



# AB-1743 - Placement Agents in CA

A Preqin Special Report

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On January 1st 2011, AB-1743 came into effect in California. The Act states that any placement agent soliciting funds from CalPERS (California State Public Employees' Retirement System) or CalSTRS (California State Teachers' Retirement System) must register as a lobbyist, the purpose being to ensure that all investments made are impartial. The legislation was passed in response to investigations into alleged corrupt practices involving the use of placement agents with respect to public retirement systems or pension funds.

The Act limits the types of compensation placement agents can receive for soliciting investment from CalSTRS and CalPERS, the state retirement systems, and imposes new disclosure requirements on placement agents soliciting these pension plans.

Under the new legislation, placement agents are also subject to lobbyist reporting and the prohibitions of the 1974 California Political Reform Act, which proscribes success fees and some campaign contributions.

There are two exceptions set out in the Act:

- Employees, officers directors, equity-holders, partners, members or trustees of an external manager 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;
- Employees, officers or directors of an external manager if the external manager: (1) is registered as an investment adviser or a broker-dealer with the SEC or, if exempt, any appropriate state securities regulator; (2) has been selected through a competitive bidding process and is providing services pursuant to that contract; and (3) has agreed to a fiduciary standard of care set forth in Article XVI, § 17 of the California Constitution.

After registration, placement agents must file quarterly reports disclosing their compensation. The agents are barred from making campaign contributions to pension fund board members and are required to attend a biennial ethics class, which is to be held in Sacramento.

Preqin conducted a study to ascertain the impact the Act will have on placement agents operating in California, and/or working with the state's public pension systems.

### Methodology

An email survey was sent out to placement agents based around the world. The document included a range of multiple choice questions and a number of sections in which participants were invited to discuss their opinions on certain aspects of the legislation. Finally, subjects were able to provide general feedback on the legislation.

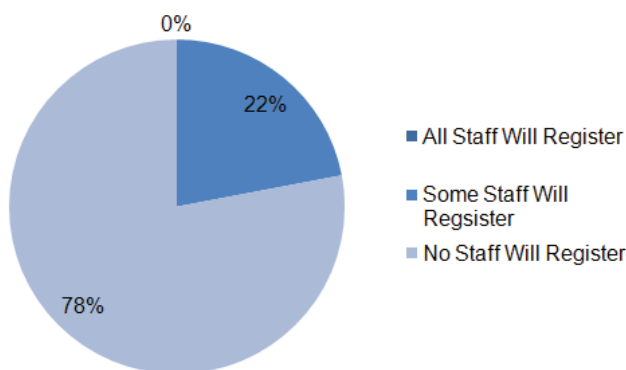
Results were collated, and are analyzed in-depth in the report which follows.

### Proportion of Firms That Plan to Register as Lobbyists

Placement agents were asked whether or not their firm planned to register staff as a lobbyists in California as outlined in the legislation. The results are shown in Fig. 1; over three-quarters stated that placement agents at their firms will not be registering,

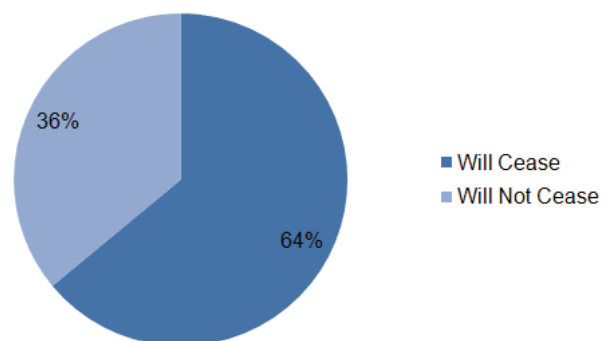
Offering opinions on the matter, one respondent stated: "It is unfair and unrealistic to expect sales professionals that are already FINRA registered (and registered in the individual states to sell private placements) to also have the additional requirement of registering as a lobbyist and being told how you can be paid for providing your services."

Fig. 1: Proportion of Firms That Will Register Staff as Lobbyists



Source: Preqin

Fig. 2: Impact of Legislation on Firms' Future Business with Affected Pension Plans in CA



Source: Preqin

Another was also opposed to the law, saying: “Third -party marketers are not lobbyists and should not have to register as such.”

**Changes to Job Descriptions or Employment Statuses**

Those stating that their firm would be registering were asked whether or not employees job descriptions and/or employment statuses would be changing as a result. None of those firms registering will be making changes of this kind.

