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CALIFORNIA REGULATION OF PRIVATE FUNDS

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April 3, 2019

Agenda

- California Lobbyist Registration Requirements
- California Public Disclosure Law Considerations
- Registering in California as an Investment Adviser

CALIFORNIA LOBBYIST REGISTRATION REQUIREMENTS

Who needs to register?

- California state-level lobbying is governed by the California Political Reform Act (CPRA) and regulated by the Fair Political Practices Commission (FPPC)
- A "Lobbyist" is defined to include a "placement agent" when they influence an "administrative action" on behalf of an "external manager"
- A person acting as a "placement agent" in connection with any investment made by a state public retirement plan violates California state law if such person fails to register as a lobbyist with the California Fair Political Practices Commission.

Who needs to register?

- Definition of a placement agent
  - Person directly or indirectly hired, engaged or retained by, or serving of the benefit of an "external manager" or an investment vehicle managed by an "external manager"
  - Who acts or has acted for compensation
  - As a finder, solicitor, marketer, consultant, broker or other intermediary
  - In connection with the offer or sale of the services of an "external manager" to a state public retirement system in California or an "investment vehicle"
  - Of either of the following:
    - the investment management services of the external manager; or
    - an ownership interest of an investment fund managed by the external manager.

Who needs to register?

- "administrative action" includes "the decision by a state agency to enter into a contract to invest state public retirement system assets on behalf of a state public retirement system."

Who needs to register?

- "external manager" includes
  - persons retained or seeking to be retained
  - to manage a portfolio of securities or assets for compensation or
  - who is engaged in the business of investing, reinvesting, owning, holding or trading securities or other assets
  - or offers or sells securities to a state public retirement system.
- Definition revised in "clean-up bill" SB 398 to exclude broker-dealers who provide routine trading and sales advice in a broker firm while servicing a state public retirement account.

Exemptions: One-Third Exemption

- One-third exemption for individuals of an "external manager"
  - 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.

Exemptions: One-Third Exemption

- Basis for the One-Third Exemption
  - Permits those who are not primarily making offers or sales to public retirement systems to perform their job duties without being subject to lobbyist registration requirements.
  - Includes firm principals or employees who direct the purchase or sale of investments.
  - Allows such persons to offer support to the placement agents without becoming one themselves.

Exemptions: One-Third Exemption

- What activities is "managing" the securities or assets and qualify for the one-third calculation?
  - Non solicitation activities fall into 2 categories:
    - Hands-on activities that directly relate to overseeing an investment fund's performance and investment strategies. *These fall into the "managing" definition.*
    - Other management responsibilities such as hiring, supervising or simply participating in the firm's operations. *Although they facilitate the securities management aspect of the position, they are not actively managing securities.*

Exemptions: One-Third Exemption

- *Category 1* - Hands-on activities that directly relate to overseeing an investment fund's performance and investment strategies and do qualify for the one-third calculation include:
  - Regularly meeting with the investment staff to discuss firm strategies, including potential acquisitions of target companies and liquidity events.
  - Developing ongoing investment management strategies.
  - Preparing and reporting on the analysis of investments and investment strategies.
  - Monitoring financial or operational performance of investments to ensure portfolios meet risk goals.

Exemptions: One-Third Exemption

- *Category 2:* Other management responsibilities such as hiring, supervising or simply participating in the firm's operations and do not qualify for the one-third calculation include:
  - ~~Regularly meeting with the investment staff to discuss firm strategies, including potential acquisitions of target companies and liquidity events.~~
  - Overseeing the legal negotiations and related activity required to close investment deals.
  - Handling business and legal issues involving particular investment assets or properties.
  - Ensuring and overseeing regulatory compliance.
  - Evaluating, training and hiring staff as needed.
  - Maintaining an internal database of information on the investors.
  - Performing the general operations work of an investment manager.

Exemptions: Experts

- FPPC approved a regulation that made a narrow exception for certain experts from the placement agent definition.
- Applies to situations where a registered placement agent meets with a state public retirement system and brings along a technical expert.
- The individual does not become a placement agent solely as a result of communicating with the state public retirement system representative provided that:
  - The individual or his or her organization
  - Is present only to provide additional substantive information
  - And would not otherwise qualify as a placement agent.

