FAIR POLITICAL PRACTICES COMMISSION
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June 30, 1999

Julia A. Moll
Deputy City Attorney
City and County of San Francisco
City Hall
1 Dr. Carlton B. Goodlett Place, Floor 2
San Francisco, California 94102-0917

Re: Your Request for Advice
Our File No. I-99-134

Dear Ms. Moll:

This letter is in response to your request for advice regarding the provisions of the Political Reform Act (the "Act").[1] Because your letter requests guidance as to general policy issues and does not seek advice as to the actions of specific persons and situations, we are treating your request as one for informal assistance. Please be aware that informal assistance from this office does not confer the immunity provided by an opinion or formal advice.[2] Please bear in mind that nothing in this letter should be construed as evaluation of any conduct which may already have taken place. Further, this letter is based on the facts as they have been presented to us. The Commission does not act as the finder of fact in providing advice. (*In re Oglesby* (1975) 1 FPPC Ops. 71.)

QUESTION

What are the reporting requirements applicable to investments made through San Francisco's Deferred Compensation Plan?

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[1] Government Code sections 81000 - 91014. Commission regulations appear at title 2, sections 18109 - 18995, of the California Code of Regulations.

[2] Section 83114; Regulation 18329(c)(3).

CONCLUSION

Investments of $1,000 or more made by plan participants in non-registered mutual funds must be disclosed.

FACTS

San Francisco offers a Deferred Compensation Plan (the "plan") to employees. The plan is administered by a private entity. Until 1999, the plan was managed by Hartford Life; commencing in 1999, the plan is managed by Aetna. The plan offers more than 20 investment options to the plan participants. The city attorney's office has confirmed that many of those investment options are either diversified mutual funds registered with the Securities and Exchange Commission ("SEC"), or money market funds.

In addition to diversified mutual funds registered with the SEC and money market funds, the following funds were offered as investment options during 1998: American Century Income & Growth Fund; American Century Value Fund; American Century Twentieth Century Ultra Fund; Calvert Responsibly Invested Balanced Fund; Fidelity Advisor Balanced Fund; Fidelity Advisor Growth & Income Fund, Fidelity Advisor Growth Opportunities Fund; Hartford General (Declared Interest Rate) Fund; and Hartford Advisers Fund. These funds are not mutual funds registered with the SEC,[3] but they bear many, if not all, of the characteristics of mutual funds, particularly in that the funds hold a large variety of securities, and fund investors do not choose (and may not receive any notice of) the securities traded and held by the funds. You note in your letter that some of the investment options offered for 1999 also do not appear to be mutual funds registered with the SEC.

You have asked us to assume, for purposes of our analysis, that a plan participant has invested $10,000 through the plan, and all of that money is, in turn, invested in a fund that holds various stocks. The plan participant controls the nature, timing and amount of the investment in the fund, and the benefit received depends on the success of the plan participant's investment decisions. However, the plan participant does not control the nature, timing or amount of investments made by the fund. Finally, you ask us to assume that the fund bears all the characteristics of a diversified mutual fund although it is not registered as such with the SEC.

ANALYSIS

Under Section 87203, certain persons designated by the Act must, each year, file a statement disclosing, among other things, his or her investments held at any time during the

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[3] As confirmed with the SEC by your office.

period covered by the statement.[4] The statement shall contain a statement of the nature of the investment and the name of the business entity in which each investment is held, together with a general description of the business activity in which the business activity is engaged. (Section 87206.)

