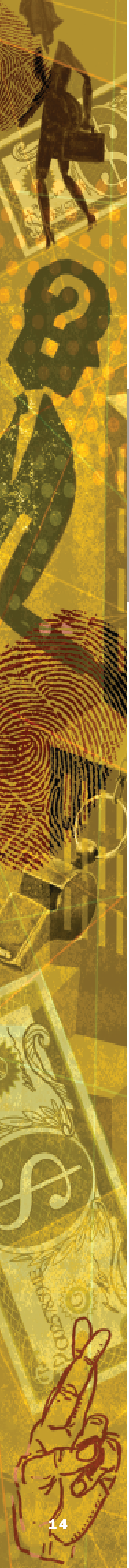

We Need to Stop Pay-to-Play Corruption

Pay-to-play contracting has long been an ethics issue in government. Efforts to eliminate or reduce pay-to-play continue, including a proposed rule from the SEC as well as state and federal legislation.

The Securities & Exchange Commission (SEC) appears to be having success in its efforts to curb fraud and pursue wrongdoers, issuing an average of 46 litigation releases per month in 2009 through July, compared to 35.8 per month in all of 2008. Additionally, it's creating five new national units to specialize in enforcement of complex areas of securities law. The five units will focus on municipal securities, public pensions, asset management, market abuse, structured and new products, and the Foreign Corrupt Practices Act. Further, the SEC has recently issued many rule-making pronouncements, including proposed rules for the regulation of credit-rating agencies, money market reform, short selling, a roadmap for adoption of international accounting standards, and improved shareowner participation.

Possibly the most important ethical issues involve proposed SEC rules that would prevent an investment adviser from paying, soliciting, or coordinating contributions to elected officials, candidates, or political parties where the adviser is providing or seeking government business. In other words, the SEC is attempting to stop pay-to-play corruption payments designed to influence the selection of investment managers for huge funds of assets accumulated for state, municipal, teacher, and other government retirement, transportation, education, and other purposes. Public pension assets are estimated to be $2.2 trillion. In 2009, they represent one-third of all U.S. pension assets. They are among the largest and most active institutional investors in the U.S.

> **The proposed rule not only bans direct political contributions or solicitations by those attempting to obtain investment management contracts, but it also seeks to prevent corruption by indirect means.**

The record of SEC efforts to prevent corruption in this area is long. It addressed pay-to-play practices in the municipal securities markets in 1994. Following the adoption of rules prohibiting corruption in municipal underwriting, however, the Commission believed that pay-to-play migrated to investment management where elected officials, or trustees they appoint, may have the sole authority to select investment managers of funds. In response to these concerns, the SEC proposed rules in 1999 designed to prevent pay-to-play practices in investment management, but these rules weren't adopted because of a mixed response from the public. Some commenters said that pay-to-play wasn't a problem.

Several states have attempted to deal with the problem of pay-to-play contracting with mixed success. In Ohio, on January 2, 2007, then Governor Bob Taft signed into law sweeping changes to Ohio's pay-to-play laws that placed significant restrictions on many political contributors who currently held, or hoped to win, some kind of contract with the state or a local government entity. The new law also extended prohibitions to many political subdivisions that weren't covered under previous versions of the law, including county commissioners, city council members, township trustees, school board members, and other local boards, commissions, task forces, and authorities. This law was voided on April 15, 2009, by the Ohio Appellate Court affirming union challenges to its constitutionality and reinstating previous procurement contract law.

New Jersey's pay-to-play law took effect January 1, 2006. On January 13, 2008, Governor Jon Corzine signed into law the clarification that the pay-to-play disclosure laws don't apply to nonprofit entities. New Jersey politicians complained that contributions from contractors just dried up. The law was declared constitutional by the New Jersey State Supreme Court on January 15, 2009. Perhaps as a result of the law, citizens of the Garden State received a wake-up call in early August 2009 as 44 people around the state, including two state legislators, three mayors, and several other local officials, were arrested on public corruption charges. In spite of this success, the Citizen's Campaign of New Jersey believes that coverage of pay-to-play laws needs to be extended. It noted in the *Asbury Park Press* (APP.com) on August 2, 2009, "The nod and the wink exchanging of government contracts, development approvals, and other goodies in return for political contributions and even the occasional bag of cold hard cash is still very much alive and well." It continued, "Now is the time to act on local pay-to-play reform and apply the same limits in place at the state level to counties, municipalities, and school boards."

For guidance in applying the *IMA Statement of Ethical Professional Practice* to your ethical dilemma, contact the IMA Ethics Helpline at (800) 245-1383 in the U.S. or Canada. In other countries, dial the AT&T USADirect Access Number from www.usa.att.com/traveler/index.jsp, then the above number.

