Morgan Lewis

2011 Insurance Industry Roundtable

Pay-to-Play – Employment Law Implications

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Schedule

- Brief overview of the Rule
- Compliance issues
  - State laws and regulations
  - Best compliance practices
  - What advisers are doing
- Employment law perspective
  - State privacy laws
  - State law limitations on employer efforts to regulate or monitor political activities
  - State anti-discrimination laws
  - Public policy exception to at-will employment
  - Federal pre-emption of state laws

The Rule - 4 Prohibitions

AN ADVISER CANNOT:

1. Be compensated by a government entity for advisory services within two years after it or its covered associate makes a prohibited contribution to a candidate/official of the government entity

AN ADVISER AND ITS COVERED ASSOCIATES CANNOT:

2. Pay a third party to solicit a government entity for advisory services unless such person is subject to pay-to-play rules
3. Aggregate and target contributions toward current/future client jurisdictions
4. Indirectly violate the Rule

The Rule - 3 Exceptions

1. ***The De Minimis Exception.*** Natural person covered associates can contribute $350 per official, per election (if they can vote for the official) and $150 per official, per election (if they cannot vote for the official)

2. ***The New Covered Associate Exception.*** "New" covered associates (either by way of hiring or promotion) who will not solicit clients for the adviser are only subject to a 6-month "look-back"

3. ***The Corrected Contribution Exception.*** If a covered associate makes a prohibited contribution of $350 or less that is discovered within four months and re-collected within 60 days of discovery, then the "two-year timeout" will be lifted

The Rule – Application to Funds

- The Rule applies to advisers who manage or solicit government assets *through* a "covered investment pool"
  - Registered funds (i.e., mutual funds) that are investment options in participant-directed government plans/programs (i.e. college saving or retirement plans)
    - *Including government-selected funds that are part of a participant-selected "model portfolio"*
  - Funds that would be registered, but for 3(c)(1), (7) or (11) (i.e., hedge, private equity and venture capital funds, and collective investment trusts)

State & Local Statutes and Regulations

- State pay-to-play and placement agent/lobbyist laws and regulations
  - A complicated matrix of state and local laws, rules and executive orders that is constantly changing
  - Further complicated by court decisions and agency/commission interpretations
  - Generally structured to apply to “government contracts”
  - Differing obligations – registering, reporting
  - Differing applications – placement agents/lobbyists, contributions/gifts, contract thresholds, officials/entities

Compliance Programs – Key Policy Decisions

- Which positions to subject to disclosure, pre-clearance and monitoring requirements
- When to require and when to grant pre-clearance
- How to screen applicants for employment or promotion

Compliance Programs – What Are Your Options?

- A good compliance policy and program will:
  - Be well thought out and include carefully defined terms
  - Be carefully tailored to the adviser's particular structure/business
  - Screen applicants for "covered associate" positions
  - Include mandatory disclosure and pre-clearance requirements
  - Reflect the applicable rules of each jurisdiction
  - Include an employee education component
  - Include monitoring, certification and recordkeeping components
  - Be periodically revisited and revised as business/law changes

Compliance Programs – What Are Your Options?

Which Positions Should Be Treated as "Covered Associate" Positions?

Is your firm treating all positions as "covered associate" positions in your policy and procedures, or is your firm treating only some positions as "covered associate" positions?

A. All positions will be treated as "covered associate" positions
B. Certain defined positions will be treated as "covered associate" positions

Compliance Programs – What Are Your Options?

Who Should Be Treated as "Covered Associates"?

Which of the following does your firm include under your policy?

A. Administrative employees that may not be "covered associates" under the Rule
B. Spouses and/or spousal equivalents of employees/covered associates
C. Persons in the same household as employees/covered associates

Compliance Programs – What Are Your Options?

Pre-Hire Disclosure Requirements

How would you categorize your firm's approach to pre-hire disclosure requirements?