Exemptions: Experts

- The definition of placement agent also excludes financial experts who a placement agent calls to share his or her expertise with a client.
- Applies to a scenario where a placement agent has concluded a sale of an investment fund or the services of an external manager, the state public retirement system.
- If that system wants to discuss a particular investment, including information about its performance or returns, the person the state would want to contact is the financial expert, not the placement agent who marketed the deal.
- Such a discussion call does not make the financial expert a marketer.

Exemptions: Other Exemptions

- An attorney who provides counsel to an "external manager" on contractual issues arising from the offer and sale of a portfolio or asset does not qualify as a placement agent because there is not attempt to influence an administrative action.
- Employees of an "external manager" are not considered placement agents when they provide services under a contract that has already been awarded by a state public retirement system for investment manager services.

Exemptions: Exemption for Competitive Bidding

- Competitive bidding exemption for individual of an "external manager"
  - An employee, officer or director of an external manager (or its affiliate)
  - Is not a placement agent with respect to an offer or sale of investment manager services if the "external manager":
    - is registered as an investment adviser or a broker deal with the SEC or if exempt, any appropriate state regulator;
    - is participating in a competitive bidding process such as a request for proposals or has been selected through that process and is providing services; and
    - Has agreed to a fiduciary standard of care required under the California constitution for management of a portfolio of assets of a state public retirement system in California.

Exemptions: Exemption for Competitive Bidding

- Competitive bidding exemption revised in "clean-up bill" SB 398 to:
  - Clarify that the competitive bidding exception to the definition of "placement agent" applies during the competitive bidding process to all those competing, and not only to those selected; and
  - Make the competitive bidding exception applicable to the requirements of local governments with respect to local retirement plans.

Implications of having to register

- Disclosure Requirements: After registering, a registrant must file a report every three months that discloses:
  - The amount spent on state-level lobbying;
  - the bills, regulations and other matters on which the organization lobbied;
  - payments to lobbyists; and
  - details on gifts (if any) the organization made to covered state officials.

Implications of having to register

- Lobbying entities who incur $2,500 in lobbying activity in a quarterly filing period, must file electronically or online for that quarter and all subsequent quarterly filing periods (regardless of the level of activity).
- *Quarterly Disclosures – Forms 635 and 615*
  - Lobbyist Employers must file a report on Form 635 along with their Lobbyist employees' Forms 615 by the end of the month following each calendar quarter-end.
  - These reports must include information on payments made in connection with lobbying activities, including an allocated portion of salaries paid to employees who are Lobbyists, itemization of "activity expenses" incurred or arranged during the quarter, and a description of political contributions of $100 or more.

Implications of having to register

- *Lobbyist ethics orientation*
  - Lobbyists are required to attend an ethics orientation course conducted by the Legislature.
  - The Legislature will notify lobbyists of course dates, and will provide a certificate of completion of the course.
  - If the lobbyist has not already completed the course within the previous 12 months, the lobbyist must take the course within either the 12 months after qualifying if they are a new lobbyist, or by June 30 of the following year if the lobbyist is renewing his certification.
  - Lobbyists must certify that they have taken the ethics course on their Form 615s.

Implications of having to register

- Contingency Fees
  - Lobbyists and lobbying firms are prohibited from accepting payment contingent upon defeat, enactment, or outcome of any legislative or administrative action.
  - As such, placement agents registered as lobbyists are not permitted to "accept or agree to accept any payment in any way contingent upon … the decision by any state agency to enter into a contract to invest state public retirement system assets on behalf of a state public retirement system."
  - Fees may still be paid by investment managers to placement agents for services rendered but may not be contingent on "the defeat, enactment or outcome of any" proposed investment action.
  - Compensating a placement agent with a percentage of investor commitments is prohibited with respect to a California state public pension plan commitment.

Implications of having to register

- Gifts
  - Lobbyists and lobbying firms are prohibited from making gifts or acting as intermediaries in making gifts, aggregating more than $10 in a calendar month to a legislative official, state agency official, state candidate or officer, or to any official of an agency listed on their registration statement.
    - $10 gift limit does not apply to lobbyist employers, as long as lobbyist or lobbying firm is not involved in making arrangement of the gift.
    - An official may not accept gifts from a single source in any calendar year totaling more than $420.