Under the proposed SEC rule, an investment adviser who makes a political contribution to an elected official in a position to influence the selection of an adviser to manage investments would be barred for two years from providing advisory services for compensation, either directly or through a fund. The proposed rule not only bans direct political contributions or solicitations by those attempting to obtain investment management contracts, but it also seeks to prevent corruption by indirect means. It bans payments through third parties, such as spouses, attorneys, and affiliated companies.

Andrew J. Donohue, director of the SEC's Division of Investment Management, stated, "Pay-to-play serves the interests of advisers to public pension plans rather than the interests of the millions of pension plan beneficiaries who rely on their advice. The rule we are proposing today would help ensure that advisory contracts are awarded on professional competence, not political influence."

The SEC also has had success settling cases concerning kickbacks and other fraudulent schemes involving investment management in New York, Connecticut, and New Mexico. In addition, criminal authorities have brought pay-to-play corruption cases in New York, New Mexico, Illinois, Ohio, Connecticut, and Florida. One casualty of the New Mexico probe was Governor Bill Richardson's chance to be U.S. Secretary of Commerce. On January 13, 2009, *The New York Times* noted that federal prosecutors were investigating whether "his aides steered a lucrative state contract to a generous political donor." But more action is needed to stop pay-to-play. *The Times* editorialized: "Pay-to-play is a staple of bad government. Proving an actual quid pro quo that can be prosecuted can be difficult, especially under porous state laws.…What's needed is some courage in statehouses to fix the shoddy campaign-finance rules and laissez-faire lobbying privileges and impose bans on 'fact-finding' junkets and other 'honest graft' for legislators. Clear rules would remove any doubt and any temptation."

An obvious place to extend bans on pay-to-play practices is in other areas of government procurement. According to Public Citizen, on two occasions—once in New Jersey in 2004 and once in Illinois in 2008—the Federal Highway Administration (FHWA) agency withheld billions of dollars in desperately needed highway construction funds because of the

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existence of state pay-to-play laws. FHWA officials deemed pay-to-play laws not "cost effective" and found that they fail to conform to federal contracting standards. The FHWA argued that state pay-to-play laws deter contractors from entering the bidding process, thus weakening the competitive pool, driving up costs, and violating their interpretation of Section 112 of Title 23 of the U.S. Code.

To close this loophole, Congressman Mike Quigley (D.-Ill.), the newly elected replacement for current White House Chief of Staff Rahm Emanuel, introduced H.R. 3427—the State Ethics Reform Protection Act—on July 30, 2009. Supporting his bill, Quigley said that the FHWA actions result in weakening of anticorruption laws "enabling more graft or undermining a legislature's efforts to clean up their own state." Quigley characterized the bill's benefits by saying, "Allowing states to enforce aggressive reform measures helps us to ensure that government is operating in the best interest of the citizens and that publicly-funding projects are chosen on merit, not influential political contributions." The bill has been referred to the House Transportation and Infrastructure Committee for consideration after the summer recess.

Elsewhere within Washington, Senator Robert Bennett (R.-Utah) on July 7, 2009, requested that the SEC look into pay-to-play by law firms, saying, "Campaign contributions by law firms in exchange for business is no less serious a threat to the integrity of the nation's public pension funds." It's apparently well known that securities class action law firms shell out tons in campaign contributions to state politicians who often return the favor by hiring the firms to file securities suits on behalf of state pension funds. The *Law Blog* revealed a July 14, 2009, response by the SEC, stating, "The Commission's review of pay-to-play practices involving public pension funds relates to fund managers and other financial firms that are subject to Commission regulation under the securities laws." In other words, pay-to-play and other practices of law firms to obtain business are beyond the purview of the SEC and perhaps any other regulation.

While not pay-to-play, examples of a softer method of possibly obtaining influence are the two prominent senators who accepted VIP special mortgage treatment from Countryside Financial as members of a group known as "Friends of Angelo," which refers to Angelo Mozilo, Countryside's former CEO. The two were cleared of rule breaking by the Senate Ethics Committee but were scolded for not being more careful to avoid the appearance of sweetheart deals.

Corruptive campaign and other payments seem to be a Washington fixture, regardless of periodic "reform" efforts. In his article titled "Pay-to-Play is Washington's Sport of Kings," in *Bill Moyer's Journal*, Michael Winship notes that even Honest Abe had his share of tainted colleagues. One of the most notorious was Secretary of War Simon Cameron. His definition of an honest politician was "one who, when he is bought, stays bought."

When will we recognize the true cost of extravagant pay-to-play spending? **SF**

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around the globe.

As I close the first full year of serving as your president and CEO, I want to thank you for your commitment to IMA. We must all work together as an inspired community—including the Board of Directors, chapters and councils, members and staff—to enable our global association to reach its full potential. We must envision the future and provide exemplary (not just good) products and services that enhance careers, organizational capabilities, and economic development. Our members and the global profession expect nothing less of us.

Sincerely,
Jeff Thomson
IMA President and CEO