A. All applicants for all positions
B. All applicants for "covered associate" positions
C. Disclose all contributions
D. Disclose contributions beyond *de minimis*
E. Disclose contributions to certain candidates
F. Disclose contributions to certain candidates beyond *de minimis*
G. Disclose all past contributions
H. Disclose contributions made on or after 03/14/11 and within applicable look back period

Compliance Programs – What Are Your Options?

Pre-Clearance Requirements

How would you categorize your firm's approach to pre-clearance requirements for individual contributions to political candidates?

A. Complete ban
B. Pre-clearance of all contributions
C. Pre-clearance of contributions beyond *de minimis*
D. Pre-clearance of contributions to certain candidates
E. Pre-clearance of contributions to certain candidates beyond *de minimis*

Compliance Programs – What Are Your Options?

Monitoring and Record Keeping Requirements

For monitoring, reporting and verification, which of the following processes does your firm have (or will soon have) in place?

A. Periodic certifications from “covered associates” or all employees
B. Acknowledgments of receiving and reviewing firm policy
C. Spot checks of employees who report “no contributions”
D. Exploring/using third-party vendors to vet and/or monitor political contributions by “covered associates”
E. Exploring/using third-party vendors to vet and/or monitor political contributions by all employees
F. Conditioning offers for employment/promotion on no Rule violations or political contributions during the applicable “look back” period
G. Restricting personnel involved in “solicitation activity”

Compliance Programs – What Are Your Options?

Training

How is your firm educating employees?

A. Requiring formal training sessions (either in person or online)
B. Firm “alert” or “newsflash” in hard copy or e-mail
C. Department or unit “experts” for collecting employee questions
D. Circulating a Q&A flier or list of examples along with policy
E. Executive/management level formal training/presentation
F. Targeted training to key employees/frequent political contributors

Compliance Programs – What Are Your Options?

Responsibility for Monitoring and Recordkeeping

Who in your firm has responsibility for monitoring and recordkeeping functions, including collecting and maintaining information concerning political contributions?

A. Compliance
B. Human Resources

Compliance Issues – What Are Advisers Doing?

Based on our informal survey of approximately 40 representatives of advisers:

- 2/3 of advisers are defining "covered associate" rather than covering all employees
- About 60% of advisers are including spouses and/or spousal equivalents under their policies
- More than 85% of advisers are using a "total pre-clearance" or "pre-clearance beyond *de minimis*" approach
- Very small minority are implementing a total ban

Compliance Issues – What Are Advisers Doing?

Based on our informal survey of approximately 40 representatives of advisers:

- More than 3/4 of advisers are implementing periodic certifications or acknowledgments
- Roughly half of advisers are conditioning offers for employment and/or promotions on absence of triggering contributions
- Substantial minority of advisers are implementing more robust monitoring programs (i.e., spot checks, vendors)

Compliance Issues – What Are Advisers Doing?

Based on our informal survey of approximately 40 representatives of advisers:

- Advisers are taking various approaches toward educating employees
- Vast majority of advisers are implementing and carrying out compliance programs through their compliance departments, not human resources

Employment Law Implications

- Employment Laws
  - Some states and municipalities (including CA, CT, CO, MA, NY and Seattle, WA) have laws that arguably restrict or prohibit private employers from:

    (1) requiring employees and/or applicants to disclose, pre-clear, or agree to monitoring of political contributions;

    (2) regulating or monitoring political contributions; and/or

    (3) taking adverse employment actions based on political contributions or a failure or refusal to disclose, pre-clear, or agree to monitoring of political contributions

Employment Law Implications

- Employment Laws
  - State privacy laws
  - State law limitations on employer efforts to regulate or monitor political activities
  - State anti-discrimination laws
  - Public policy exception to at-will employment
- Federal pre-emption of state laws