An "investment" is defined in Section 82034 as follows:

> ""Investment' means any financial interest in or security issued by a business entity, including but not limited to common stock, preferred stock, rights, warrants, options, debt instruments and any partnership or other ownership interest owned directly, indirectly or beneficially by the public official, or other filer, or his or her immediate family, if the business entity or any parent, subsidiary or otherwise related business entity has an interest in real property in the jurisdiction, or does business or plans to do business in the jurisdiction, or has done business within the jurisdiction at any time during the two years prior to the time any statement or other action is required under this title. No asset shall be deemed an investment unless its fair market value equals or exceeds one thousand dollars ($1,000). The term 'investment' does not include a time or demand deposit in a financial institution, shares in a credit union, any insurance policy, interest in a diversified mutual fund registered with the Securities and Exchange Commission under the Investment Company Act of 1940 or a common trust fund which is created pursuant to Section 1564 of the Financial Code, or any bond or other debt instrument issued by any government or government agency. Investments of an individual includes a pro rata share of investments of any business entity, mutual fund, or trust in which the individual or immediate family owns, directly or beneficially, a 10-percent interest or greater. The term 'parent, subsidiary or otherwise related business entity' shall be specifically defined by regulations of the commission."

It is important to emphasize that pursuant to the specific language of Section 82034, the term "investment" does **not** include an interest in a diversified mutual fund registered with the SEC.

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[4] The magnitude of disclosure is governed by both the Act (e.g., Section 87200) and an individual agency's conflict of interest code. Because we are providing general advice only and have no specific examples from which to work, we will provide advice relating to full disclosure.

Initially we point out that, unlike some other governmental retirement or deferred compensation programs (e.g., the CalPERS funds referenced in the *Gillan* Advice Letter, No. I-98-216), the San Francisco plan is managed by a private entity (Harford Life in 1998 and Aetna in 1999). Thus, the plan - and the investments made through it - are subject to evaluation under Section 82034.[5] Notwithstanding the foregoing statement, the Commission has previously determined that a participant will not have an investment interest in the deferred compensation plan itself. (*In re Elmore* (1978) 4 FPPC Ops. 8; *McMurtry* Advice Letter, No. A-99-058.) The deferred compensation plan is merely a means for deferral of federal income taxes on the funds invested in the plan; for purposes of disclosure of economic interests, investments made through a deferred compensation plan should be treated as if the participant had received the salary and invested the money in the investment vehicles offered by the deferred compensation plan. (*In re Elmore, supra.*) Therefore, in this matter, we look past the city's plan and, instead, determine whether the investments made in the vehicles offered by the plan are reportable.

You state that the investment options offered by the plan consist of both mutual funds registered with the SEC and mutual funds not registered with the SEC. Under Section 82034, investments in diversified mutual funds registered with the SEC would not be "investments" subject to reporting under the Act. However, the clear language of Section 82034 offers no such exception for mutual funds (diversified or otherwise) that are **not** registered with the SEC. Accordingly, investments of $1,000 or more made by plan participants in the non-registered mutual funds must be disclosed.[6] (Section 82034.) If a plan participant's investment in the non-registered mutual fund results in the plan participant having a 10 percent or greater interest in the fund, then the plan participant must also disclose his or her pro rata interest in any investment made by the fund if that interest totals $1,000 or more and the business entity in which the investment is made does, has done or will do business in the jurisdiction. (Section 82034; *Todorov* Advice Letter, No. I-93-393; *Gillan* Advice Letter, *supra.*)

Under the facts you have asked us to consider, the plan participant must report the $10,000 investment in the non-registered fund.[7]

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[5] The definition of "investment" under Section 82034 requires a relationship with a business entity. Section 82005 defines a business entity as "any organization or enterprise operated for profit, including but not limited to a proprietorship, partnership, firm, business trust, joint venture, syndicate, corporation or association." Both Hartford Life and Aetna meet this broad definition.

[6] These funds meet the "doing business in the jurisdiction" test of Section 82034 since San Francisco employees choose or may choose to invest money in these funds.

[7] In addition, due to the "pass through rule," if the $10,000 investment amounts to a 10 percent interest in the fund itself, then the investments made by the fund (that are not exempt under Section 82034) must also be reported.

If you have any other questions regarding this matter, please contact me at (916) 322-5660.

Sincerely,

Steven G. Churchwell
General Counsel

Lisa L. Ditora

By: Lisa L. Ditora
Staff Counsel, Legal Division

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