
Michigan Pay to Play Law Targeting Service Providers to Public Employee Pension Plans Takes Effect

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A Michigan law aimed at curbing the "pay to play" practices of service providers to public pension systems came into effect on March 28. The provision is part of a larger bill signed into law late last year by Governor Snyder, Public Act 347, which amends the Public Employee Retirement System Investment Act in numerous areas. Pay-to-play is the practice by which service providers make campaign contributions to officials of a governmental entity in order to influence the awarding of lucrative contracts for the management of public pension plan assets. The law contains language that mirrors the Securities and Exchange Commission's pay-to-play rule applicable to registered investment advisors.

The Law

Generally, the new pay to play law prohibits an investment fiduciary of a public pension system from making a payment or providing compensation to a system's service provider(s) if the service provider or a covered associate of the provider had made a contribution to an official of a governmental entity during the previous 24 months. The law broadly defines the term "service provider" to cover persons retained to provide services to a public pension system, including investment advisers, consultants, custodians, accountants, auditors, attorneys, actuaries, administrators, and physicians. It also includes a service provider's "covered associates," including,

- (1) a general partner, managing member, agent, or officer of the service provider or any other individual with a similar status or function for the service provider;
- (2) an employee of the service provider who solicits a governmental entity on behalf of the service provider and any individual employed by the service provider who directly or indirectly supervises that employee; and,
- (3) a political action committee controlled by the service provider.

A service provider contribution to an "official of a governmental entity" will trigger the law's payment and compensation restrictions. An official of a governmental entity means an individual who, at the time of the contribution, was an incumbent, candidate, or successful candidate for an elective office in a governmental entity if the office,

- (1) is directly or indirectly responsible for or can influence the outcome of the hiring of a service provider by a system sponsored by the governmental entity; or,
- (2) has the authority to appoint an individual who is directly or indirectly responsible for or can influence the outcome of the hiring of a service provider by a system sponsored by the governmental entity

Similar to the SEC's rule, this law has exceptions -- it does not apply when:

- (1) the service provider or covered associate was entitled to vote for the official at the time of the contribution and it did not exceed \$350 per election;
- (2) the service provider or covered associate was not entitled to vote for the official but the contribution did not exceed \$150 per election;
- (3) the contribution was made to an official by an individual more than six months before he or she became a covered associate of the service provider; or,
- (4) the contribution was made to an official and was discovered within four months, did not exceed \$350, and the contribution is returned.

A Compliance Plan is Critical

Under the state's new pay to play law, if public pension system service providers, or their "covered associates," contribute to applicable governmental entity officials, they and their firms will be in jeopardy of being disqualified from public pension system service contracts. In light of these severe consequences, we encourage pension system service providers to implement comprehensive compliance plans to guard against any potential violations. Compliance plans should include, but not be limited to:

- (1) Instituting disclosure policies for newly-hired employees or applicants with regard to their previous political contributions;
- (2) Establishing a pre-clearance system for approving political contributions for public pension system service providers and their employees;
- (3) Performing a comprehensive internal political audit to determine who would fall under the definition of "covered associate";
- (4) Delegating political compliance data gathering duties to a specific person within the organization; and,
- (5) Instituting mandatory firm-wide political law compliance training programs for all service providers to public pension systems.

The complicated nature of Michigan's new pay to play law, coupled with the considerable potential for inadvertent violations with major financial consequences, suggests that service providers and their firms seek experienced legal counsel to assist them in implementing a compliance plan.