

LOWENSTEIN SANDLER PC CLIENT ALERT

PAY TO PLAY

ATTORNEY ADVERTISING

EFFECTIVE NOVEMBER 7, 2009: NEW YORK INVESTMENT ADVISERS SUBJECT TO NEW "PAY-TO-PLAY" RULES

By Michael T.G. Long, Esq., and Kerstin M. Sundstrom, Esq.

November 2009

On November 7, 2009, new "pay-to-play" rules go into effect regarding political contributions by investment advisers who provide investment services to or accept investments from the New York State Common Retirement Fund (the "CRF").

Under the new rules, investment advisers and their key personnel that make a political contribution *in any amount* to a candidate for New York State Comptroller may be disqualified for two years from accepting investments from or contracting to provide investment services to the CRF. In addition, going forward, a prohibited contribution or a failure to make proper disclosure of any contribution may result in termination of the investment adviser's existing CRF investments or investment service contracts, as well as other penalties such as forfeiture of interest and fees.

We are pleased to provide this summary of these new rules.

A Brief Review Of "Pay To Play" In New York

Until recently, New York had imposed relatively few restrictions on the political contribution activity of investment advisers who advise or manage investments for the CRF. However, a recent string of enforcement actions by New York Attorney General Andrew Cuomo and the Securities and Exchange Commission (the "SEC") have involved allegations that certain fund managers and their intermediaries made political contributions in an attempt to influence the CRF's investment decisions. Moreover, in August 2009, the SEC proposed regulations that, among other provisions, would impose certain nationwide restrictions on the ability of investment management firms and their key personnel to make contributions to state and local politicians and public pension officials.

On September 23, 2009, New York State Comptroller Thomas P. DiNapoli issued an Executive Order (the "Executive Order") imposing the pay-to-play rules discussed herein.¹ As noted, according

to the Executive Order, these new rules become effective on November 7, 2009 and apply to all contributions and investments made on or after that date. According to the Executive Order, these rules will remain in place until and unless the SEC adopts its proposed regulations.

Whose Contributions Are Subject To The Prohibition?

The Executive Order prohibits the CRF from "engaging, hiring, investing with, or committing to" an "investment adviser" who has made a contribution *in any amount* to the incumbent or candidate for State Comptroller within the previous two years. The prohibition extends to contributions made toward the transition or inaugural expenses of a successful candidate for Comptroller. The Executive Order also prohibits so-called "indirect violations" whereby the investment adviser uses intermediaries to make or solicit prohibited contributions that the investment adviser could not make itself.

The restrictions on political contributions extend beyond the company or individual “investment adviser” to reach certain key personnel of the investment adviser, including “covered associates” and “executive officers.” Those subject to the Executive Order are set forth in the table below:

Investment Adviser	<ul style="list-style-type: none"> Investment advisers required to register with the SEC Investment advisers exempt from registration pursuant to section 203 of the Federal Advisers Act, 15 U.S.C. 80b-3(b)(3)
Covered Associate of an Investment Adviser	<ul style="list-style-type: none"> General partner (incl. others with similar status or function) Managing member (incl. others with similar status or function) Executive officer (incl. others with similar status or function) Employee who solicits a government entity for the investment adviser Political Action Committee controlled by the investment adviser, its general partner, managing member, or executive officer
Executive Officer	<ul style="list-style-type: none"> President Vice President responsible for a principal business unit (such as sales, administration, or finance) Any other executive who (i) performs advisory services; (ii) solicits a government entity for the investment adviser or supervises others who solicit; (iii) supervises other executive officers as defined above

Contributions By Covered Associates Prior To Employment

Under the Executive Order, an investment adviser can be disqualified as a result of hiring a covered associate who made a prohibited contribution during the prior two years, even if the contribution was made *before the covered associate was hired* by the investment adviser. Investment advisers are, therefore, strongly cautioned to perform necessary due diligence with regard to the prior political contribution activity of prospective new hires. Similarly, covered associates must be aware that prohibited contributions they make will “follow” them for two years, even if they seek to switch employers.