**Impact of the Legislation on Business Conducted by Placement Agents in California**

It is important to note that CalPERS and CalSTRS are formally covered by the law, and it also applies to individuals and firms marketing investments to the California Judges’ Retirement System, and the University of California Regents’ Retirement Fund. Other public pension funds in California can adopt different legislation; LACERS, for example, introduced a process which requires certain disclosures, but not formal registration as a lobbyist. However, as shown in Fig. 2, 64% of participants still stated that they would no longer do business within California, following the passing of the legislation.

Commenting on the subject, one respondent stated: “It is unfortunate that the state of California will be placing this additional burden on those who seek to serve it. Some may opt out of offering their services, which ultimately, is a loss for the state.”

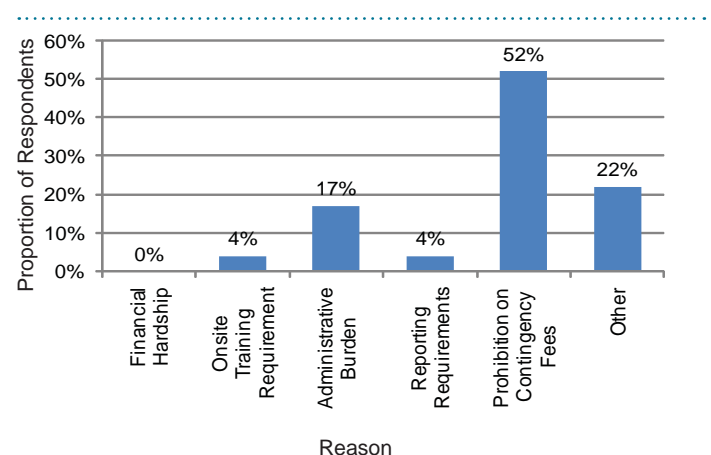
Another claimed: “The state legislature have created a platform where public pension plans may miss investment opportunities because of added red tape.”

Approaching the matter from a different angle, a third placement agent said: “The rules will make it more difficult for smaller and newer managers to access large state pension funds, depriving fund recipients of the opportunity to gain from the higher returns that smaller funds have historically generated.”

**Reasons for Ceasing to Do Business with Affected Public Pension Plans in California**

Respondents were asked why they would no longer do business

**Fig. 3: Reasons for Ceasing to Do Business with Affected Public Pension Plans in CA**



Source: Preqin

with California. They were given the following options, along with the opportunity to name reasons not listed:

- Financial hardship
- Onsite training requirement
- Administrative burden
- Reporting requirements
- Prohibition on contingency fees

A breakdown of results is shown in Fig. 3. The most frequently cited reason was the prohibition on contingency fees, with 58% of respondents stating that they would no longer do business in California for this reason.

Discussing the matter in greater detail one respondent stated: “What sales person in this country will be motivated to sell anything without some sort of incentive? This will kill innovation and competition as small, emerging managers will simply not have the wherewithal to hire an internal marketing team.”

Along the same lines, another suggested: “I liken it to a real estate broker accustomed to working for a standard commission going to sell a house, and a bidder says ‘I want to buy that house, but you can’t get a commission.’”

A third commented: “Placement agents should be entitled to earn a contingent fee if the legitimate, professional services they provide result in legally authorized allocation of capital to their client.”

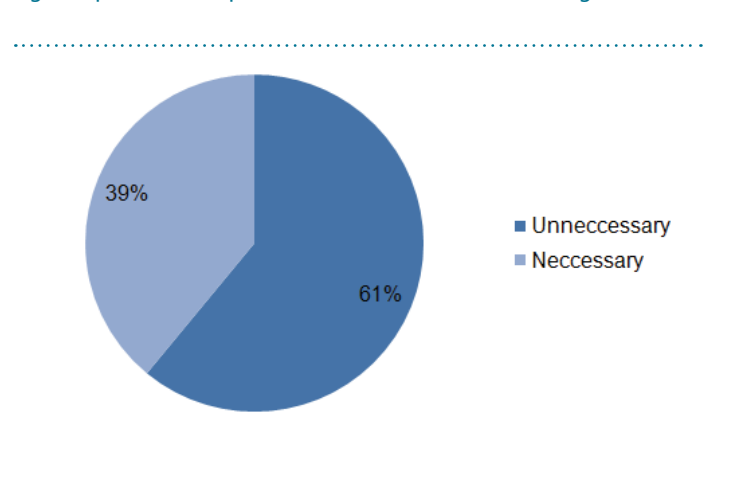
21% of respondents chose a reason not listed; for all of them, that reason was “all of the above.”

**FPPC Requirement to Attend Ethics Training**

The survey asked for opinions on the need to attend ethics training under the new legislation. As shown in Fig. 4, just under two-thirds (61%) stated that such training was unnecessary.

