

# Private Fund Update

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This week, new Federal Reserve Chair Janet Yellen visits Capitol Hill, a CFTC advisory committee meets on cross-border swaps, and the House is expected to vote on a pilot program for emerging growth companies.

This update includes:

- The SEC's No Action Letter on M&A brokers;
- Last week's House Financial Services Committee hearing on how the Volcker Rule limits job creation;
- A recent controversy regarding the taxation of private equity monitoring fees; and
- EY's 2014 Global Private Equity Survey.

Last week, the SEC's Division of Trading and Markets released its long-awaited No Action Letter on M&A brokers, ACG held its [Third Annual Middle Market Public Policy Summit](#), and CBO released its budget and economic outlook for 2014 to 2024.

## The 113<sup>th</sup> Congress

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### House of Representatives

This week, the full House of Representatives is expected to vote on [H.R. 3448, the "Small Cap Liquidity Reform Act of 2013,"](#) which would create a pilot program to allow the securities of emerging growth companies with total annual gross revenues of less than \$750 million to be traded at either \$0.05 or \$0.10 increments.

#### House Financial Services Committee

[Hearing with Janet Yellen on Monetary Policy](#) – On Tuesday, the full committee holds a two-panel hearing on "[Monetary Policy and the State of the Economy.](#)" Witnesses are:

#### Panel I

- The Honorable Janet L. Yellen, Chairman, Board of Governors of the Federal Reserve System

#### Panel II

- Dr. John B. Taylor, Professor of Economics, Stanford University
- Dr. Mark A. Calabria, Director, Financial Regulation Studies, Cato Institute
- Ms. Abby M. McCloskey, Director, Economic Policy, American Enterprise Institute
- Dr. Donald Kohn, Senior Fellow, Economic Studies, Brookings Institution

The Committee Memorandum is [here](#).

[Hearing on Volcker Rule](#) – Last week the HFSC held a [hearing on the Volcker Rule](#) and whether it is harmful to the U.S. economy, its capital markets, and our domestic job-creating businesses. The Committee Memorandum is [here](#).

Witnesses at the hearing were:

- [The Honorable Daniel Tarullo](#), Governor, Federal Reserve Board
- [The Honorable Mary Jo White](#), Chairman, SEC
- [The Honorable Thomas Curry](#), Comptroller of the Currency
- [The Honorable Martin Gruenberg](#), Chairman, FDIC
- [The Honorable Mark Wetjen](#), Acting Chairman, CFTC

A video of the hearing is [here](#) and the Committee Memorandum is [here](#).

[Hearing on the Office of Financial Research](#) – The Committee also held a hearing with Dr. Richard Brener, Director of the Office of Financial Research. As with the Senate hearing last week, the hearing is likely to focus on the OFR's [controversial report on the asset management industry](#). The Committee Memorandum is [here](#).

#### House Small Business Committee

[Hearing on Duplication in Federal Financial Assistance Programs](#) – On Thursday, the committee holds a hearing on [duplication, overlap, and fragmentation](#) in federal financial assistance programs.

Witnesses are:

- William B. Shear, Director, Government Accountability Office
- Ann Marie Mehlum, Associate Administrator, Office of Capital Access, SBA
- Lillian Salerno, Administrator, Department of Agriculture

## The Senate

#### Senate Banking Committee

[Semiannual Monetary Policy Report](#) – SBC has its first meeting with Janet Yellen, new Chair of the Board of Governors of the Federal Reserve, on Thursday when the committee holds its semiannual monetary policy report.

Last week the committee held two hearings, one on [financial stability and data security](#), and another on [safeguarding consumers' financial data](#).

## Securities and Exchange Commission

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#### **No Action Letter on M&A Brokers**

The SEC's Division of Trading and Markets issued a long-awaited No Action Letter regarding M&A Brokers last week. The letter confirms that M&A brokers (defined as persons engaged in the business of effecting securities transactions solely in connection with the transfer of ownership and control of a privately-held company to a buyer that will actively operate the company or business) do not need to register as broker-dealers.

However, the letter is likely to provide limited relief with respect to broker-dealer registration for private equity funds that charge portfolio companies transaction fees. This is because the letter contains ten

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criteria that must be met to qualify for relief, including that the M&A broker not have the ability to bind a party to the transaction and that the M&A broker not have custody, control or possession of funds or securities in exchange with the transaction.

#### **Seeking Public Comment on Draft Strategic Plan**

The SEC published its [Draft Strategic Plan](#), which outlines the agency's strategic goals for fiscal years 2014 to 2018. As part of the Draft Strategic Plan, performance goals would include monitoring the percentage of investment advisers examined during the year, the number of compliance exams concluded during the year, and the percentage of exams that identify deficiencies, "significant findings" and/or are referred to the Division of Enforcement. Public comments may be submitted via email to [PerformancePlanning@sec.gov](mailto:PerformancePlanning@sec.gov) by March 10, 2014.

#### **Investment Adviser Compliance Seminar – Video Now Available**

On January 30, the SEC [held its national compliance seminar](#) for investment advisers and investment companies. The event intended to help these firms' Chief Compliance Officers (CCOs) and other senior personnel to enhance their compliance programs for the protection of investors. The seminar agenda is [here](#), and a video webcast of the seminar is [here](#).

