

Private Fund Update

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Scott E. Gluck, Esq.
Venable LLP

Washington, DC Office:

t 202.344.4426

c 540.454.4820

Los Angeles Office:

t 310.229.9900

c 540.454.4820

sgluck@Venable.com
www.Venable.com

It's a busy week as Congress and just about everyone else is counting down the days until August recess. This update includes:

- The building momentum for imposing a user fee on registered investment advisors to fund additional SEC examiners;
- The growing battle over FY 2015 funding for the Securities and Exchange Commission;
- CBO's disturbing report on long-term U.S. debt, which finds that the federal debt will double the total U.S. economy within twenty-five years; and
- This week's Senate Permanent Subcommittee on Investigations hearing on the use of structured financial products to evade U.S. short-term capital gains tax.

Note: The head of the SEC's Office of Compliance Inspections and Examinations recently [gave a speech](#) (described below) warning private equity managers about several areas where PE funds are failing to meet their obligations under the Investment Advisers Act. A key problem area is the issue of fees and expenses charged by the general partner.

Venable attorneys, including myself, can help fund advisers comply with the IAA and avoid the issues described in the speech. If you would like to discuss having Venable perform a risk assessment for your firm, or if you have any other questions, please [contact me directly](#).

Venable LLP [tracks a wide range of regulatory issues](#), so please contact me for more information regarding anything contained in this update.

The 113th Congress

House of Representatives

The full House of Representatives passed [the FY 2015 financial services appropriations by a 228-195 vote](#). The bill funds the Securities and Exchange Commission at \$1.4 billion for FY 2015, approximately \$300 million below the amount requested by the Administration. Last week, the Office of Management and Budget (OMB) issued a [7-page Statement of Administration Policy recommending a veto](#) of the House bill for various reasons, including SEC funding.

Several of the amendments offered on the House floor are noteworthy. HFSC Ranking Member Maxine Waters [offered an amendment](#) to impose a user fee on all registered investment advisors to fund additional SEC examiners. The amendment [failed by a 184-235 vote](#) with one Republican, former HFSC Chairman Spencer Bachus (R-AL), voting in favor of it. Last week, former HFSC Chairman Bachus also signed on as a cosponsor to Ranking Member Waters' bill, [H.R. 1627](#), the "[Investment Adviser Examination Improvement Act](#)," which is identical to the amendment offered on the floor. A link to Ranking Member Waters' floor speech in support of her amendment is [here](#).

The House also [approved by a 231-192 vote](#) an amendment to the bill that would restrict the Treasury Department and SEC from spending funds to penalize financial institutions for providing services to marijuana-related businesses that operate according to state law.

House Financial Services Committee

HFSC holds two hearings this week:

[Hearing on Four-Year Anniversary of Dodd-Frank](#) – On Wednesday, the full committee will hold a hearing titled "[Assessing the Impact of the Dodd-Frank Act Four Years Later](#)." Witnesses are:

- Dale K. Wilson, CEO, First State Bank
- Anthony J. Carfang, Partner, Treasury Strategies, Inc.
- Paul H. Kupiec, Resident Scholar, American Enterprise Institute
- Thomas C. Deas, on behalf of the Coalition for Derivatives End-Users

The Committee Memorandum is [here](#).

[Oversight of SEC's Division of Corporate Finance](#) – On Thursday, the Capital Markets subcommittee will hold a hearing titled "[Oversight of the SEC's Division of Corporation Finance](#)," which will cover JOBS Act implementation.

The Committee held four hearings last week, none of which are directly relevant to private funds: the [Bank Account Seizure of Terrorist Assets \(BASTA\) Act](#), [Regulatory Relief for Community Financial Institutions](#), and [The Department of Justice's 'Operation Choke Point'](#). The final hearing is the semi-annual "[Monetary Policy and the State of the Economy](#)," with Federal Reserve Chairwoman Janet Yellen.

House Appropriations Committee

[SEC FY 2015 Budget](#) – As noted above, last week the House approved [H.R. 5016](#), which funds the SEC at \$1.4 billion, \$50 million above the FY 2014 enacted level but \$300 million below the President's requested level.

House Small Business Committee

[Hearing on SBIR/SBTT Programs](#) – On Wednesday, the HSBC will hold a hearing on the Small Business Innovation Research (SBIR) and Small Business Technology Transfer (SBTT) programs, which will provide grants to private small businesses to fund research. The purpose of the hearing is to examine private sector actions of the SBA, NIH, and DOD regarding the program. Witnesses are:

- Javier Saade, Associate Administrator, SBA
- Marie Mak, Acting Director, Acquisition and Sourcing Management Team, GAO
- Andre Gudger, Director, Office of Small Business Programs, DOD
- Matthew Portnoy, Director, NIH SBIR/STTR

The committee will also hold a hearing on [modernizing agriculture producer size standards](#).