When probed further on the issue, discussing the requirement that this ethics training be conducted in person in Sacramento, just 3% felt that it was justified. As shown in Fig. 5, the majority (47%) stated

**Fig. 4: Opinion of Requirement to Attend Ethics Training**



Source: Preqin

that online training would be preferable, while 33% maintained that such training was simply not needed.

Some placement agents offered opinions on the matter. One stated: "Sure, it's reasonable, but I don't think additional regulation necessarily increases ethics, just makes participants more aware of the issues."

Another offered a slightly different take on this, suggesting: "Regulation cannot solve ethical weaknesses. The rule seems to be an example of closing the barn door after the horse has left."

A more strongly worded response read: "This is a ridiculous attack on a group, placement agents, because some politicians became placement agents for the sole purpose of receiving kickbacks and illegal payments. There are many placement agents who have been honourably performing fundraising on behalf of their clients for decades. It is pretty easy to tell the difference between the honourable ones and the dishonourable ones."

**Additional Expenses Anticipated Following Registration**

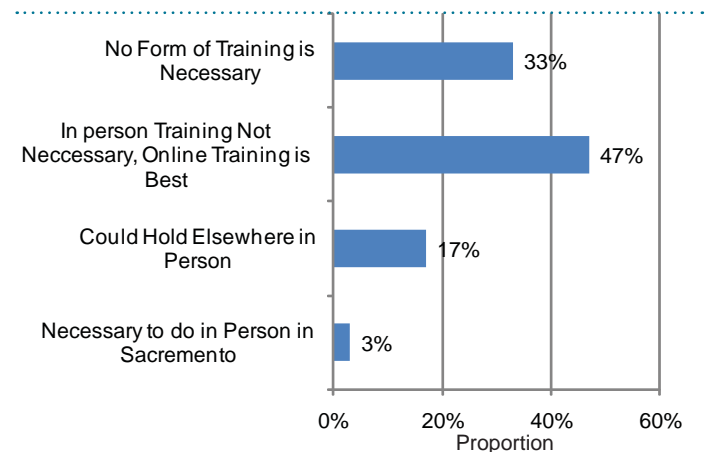
Those agents that stated they were planning on registering as a lobbyist were asked to what extent they anticipated their expenses to increase. As shown in Fig. 6, 92% expect an increase, significant or otherwise, in their business costs.

Musings on the subject include: "While we do not anticipate material cost increases, there is a fairly onerous additional level of reporting which requires resources to undertake (externally outsourced) on our behalf. It is our view that the level of reporting required is unnecessary and questionable with regard to its utility." While another simply stated: "[It is] unreasonable, a complete waste of time and expensive."

**What Will Your Firm Do if Other States Follow California's Lead?**

Similar lobbying rules are being considered by other states, including New York. Participants were asked what they would do if affirmative action was taken. 63% stated that they would not register in any states, as shown in Fig. 7. 27% would opt to register selectively, depending on perceived opportunities.

**Fig. 5: Proportion of Respondents That Favour Each Option for Ethics Training**



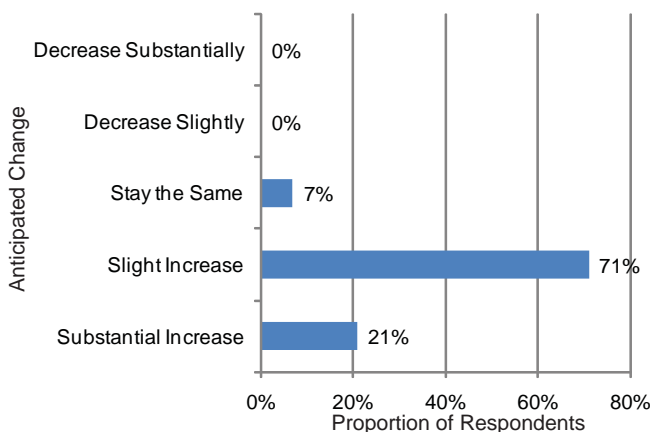
Source: Preqin

Discussing this scenario, one respondent wrote: "The New York State fiasco was done by politicians who entered the business with no prior skills, to capitalize on their contacts. The fact that they were ethically challenged is no reflection on other, ethical placement professionals. California's "fix" is typical overreach by people who see ghosts where none reside. The fact that other states may follow reflects their collective inability to really provide solutions, or to preempt problems before they exist."

Another stated: "The situations in both NY and CA were driven by unethical behaviour on the part of internal board members at CalPERS, NY State Common and NY City. It is tragic that the political power of these large public funds have enabled them to deflect the blame and point their fingers publicly at placement agents. NY and CA need to make it impossible for one public board member to make an unethical decision. CalPERS, NY Common and NY State need to be forced to change their decision-making trees!"