Implications of having to register

- Records Retention
  - Employers and employees must keep detailed records supporting the information disclosed in lobbyist filings for 4 years.
- Political Contributions
  - Lobbyists may not contribute to state candidates/officeholders if they are registered to lobby the candidate's/officeholder's agency
- Penalties
  - Any person who knowingly or willfully violates any provision of the Political Reform Act is guilty of a misdemeanor
  - Persons convicted of a misdemeanor may be disqualified for 4 years from the date of conviction from serving as a lobbyist or running for elective office
- A lobbyist may also be subject to audit by the California Franchise Tax Board.

Local Pension Plan Rules Also Apply

- Any person
  - acting as a placement agent in connection with
  - any potential investment made by a California local public retirement system (e.g., the retirement systems of the cities or local municipalities)
  - must register (if required)
  - with such local government,
  - file any applicable reports to the local government and
  - otherwise apply with their local regulations.

Federal Provisions also apply

Marketing to State or Local Government Entities

- SEC Rule 206(4)-5 ("Pay to Play Rule")
  - Prohibits/restricts certain political contributions and contribution solicitation activities
  - Limits on contributions to state and local officials and candidates
  - Applies to contributions to some PACs
  - Family members not limited, but watch out for the "doing indirectly" problem
  - ***Two year time out from taking fees if excessive contributions made***

PUBLIC DISCLOSURE LAW CONSIDERATIONS

Genesis

- Assembly Bill 2833, codified in Cal. Govt. Code 7514.7 (the "Fee Disclosure Law"), was introduced in February 2016.

- Sponsored by California State Treasurer John Chiang as legislation to set reporting requirements and establish transparency for private equity funds.

- Applies to any new contracts and additional commitments entered into by California public pension and retirement systems ("state plans") after January 1, 2017.

Overview

- What does the Fee Disclosure Law require from private funds?

- What does the Fee Disclosure Law require from state plans?

Common Misunderstandings

- Defined Terms
- Efforts Clauses and Conditional Obligations
- Limitations

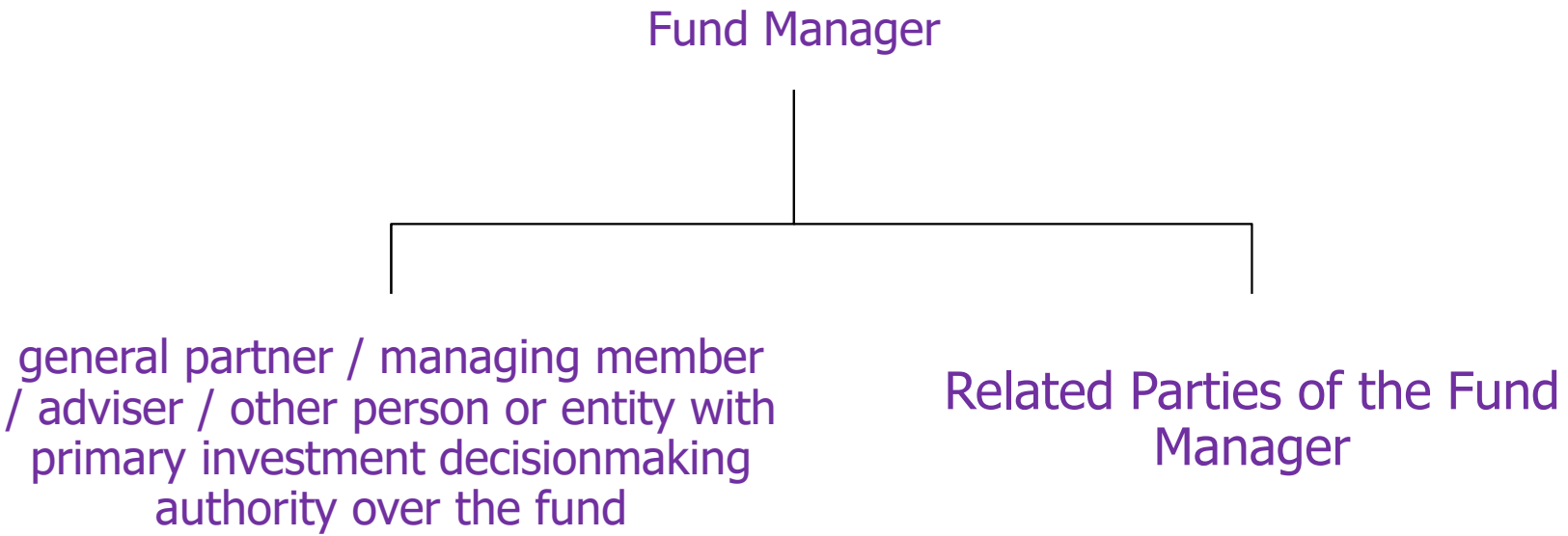
What Needs to be Disclosed?

