of "placement agent," the term generally relates to any third party that is compensated by an adviser for the purpose of securing investment contracts. Placement agent may also be referred to as a third party solicitor, marketer, finder, introducing broker, lobbyist, consultant or other intermediary.

- ***Conclusion***

Investment advisers working with public pension plans in any state or municipality should be alert to possible changes to pay-to-play practices. There is every indication that similar bans or disclosure requirements may be instituted in other states, and Ohio has had a long-standing ban in place. In addition***, the SEC recently announced its own measures to curtail these practices within the public pension plan arena. The comment period for Proposed Rule 206(4)-5 under the Investment Advisers Act of 1940 ends October 6, 2009.*** Vista360 will continue to monitor these developments with regard to pay-to-play practices and will keep our readers informed.

To read past issues of the Perspective including Vista360's most recent quarterly Hot Industry Topics List, please visit our web site at http://www.vista360llc.com/vista360-news.htm.

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