#### **Risk Alert on Selection of Alternative Investment Advisers**

The SEC [issued a Risk Alert](#) summarizing OCIE staff observations on the due diligence practices of certain investment advisers that manage and/or recommend alternative investments to their clients. The SEC recommends (i) the use of separate accounts to gain full transparency and control; (ii) the use of transparency reports issued by independent fund administrators and risk aggregators; (iii) the verification of relationships with critical service providers; (iv) the confirmation of existence of assets; (v) routinely conducting onsite reviews; (vi) the increased emphasis on operational due diligence; and (vii) having independent providers conduct comprehensive background checks.

## **Commodity Futures Trading Commission (CFTC)**

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#### **Full Agenda Released for Meeting of Global Markets Advisory Committee on February 12**

The CFTC [released the full agenda](#) for its Global Markets Advisory Committee meeting on Wednesday, February 12. The Committee will hold two panels to discuss the CFTC [staff advisory](#) issued on November 14, 2013, related to the CFTC's cross-border guidance. Topics for discussion will include whether a non-U.S. swap dealer (SD) must comply with Dodd-Frank's Transaction-Level Requirements when entering into a swap with a non-U.S. person if the swap is arranged, negotiated, or executed by agents of the non-U.S. SD located in the United States.

#### **Meeting of Technology Advisory Committee on February 10**

The CFTC's Technology Advisory Committee will be holding a public meeting on Monday, February 10. Topics will include the Commission's [concept release on automated trading environments](#), swap execution facilities, and swap data reporting.

#### **Weekly Swaps Report**

Here is a link to the CFTC's [Weekly Swaps Report](#) for the week ending January 24, 2013. The weekly report provides a detailed view of the swaps marketplace, covering the interest rate and credit asset classes that comprise about 90% of the approximately \$400 trillion swaps market. The report includes: the gross notional outstanding value, the weekly transactions measured by dollar volume, and the weekly transactions measured by ticket volume.

## **Congressional Budget Office (CBO)**

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#### **Budget and Economic Outlook 2014 to 2024**

CBO released its lengthy [Budget and Economic Outlook for 2014 to 2024](#), which projects that the federal

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deficit will total \$514 billion in fiscal year 2014, compared with \$1.4 trillion in 2009. This equals 3.0 percent of the nation's GDP — close to the average percentage of GDP seen during the past 40 years. CBO projects that the economy will grow at a solid pace until 2017, after which growth will diminish and deficits will increase, topping \$1 trillion per year starting in 2022.

The part of the report that generated controversy is the finding that the Affordable Care Act would *effectively* reduce the number of workers by 2.5 million in 2024 — looking at the number of “full time equivalent” positions, or in other words, the cumulative lost man-hours of work due to the ACA. A slide presentation summarizing the report is [here](#).

## The Administration

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The President [signed the Farm Bill](#) last week, which [passed the Senate by a 68-32 vote](#). OMB also issued three Statements of Administration Policy (SAPs) in opposition to three bills, each of which recently passed the House of Representatives. The [SAP against H.R. 3964](#), which would preempt California state water law to help alleviate drought conditions, contains a veto threat.

## Association for Corporate Growth (ACG)

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### InterGrowth 2014

Registration has opened for [InterGrowth 2014](#), which will be held April 28 – May 1, 2014, at the Aria Hotel in Las Vegas. To register online for InterGrowth, click [here](#).

### Middle-Market Public Policy Summit

ACG held its [2014 Middle-Market Public Policy Summit](#) in Washington, DC last week. Photos and a synopsis to follow.

## Small Business Investor Alliance (SBIA)

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### SBIC Regulations Class on June 12

The SBA/SBIC will be holding an [SBIC registration class](#) on [June 12](#) at the Hilton Garden Inn in Washington, DC. The purpose of this class is to familiarize SBIC principals with the SBIC rules, regulations, and compliance procedures. Classes are limited in size and a licensed SBIC may not draw down leverage until all principals have completed the training.

## Miscellaneous

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### Controversy Regarding PE Monitoring Fees

Tax law professor Gregg Polsky triggered a bit of a firestorm with [a controversial tax note](#) in which he argued that the “primary purpose” of the monitoring fee/management offset structure for private equity funds is “almost certainly” tax avoidance — *i.e.*, an effort to disguise dividends paid by portfolio companies as deductible compensation. As Professor Polsky states “In other words, the idiosyncratic monitoring fee/offset structure is a blatant earnings-stripping strategy that often does not work, although the IRS has apparently not seriously scrutinized it yet.” This rift was picked up by Dan Primack, a reporter with *Fortune Magazine*, who [wrote an article](#) agreeing with Professor Polsky's analysis.

### EY 2014 Global Private Equity Survey

Ernst & Young released its [2014 Global Private Equity Survey](#), a survey of private equity chief financial officers. Interestingly, the report finds that CFOs are positive regarding near-term growth. Nearly four out of five CFOs responded that their firms recently finished raising a fund, expected to raise another fund in

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the next three years, and believed that the new fund will be of equal or greater value than the last. Respectful of the industry's bullish opinion on growth, finance executives are acutely aware that successful operating models rest on their ability to proficiently manage resources and costs

***Washington Post* Article on PE and the Defense Industry**

The *Washington Post* had an interesting article on the role that private equity is playing in the defense industry. The article notes that from 2004 to 2013, private equity invested more than \$30 billion in 358 U.S. aerospace and defense companies, according to Pitchbook data supplied by the Private Equity Growth Capital Council.

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