1. Fees and expenses that the state plan pays directly to the fund, the Fund Manager or Related Parties
2. State plan's pro rata share of fees and expenses not included in 1 above that are paid from the fund to the Fund Manager or Related Parties.
3. State plan's pro rata share of carried interest distributed to the Fund Manager or Related Parties.
4. State plan's pro rata share of aggregate fees and expenses paid by all of the portfolio companies of the fund to the Fund Manager or Related Parties.
5. Any other information described in Section 6254.26(b).
6. Gross and net rate of return of the fund, since inception.

Unpacking Definitions

"Carried interest" means any share of profits from a fund that is distributed to a Fund Manager, a general partner or Related Parties, including allocations of fund profits received by a Fund Manager in consideration of having waived fees that it might otherwise have been entitled to receive.

Unpacking Defined Terms



Unpacking Defined Terms

Related Party

Related Person

Any current or former employee, manager, or partner of any related entity that is involved in the investment activities or accounting and valuation functions of the Relevant Entity or any of their respective family members

Operational Person

Any operational partner, senior advisor, or other consultant or employee whose primary activity for a Relevant Entity is to provide operational or back office support to any portfolio company of the fund or other accounts or funds managed by a Related Person

Any entity more than 10% of the ownership of which is held directly or indirectly, by a Related Person or an Operational Person

Any consulting, legal or other service provider regularly engaged by portfolio companies of the fund or other accounts or funds managed by a Related Person and that also provides advice or services to any Related Person or Relevant Entity

"**Relevant Entity**" means the general partner, any separate carry vehicle, the investment advisor, any of the investment advisor's parent or subsidiary entities, or any similar entity related to the fund or any other account or fund advised or managed by any current or former Related Person.

Hypotheticals – Scenario #1

- California Police Dogs Retirement Fund ("CalDogs") invested in PE Fund X, L.P. in January 2019.
- The investment adviser of PE Fund X, L.P. is managed by PE Fund Advisers LLC.
- Jon Snow is a former employee of PE Fund Advisers LLC. He assisted with determining valuations of portfolio companies of PE Fund IX, L.P. but was let go from the firm because he knew nothing.
- PE Fund IX, L.P. provided Mr. Snow his final payment in March 2019.
- Does PE Fund Advisers LLC need to include Mr. Snow's payment when disclosing Fee Disclosure Law information to CalDogs?

Hypotheticals – Scenario #2

- Assume same facts as Scenario #1, except Mr. Snow's final payment was paid by a portfolio company of PE Fund IX, L.P., in which PE Fund X, L.P. has also made an investment.
- Does PE Fund Advisers LLC need to include Mr. Snow's payment when disclosing Fee Disclosure Law information to CalDogs?

Hypotheticals – Scenario #3

- CalDogs invested in PE Fund X, L.P. in January 2019.
- Mr. Snow was a former consultant of a portfolio company of PE Fund X, L.P., and in that capacity, provided valuation services to PE Fund Advisers LLC.
- The portfolio company provided Mr. Snow his final payment in March 2019.
- Does PE Fund Advisers LLC need to include Mr. Snow's payment when disclosing Fee Disclosure Law information to CalDogs?

Bringing it back home

- State plan is always the crux.
- Definitions are expansive but funds only need to follow the money.
- Refer to the operative provisions.

REGISTERING IN CALIFORNIA AS AN INVESTMENT ADVISER

Legal consideration of when to register with a state

- Post Dodd-Frank, states act as the primary regulator for investment advisers with less than $100 million of assets under management and for advisers solely to private funds with less than $150 million of assets under management.
- For purposes of the foregoing exception, "assets under management" is defined as the securities portfolios with respect to which an investment adviser provides continuous and regular supervisory or management services.
- "Private funds" are unregistered funds relying on a 3(c)(1) or 3(c)(7) exemption under the Investment Company Act of 1940 that have not elected to be treated as a business development company in compliance with the Investment Company Act.

Legal consideration of when to register with a state

- If you are an investment adviser;
- With your principal office and place of business in the United States;
- With less than $100 million of assets under management and for advisers solely to private funds with less than $150 million of assets under management;
- You are a U.S. private fund adviser and exempt from registration with the SEC.
- Notwithstanding such exemption:
  - SEC reporting requirements still apply;
  - SEC recordkeeping still applies; and
  - State registrations requirements may apply.