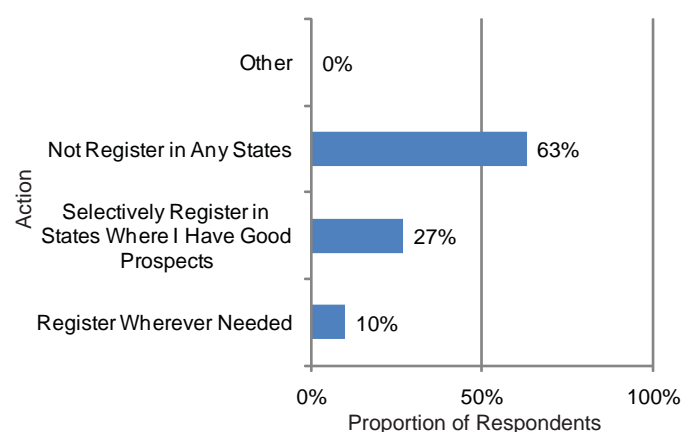
As shown in Fig. 8, 84% of those surveyed stated that they would rely less on public funds going forward as a result of the lobbying rules.

**Fig. 6: Anticipated Change in Expenses as a Result of the Legislation**



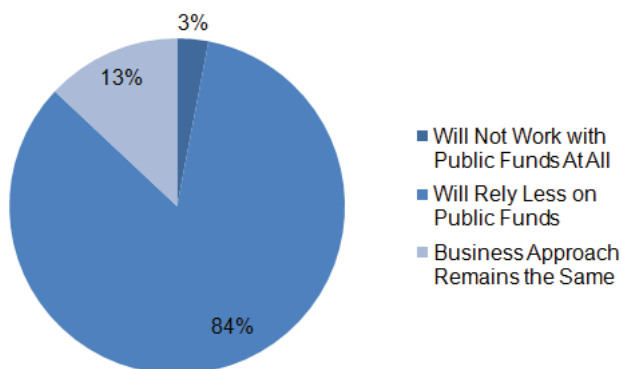
Source: Preqin

**Fig. 7: Action Firms Will Take if Other States Adopt Similar Legislation**



Source: Preqin

Fig. 8: Impact of Legislation on Firms' Willingness to Work with Public Funds



Source: Preqin

Other Comments

That the legislation is punishing placement agents for the misdemeanours of politicians was a recurring theme in the comments made by survey participants. Statements included: "The structure of approval and the ethics of the trustees and staff seem to be key elements that contributed to the wrongs in these scandals."

And: "Registering as a lobbyist makes no sense. It was lobbyists and political fixers, not legitimate registered representatives/broker-dealers that caused many of the 'pay-to-play' scandals, problems and violations."

Another read: "This entire piece of legislation is designed to take the spotlight off the unethical, unlawful behaviour of the boards and staff of the various California Public Funds and those who used to be on these boards, who used their connections to exhibit unethical and illegal behaviour."

One respondent highlighted the following point: "Ethics boundaries were crossed by prior board members and staff of CalPERS. This lobbying requirement is a ruse to point the finger in external directions. The board of CalPERS has not adopted rules to prevent prior employees or board members from soliciting their system. Two PE managers partially owned by CalPERS have been involved in the placement agent difficulties in CA and one has been involved in three states. They are not banned in any of these three states and may not be subject to lobbying laws, as they hired placement agents, but weren't placement agents themselves."

Similarly, many of those surveyed do not want to register, simply because they are not lobbyists. One respondent stated: "Placement agents are not lobbyists, we are brokers registered with FINRA/SEC and meet all requirements imposed. The problem is not with placement agents, but with the pension officers."

Another commented: "It is mindboggling that states and cities believe that third-party marketers are actually lobbyists and thus should be subjected to the same rules and regulations."

A third said: "Professional placement agents are not lobbyists. We deal with staff and consultants, not politicians. However, amazingly, lawmakers don't seem to be able to conceive of a situation where someone can deal professionally with a government agency without being a lobbyist."

Summary

The majority of placement agents participating in the survey are unhappy with certain aspects of the legislation. Prohibition on contingency fees is the most contentious aspect of AB1743; it is deemed unfair that placement agents should work with no incentive.

The survey suggests that a significant proportion of placement agents will cease to work with CalPERS and CalSTRS as a result of the legislation. This could impact on the retirement system's ability to take advantage of the most promising and/or attractive investment opportunities. Should similar legislation be passed in other states, other public pension schemes could also be affected; a large majority of those surveyed stated that they would rely less on public funds in the future.

Placement agents also feel that the legislation will be ineffective in achieving its purpose, to prevent corruption, as it does not cover the majority of those that were involved in the illicit activities which spawned the legislation – board members and pension fund staff.

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