The Senate

Senate Banking Committee

This week, Senate Banking will hold a hearing on [building economically resilient communities](#).

[Hearing on Systemically Important Banks](#) – Last week, the committee held a hearing titled "[What Makes a Bank Systemically Important?](#)" Witnesses were:

- [Dr. Richard Herring](#), Professor, The Wharton School, University of Pennsylvania
- [Dr. James Thomson](#), Professor, University of Akron
- [Dr. Robert DeYoung](#), Professor, University of Kansas School of Business
- [Dr. Paul Kupiec](#), Resident Scholar, American Enterprise Institute

A link to a video of the hearing is [here](#).

[Hearing on Monetary Policy](#) – Last week, the SBC held its semiannual hearing on monetary policy with the [Chairwoman of the Federal Reserve, Janet Yellen](#).

Permanent Subcommittee on Investigations

[Hearing on Structured Financial Products](#) – On Tuesday, the Senate Permanent Subcommittee on Investigations will hold a three-panel hearing titled "[Abuse of Structured Financial Products: Misusing Basket Options to Avoid Taxes and Leverage Limits](#)." The hearing will examine the use of barrier options, a complex option derivative to attempt to avoid paying U.S. taxes on short-term capital gains. Witnesses will be:

Panel One:

- Steven Rosenthal, Senior Fellow, Urban-Brookings Tax Policy Center
- James White, Director, Tax Issues, GAO

Panel Two:

- Martin Malloy, Managing Director, Barclays
- Satish Ramakrishna, Managing Director, Deutsche Bank Securities Inc.
- Mark Silber, EVP, CCO, CLO, Renaissance Technologies LLC
- Jonathan Mayers, Counsel, Renaissance Technologies LLC

Panel Three:

- Gerard LaRocca, CEO, Barclays Capital Inc.
- Barry Bausano, President, Deutsche Bank Securities Inc.
- Peter Brown, Co-Chief Executive Officer and Co-President, Renaissance Technologies LLC

Senate Finance Committee

Actions on Corporate Inversions – In light of the recent increase in corporate inversions (where U.S. companies reduce their tax burden by merging with foreign companies), Treasury Secretary Jacob Lew [wrote to SFC Ranking Member Orrin Hatch](#) (R-UT) reiterating the President's proposal to prevent companies from changing their corporate tax domicile without a change in control of the company itself and calling for "a new sense of American patriotism." Ranking Member Hatch [wrote back to the Secretary](#) stating that comprehensive tax reform is the best solution to this problem, but during the week, Senator Hatch expressed openness to at least discussing a short-term solution.

Senate Appropriations Committee

[Subcommittee Markup](#) – The Financial Services and General Government subcommittee recently held a markup of the FY 2015 appropriations bill, which funds the SEC at the Presidents' requested level of \$1.7 billion – \$300 million more than the House's bill. A copy of the final bill is [here](#).

The Administration

Cybersecurity for Financial Firms

Treasury Secretary Jacob Lew delivered the keynote speech at the 4th annual Delivering Alpha conference where he [urged financial institutions to focus on cybersecurity issues](#), which are becoming increasingly important. Regarding private funds, in April, the SEC's Office of Compliance Inspections and Examinations (OCIE) announced a [Risk Alert/Cybersecurity Initiative](#), which includes a sample cybersecurity document request.

Securities and Exchange Commission

Investor Advocate Call for Greater Scrutiny of Investor Advisors

The SEC's Office of Investor Advocate (a new position created under the Dodd-Frank Act) delivered its first annual [Report on Objectives](#) to Congress. In the report, the Investor Advocate argued that Congress should give the SEC authority to collect user fees from registered investment advisers to help the agency pay for the costs of examining RIAs. The Report notes "Optimally, we believe that SEC-registered investment advisers should be examined at least every three years on average. OCIE should have the flexibility to examine higher-risk firms more often, and no firm should go longer than five years without a comprehensive examination."

Investor Advisory Committee Meeting

On July 10, the SEC's Investor Advisory Committee held a meeting to discuss several matters, including a potential change to the definition of an "accredited investor." During the morning session, the group engaged in an interesting, lengthy discussion as to who should qualify as an accredited investor, including whether private funds generally market to accredited investors or qualified purchasers. No vote on changing the definition of an accredited investor was taken. An agenda for the meeting is [here](#) and Chairwoman Mary Jo White's opening remarks are [here](#). Links to the morning and afternoon session of the meeting are [here](#) and [here](#), respectively.