When do you have to register in California?

- It is unlawful for any investment adviser to conduct business in the state unless the investment adviser first applies for and secures a certificate authorizing the investment adviser to do so.

- You must register in California as an investment adviser if:
  - You are an investment adviser;
  - You have a place of business in this state or during the preceding 12-month period you advised six or more clients who are residents of this state;
  - You are not registered as an investment adviser with the SEC; and
  - No exemption applies.

Are you an investment adviser?

- "Investment Adviser" is

  "Any person who:

  - for compensation,
  - is engaged in the business of
  - advising others, either directly or through publications or writings,
  - as to the value of securities or the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities."

When does an investment adviser need to register in California?

- No requirement to register if:
  - the investment adviser does not have a place of business in this state and
  - during the preceding 12-month period has had fewer than six clients who are residents of this state.
- Advisers registered with the SEC are not required to register in California but make an annual notice filing to the state if the adviser has 6 or more clients in California.

Does an exemption apply?

- Available exemptions under the California Code of Regulations:
  - Private Fund advisers
  - Venture Fund advisers
  - Retail Fund advisers
- Even if exempt, such advisers are subject to certain disqualifications and disclosure and fee requirements.

Exemption: Qualifying Private Fund Adviser

- A qualifying private fund adviser is an investment adviser that provides advice solely to one or more funds that qualify for exclusion from the definition of "investment company" under one or more of sections 3(c)(1), 3(c)(5) and 3(c)(7) of the Investment Company Act of 1940.
- It must satisfy each of the following conditions:
  - Not be subject to disqualification as a result of "bad acts" as defined per Rule 262 of Regulation A under the Securities Act of 1933.
  - File periodic informational notices regarding the characteristics of the adviser and associated qualifying private funds with the California Commissioner of Financial Institutions, via the IARD (including all reports required of an exempt reporting adviser under the SEC's regime such as specified sections of Part 1A of Form ADV relating to organization and operations).
  - It must pay application and renewal fees required of a certificated adviser.

Exemption: Venture Fund Adviser

- If the private fund adviser is a venture capital company, no further requirements are applicable.
- A "venture capital company" is defined as an entity that satisfies one of the following:
  - Qualifies as a venture capital fund under Rule 203(l)-1 of the Investment Advisers Act.
  - Qualifies as a "venture capital operating company" under Title I of ERISA.
  - On at least one occasion during the annual period commencing with the date of its initial capitalization, and on at least one occasion during each annual period thereafter, at least 50% of its assets (other than short-term investments pending long-term commitment or distribution to investors), valued at cost, are venture capital investments or derivative investments.

Exemption: Venture Fund Adviser

"Venture capital investments" are defined as an acquisition of securities in an operating company as to which the private fund adviser or its affiliates obtains rights (either contractually or through ownership of securities) to substantially participate in, to substantially influence the conduct of, or to provide (or offer to provide) significant guidance and counsel concerning the management, operations or business objectives of the operating company in which the venture capital investment is made.

"Operating company" means an entity that is primarily engaged, directly or through a majority owned subsidiary or subsidiaries, in the production or sale (including any research or development) of a product or service other than the management or investment of capital, but shall not include an individual or sole proprietorship.

Exemption: Venture Fund Adviser

"Management rights" are rights to substantially participate in, influence, guide or counsel the operating company with respect to its operations or business objectives.

A "derivative investment" is an acquisition of securities acquired upon conversion of a venture capital investment or in connection with a public offering, merger or reorganization of the operating company to which a venture capital investment relates.

Exemption: Retail Fund Adviser

- If the private fund adviser is not a venture capital company, the fund adviser may still be exempt but the following additional requirement apply if it is not exempt from registration as an investment company pursuant to Section 3(c)(7):
  - The fund must be beneficially owned entirely by accredited investors or managers, directors, officers or employees of the private fund adviser.
  - At or before the time of purchase of any ownership interest, each purchaser shall receive a plain English disclosure, such as a private placement memorandum, containing all material facts regarding (i) services to be provided by the investment adviser and (ii) all duties, if any, the investment adviser owes to the fund and its beneficial owners.
  - The adviser shall obtain annual audited financial statements for the fund from an independent, qualified CPA.
  - The adviser may not enter into, perform, renew or extend an investment advisory contract that provides for compensation to the adviser on the basis of a share of the capital gains of the funds of an investor that is not a qualified client (as defined in Rule 205-3(d)of the Advisers Act).