Reporting Obligation And Consequences Of Noncompliance

All investment advisers who have or are seeking investments from the CRF will be required to submit a Political

Contribution Representation (“PCR”). The PCR is essentially a certification by the investment adviser that no prohibited contribution has been made within the previous two years. The PCR is subject to review and verification by the New York Inspector General and the Special Counsel for Ethics, and may be disclosed to the public by the CRF.

Failure to comply with the PCR requirements means that “no investment shall occur and/or no

agreement shall be entered into.” If the PCR is found to contain a material misstatement, the relationship between the investment adviser and the CRF may be terminated immediately. If termination is warranted, the CRF will determine whether the termination is immediate and will be without penalty to the CRF. Penalties applicable to specific investment vehicles or services are summarized in the following table.

Public Equity Advisers	<ul style="list-style-type: none"> Termination of the investment management agreement If investments not held by the CRF’s custodian, the CRF may choose between receipt of a distribution of securities or the investment adviser paying the CRF in cash
Private Equity Advisers	<ul style="list-style-type: none"> Termination of the CRF’s obligation to make future capital contributions
Real Estate Opportunity Funds	<ul style="list-style-type: none"> Termination of the CRF’s obligation to make future capital contributions
Other Real Estate Investments	<ul style="list-style-type: none"> Removal of the general partner Forfeiture of its carried interest Termination of the CRF’s obligation to make future capital contributions
Absolute Return Strategies	<ul style="list-style-type: none"> Immediate redemption of the investment
Advisers and Consultants	<ul style="list-style-type: none"> Immediate termination of the contract and recoupment of any amounts paid pursuant to the contract

Exception For Covered Associates Entitled To Vote For State Comptroller

The Executive Order contains a very limited exception for covered associates who are entitled to vote for the office of New York State Comptroller (i.e., New York residents over 18 years old). Such individuals may contribute up to \$250 per Comptroller candidate per election without violating the prohibitions of the Executive Order. In contrast, covered associates who are not entitled to vote for State Comptroller (i.e., non-New York residents or individuals under 18 years old) are prohibited from contributing in any amount to a candidate for Comptroller.

Discretionary Exemption In The Event Of A Prohibited Contribution

In the event that a prohibited contribution is made, the Inspector General and the Special Counsel for Ethics have the discretion to grant an exemption "when necessary or appropriate and consistent with the purpose fairly intended by" the Executive Order. The decision whether to

grant an exemption takes into account a number of factors, including whether the investment adviser adopted appropriate compliance policies and procedures, what steps were taken to obtain a prompt refund of the contribution, and whether the circumstances suggest that the contribution was intended to influence the CRF.

What's Next?

As noted above, the Executive Order is an interim policy and will be effective only until the SEC finalizes its own national "pay-to-play" rules, if it does. In addition, the New York legislature is currently considering legislation proposed by Attorney General Cuomo that would widen the scope of pay-to-play restrictions in New York to cover other public pension funds and additional candidates.

As these developments reaffirm, the pay-to-play landscape is ever-changing on both state and national levels. Investment advisers must carefully consider developing and modifying policies, protocols, and internal controls to avoid disqualification and other penalties as a result of a prohibited political contribution.

Please feel free to contact either of the attorneys below for further information on the matters discussed herein:

Michael T. G. Long

973 422 6726

mlong@lowenstein.com

Kerstin M. Sundstrom

973 422 2932

ksundstrom@lowenstein.com

¹ The full text of the Executive Order is available at <http://www.osc.state.ny.us/reform/politicalcontribution.pdf>.

Lowenstein Sandler makes no representation or warranty, express or implied, as to the completeness or accuracy of the Alert and assumes no responsibility to update the Alert based upon events subsequent to the date of its publication, such as new legislation, regulations and judicial decisions. Readers should consult legal counsel of their own choosing to discuss how these matters may relate to their individual circumstances.

www.lowenstein.com

New York

1251 Avenue of the Americas
New York, NY 10020
212 262 6700

Palo Alto

590 Forest Avenue
Palo Alto, CA 94301
650 433 5800

Roseland

65 Livingston Avenue
Roseland, NJ 07068
973 597 2500