Major Speech on Private Equity Compliance Shortcomings

Andrew J. Bowden, Director of the Securities and Exchange Commission's [Office of Compliance Inspections and Examinations](#) (OCIE) delivered a major speech titled "[Spreading Sunshine in Private Equity](#)." In the speech, Director Bowden described multiple areas in which OCIE examiners have observed deficiencies in private equity advisers fulfilling their obligations under the Investment Advisers Act. Problem areas mentioned in the speech include:

- Vague limited partnership agreements;
- Valuation;
- Fees and expenses relating to a variety of areas, such as:
 - Co-Investments - Allocation of transaction-related fees and expenses (including break-up fees);
 - Operating Partners - Charging "operating partner" salaries and overhead to the fund or portfolio company, while simultaneously presenting operating partners as members of the adviser's team;
 - Fee shifting Expenses from GP to LP; and
 - "Hidden" Fees – Receiving "hidden" fees, such as monitoring fees, under agreements that are not adequately disclosed to investors.

The speech puts private equity advisers on notice that the SEC will be paying very close attention to these issues in current and future examinations. *Fund advisers should review their compliance procedures and fund documents to ensure they are complying with their obligations under the Advisers Act. Venable can conduct a risk assessment for fund managers and help managers comply with the IAA obligations, so*

please let me know if you have any questions. A link to Venable's full summary of the speech is [here](#).

Association for Corporate Growth (ACG)

Launch of Middle Market Growth Caucus

The Association for Corporate Growth (ACG), together with GE Capital and the National Center for the Middle Market, helped [launch the Congressional Caucus for Middle Market Growth](#), the first Congressional Caucus focused exclusively on issues facing the middle market. Congressional sponsors of the Caucus are Congressmen Steve Stivers (R-OH), Jared Polis (D-CO), Brad Schneider (D-IL), and Tom Rice (R-SC).

Small Business Investor Alliance (SBIA)

SBIC Regulations Class – August 7, 2014

The SBIA and the SBA will be holding an [SBIC Regulations Class](#) on August 7, 2014. The class is mandatory for any fund seeking an SBIC license. The August 7 class is [currently sold out](#), but interested persons can contact the SBIA at events@sbia.org to get added to the waiting list. There is another class on [November 13, 2014](#), but this class is also currently sold out.

Comment Letter on SBA Model LPA for SBIC Debenture Program

The SBIA recently [submitted a comment letter](#) to the Small Business Administration regarding SBA Model Form of Agreement of Limited Partnership (LPA) for an SBIC Issuing Debentures Only. The comment letter seeks, among other things, to promote flexibility in LPA deal terms, provide for side letters between an LP and GP, and eliminate required language regarding the standard of care and indemnification provisions.

Private Equity Growth Capital Council (PEGCC)

PEGCC Releases State and District Data for Private Equity Investment

The PEGCC released its fourth annual investment report, "[Private Equity: Top States and Districts](#)." Private equity firms invested more than \$443 billion in U.S.-based companies last year, a 27% increase over the previous year. PEGCC also released an [interactive map](#) showing data, including pension fund investment, for all 50 states and rankings.

Miscellaneous

CBO Report on Long-Term Budget Outlook

The Congressional Budget Office (CBO) [released a long-term budget outlook last week](#) which finds that by 2039, federal debt held by the public would exceed 100 percent of GDP. In addition, debt would be on an upward path relative to the size of the economy, a trend that could not be sustained indefinitely. CBO projects federal deficits to increase significantly over the next few years because of an aging population, rising health care costs, an expansion of federal subsidies for health insurance, and an expected rise in interest rates in the coming years.

Better Markets Poll

On the four-year anniversary of the passage of Dodd-Frank, reform organization Better Markets [released a poll showing](#) that American voters still distrust Wall Street and big banks and strongly support tough financial regulation of them. According to the poll:

- 64% of all voters and 62% of voters who own stock believe "the stock market is rigged for insiders"

and people who know how to manipulate the system;"

- A 55% majority believes "Wall Street and big banks hurt everyday Americans by pouring money into 'get-rich-quick' schemes rather than real businesses and investments;" and
- A majority of voters (51%) have an unfavorable opinion of big banks, while 50% have an unfavorable opinion of corporate CEOs and 45% of voters hold a negative view of Wall Street.

SIFMA Guidance for "Reasonable Steps" to Verify Accredited Investors in 506(c) General Solicitations

The Securities Industry and Financial Markets Association (SIFMA) [recently released guidance](#) for registered investment advisers engaging in 506(c) general solicitations to show that they have taken "reasonable steps" to verify that all purchasers in the offering are Accredited Investors. The guidance includes verification methods that RIAs can use to verify whether natural persons or legal entities qualify as Accredited Investors. The "reasonable verification" requirement applies only to Rule 506(c) offerings, is separate from the requirement that sales be limited to accredited investors, and must be satisfied even if all purchasers happen to be accredited investors. These amendments took effect on September 23, 2013.

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