How to Comply with Exempt Requirements?

- Obtain access to the Investment Adviser Registration Depository ("IARD") system by submitting a State Registrant Entitlement Packet to FINRA via the IARD website.
- Fund the Daily Account through IARD in order to pay filing fee.
- Complete Form ADV Part 1B which requires information about the investment adviser's business. Complete Form ADV Part 2A-2B which requires narratives written in plain English about advisory services offered, fee schedules, disciplinary information, conflicts of interest, and educational and business backgrounds of management and key advisory personnel.
- Submit Form ADV electronically.

Biography

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Miranda Lindl O'Connell represents fund of funds, private foundations, social entrepreneurs, pension plans and other institutional investors in private investment fund transactions. Miranda counsels clients regarding the investment in and secondary sale of interests in private investment funds of a variety of structures including private equity funds, co-investment funds, venture funds, captive funds, separate accounts and other customized private finance options. She advises social entrepreneurs, private foundations, and charities on a range of social impact investments including program-related investments, mission-related investments, and innovative investment vehicles and structures including social impact funds and debt and equity investments.

Biography

Monica H. Chang
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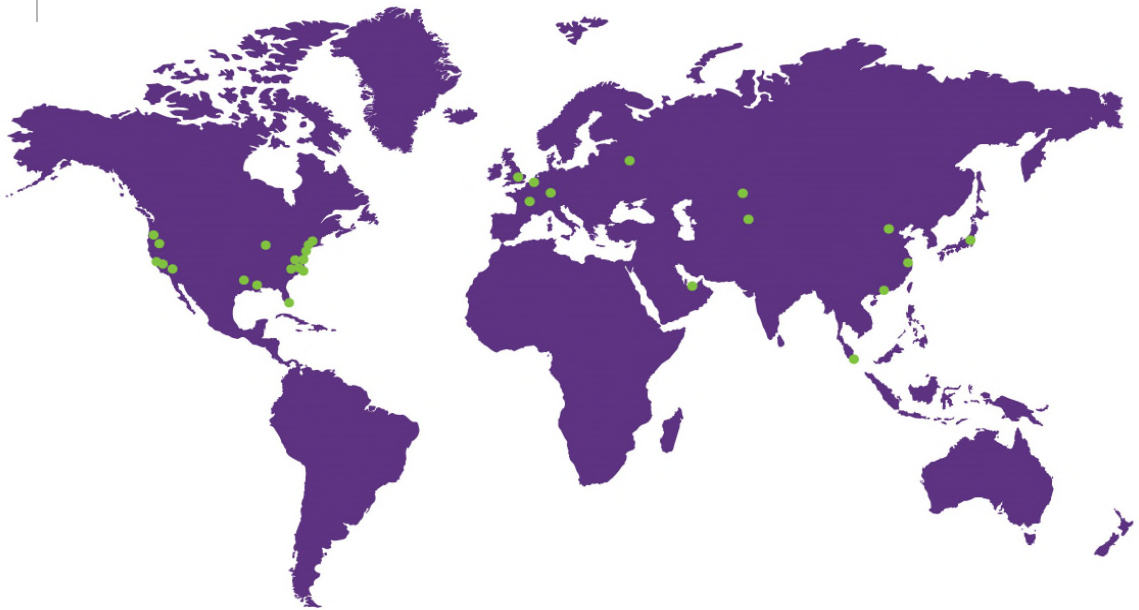
Monica H. Chang works primarily on the structuring, formation, and governance of, and investment in, US domestic and international private investment funds in all asset classes. Monica advises fund sponsors and investment managers on fund formations and the structuring of separately managed account vehicles, secondary transactions, portfolio investments, and matters relating to fund governance and issues of state corporate and partnership law.

Our Global Reach

Africa
Asia Pacific
Europe
Latin America
Middle East
North America

Our Locations

Almaty	Chicago	Houston	Orange County	Shanghai*
Astana	Dallas	London	Paris	Silicon Valley
Beijing*	Dubai	Los Angeles	Philadelphia	Singapore
Boston	Frankfurt	Miami	Pittsburgh	Tokyo
Brussels	Hartford	Moscow	Princeton	Washington, DC
Century City	Hong Kong*	New York	San Francisco	Wilmington



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