Employment Law – State Privacy Laws

- State privacy laws
  - Many states have statutory or common-law invasion of privacy laws that could arguably apply to requirements that employees or applicants disclose, pre-clear or agree to monitoring of political contributions
  - However, privacy laws typically proscribe only unreasonable interferences with a person's privacy, which means that a legitimate business interest – such as the need to comply with pay-to-play laws – may render the required disclosure reasonable
  - There is arguably no reasonable expectation of privacy in political contributions where information about them is publicly available

Employment Law – State Privacy Laws

- State privacy laws
  - If third-party vendors are used to monitor political contributions, be sure to comply with any applicable notification and authorization requirements under state law and the Fair Credit Reporting Act
  - Limit access to and disclosure of information about political contributions on a need-to-know basis

Employment Law – Political Activities

- State law limitations on employer efforts to regulate or monitor political activities
  - Some states (e.g., CA, CT, MA, NY) have statutes that arguably (1) protect employee rights to engage or participate in political activities and/or (2) prohibit employers from inquiring about, regulating or monitoring political activities, or taking adverse employment actions against employees based upon political activities (including political contributions)
  - Some states (e.g., MA) impose criminal sanctions for violations

Employment Law – Political Activities

- State law limitations on employer efforts to regulate political activities
  - Many of these laws (e.g., CT, NY) have exceptions where:
    - *(1) political activities would materially conflict or interfere with legitimate business interests of the employer; and/or*
    - *(2) the employer's actions were taken based upon a good-faith belief that its actions were required in order to comply with the law*
  - These defenses will likely be available only insofar as disclosure and pre-clearance requirements, any monitoring of political contributions, and any adverse employment actions based on political contributions or a failure or refusal to disclose, pre-clear, or agree to monitoring of contributions are appropriately limited to those that are required to comply with pay-to-play laws or otherwise advance legitimate business interests of the employer

Employment Law – Anti-Discrimination

- State anti-discrimination laws
  - Some jurisdictions (e.g., DC and PR) have statutes that ban discrimination on the basis of political affiliation
  - Employers should be able to defend such claims where adverse employment actions are based not upon any particular political affiliation, but instead upon an individual's violation of the Rule or failure or refusal to disclose or pre-clear political contributions – regardless of political affiliation - so long as the employer's policy is consistently applied and enforced

Employment Law – At-Will Employment

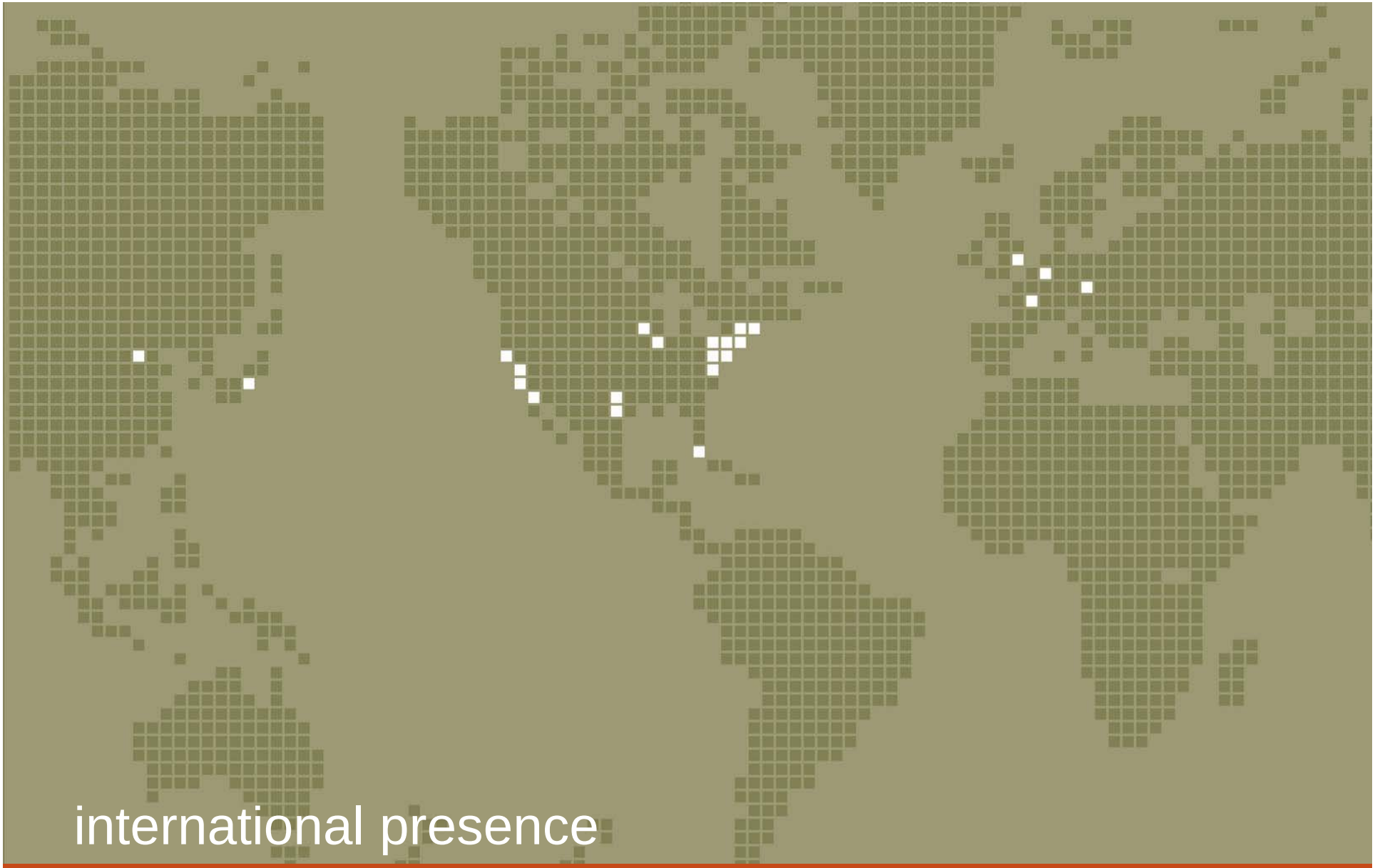
- Public policy exception to at-will employment
  - Many states recognize a public policy exception to at-will employment
  - While we are unaware of any court applying a public policy exception to protect political contributions, we expect plaintiffs to seek to expand the public policy exception to include such claims
  - Employers can reduce their risk by appropriately limiting their disclosure and pre-clearance requirements, any monitoring of political contributions, and any adverse employment actions to those that are required to comply with pay-to-play laws or otherwise advance legitimate business interests of the employer

Employment Law – Pre-Emption

- Federal pre-emption of state laws
  - State employment laws are arguably pre-empted insofar as they conflict with federal pay-to-play laws or interfere with employers' ability to comply with the Rule
  - In that regard, the only way for advisers to comply with pay-to-play laws and the Rule is to implement reasonable disclosure and pre-clearance requirements and to monitor compliance
  - Pre-emption would likely only apply insofar as disclosure and pre-clearance requirements and any monitoring of contributions are appropriately limited to those that are necessary to ensure compliance with the Rule

Employment Law – Advice

- Disclosure and pre-clearance requirements and any monitoring should be limited to contributions in excess of the *de minimis* limitations and, in the case of disclosure requirements and any monitoring, contributions that were made both
  - on or after March 14, 2011; and
  - within the applicable "look-back" period
- Consider also limiting mandatory disclosure and pre-clearance requirements and any monitoring of contributions to individuals working in or applying for positions as "covered associates," and informing other applicants and employees that they need to voluntarily disclose, pre-clear, and authorize monitoring of political contributions if they want to be eligible for consideration for "covered associate" positions in the future



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