

Private Fund Update

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The August recess flew by way too fast, and Congress returns to work this week. This update includes:

- Information on ACG's SEC Task Force, including a [link to a survey ACG is conducting](#) of private equity professionals on compliance and regulatory matters;
- The September House agenda, which includes two bills relevant to the private equity industry;
- Private Equity Growth Capital Council's private equity trends report for Q2 2014, indicating private equity fundraising surged to \$50 billion; and
- A recent lawsuit challenging the SEC's pay-to-play rule, which restricts political contributions by registered investment advisers.

As always, please let me know if you have any suggestions or comments.

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

Last week, new House Majority Leader Kevin McCarthy [unveiled the September agenda](#) for the House of Representatives, which includes sending a package of bills the House has already passed to the Senate. This package will contain [H.R. 1105](#), which would exempt private equity fund advisers from having to register under the Investment Advisers Act, and [H.R. 2274](#), which streamlines regulations for small business brokers. Both bills passed the House on a bipartisan basis, with H.R. 2274 passing by a [unanimous 422-0 vote](#). It is very unlikely the Senate will act on the package before the November elections.

House Financial Services Committee

[Hearing on the Credit Reporting System](#) – On Wednesday, the HFSC will hold a hearing titled "[An Overview of the Credit Reporting System](#)." Witnesses include:

- Stuart Pratt, President and CEO, Consumer Data Industry Association
- J. Howard Beales, Professor, George Washington University
- John A. Ikard, CEO, FirstBank, on behalf of the American Bankers Association
- Chi Chi Wu, Staff Attorney, National Consumer Law Center

[Diverse Legislation Passes Committee](#) – Before leaving for recess, the HFSC approved six diverse bills:

- [H.R. 3240](#), “[Regulation D Study Act](#),” requires the Comptroller General to study the impact on depository institutions, consumers, and monetary policy of the reserve requirement under subsections (b) and (c) of Section 19 of the Federal Reserve Act (12 U.S.C. 461) and Regulation D. Passed by voice vote.
- [H.R. 4042](#), “[Community Bank Mortgage Service Asset Capital Requirements Study Act](#),” would among other things require a study of appropriate capital requirements for mortgage servicing assets for nonsystemic banking institutions. Passed [by a vote of 44-9](#).
- [H.R. 5148](#), “[Access to Affordable Mortgages Act](#),” would amend the Truth in Lending Act to exempt certain higher-risk mortgages from property appraisal requirements and to exempt individuals from penalties for failure to report certain appraisers. Passed [by a vote of 31-23](#).
- [H.R. 3913](#), would amend the Bank Holding Company Act to require agencies to make considerations relating to the promotion of efficiency, competition, and capital formation before issuing or modifying certain regulations. Passed [by a vote of 32-22](#).
- [H.R. 4329](#), “[Native American Housing Assistance and Self-Determination Reauthorization Act](#),” would amend the process for HUD block grants for Indian Housing Plans. Passed [by a vote of 47-11](#).
- [H.R. 5018](#), “[Federal Reserve Accountability and Transparency Act](#),” would amend the Federal Reserve Act to establish requirements for policy rules and blackout periods of the Federal Open Market Committee, to establish requirements for certain activities of the Board of Governors of the Federal Reserve System. Passed [by a vote of 32-26](#).

House Small Business Committee

[Hearing on Small Business Administration](#) – On Wednesday, the HSBC will hold a hearing with SBA Administrator Maria Contreras-Sweet to examine the management and future plans for the SBA. The SBA administers the popular SBIC program for private funds. It is not clear whether the SBIC program will be discussed during the hearing.

[Hearing on Decline in Business Formation](#) – On Thursday, the HSBC will hold a hearing titled “[The Decline in Business Formation: Implications for Entrepreneurship and the Economy](#).” The purpose of the hearing is to examine the failure of the United States to rebound economically and how the declining rate of small business creation affects the economy. Witnesses are:

- Jonathan Ortman, Senior Fellow, Kauffman Foundation
- John Dearie, Executive Vice President, Financial Services Forum
- Chad Moutray, Chief Economist, National Association of Manufacturers

The Senate

Senate Banking Committee

[Hearing on Wall Street Reform](#) – On Tuesday, the SFC will hold a hearing titled “[Wall Street Reform: Assessing and Enhancing the Financial Regulatory System](#)” with top regulators. Witnesses include:

- Daniel K. Tarullo, Governor, Board of Governors of the Federal Reserve System
- Martin J. Gruenberg, Chairman, FDIC
- Thomas J. Curry, Comptroller of the Currency
- Richard Cordray, Director, CFPB
- Mary Jo White, Chair, SEC
- Timothy G. Massad, Chairman, CFTC

Permanent Subcommittee on Investigations

[Hearing on Structured Financial Products](#) – In late July, the Senate Permanent Subcommittee on Investigations held a three-panel hearing titled “[Abuse of Structured Financial Products: Misusing Basket Options to Avoid Taxes and Leverage Limits](#).” The hearing focused on the use of barrier options, a complex option derivative to attempt to avoid paying U.S. taxes on short-term capital gains. Witnesses were:

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

Here is a link to the Committee’s Report titled “[Abuse of Structured Financial Products: Misusing Basket Options to Avoid Taxes and Leverage Limits](#).” Here are links to the Exhibits ([Part 1](#), [Part 2](#), [Part 3](#), and [Part 4](#)).

The Administration

Focus on Inversions

Over the past several weeks, the White House has continued its focus [on preventing inversions](#) – where U.S.-based companies shift their residence to other countries in order to reduce their tax burden. The Office of Management and Budget [issued a Statement of Administration Policy](#) supporting S. 2569, which would impose significant penalties on companies seeking to undergo an inversion for tax purposes. In the [Treasury Notes blog](#), Assistant Secretary of the Treasury for Tax Policy Mark Mazur notes that Congress has in the past imposed retroactive effective dates for provisions that shut down egregious tax loopholes.

Securities and Exchange Commission

SEC Investor Advocate Calls for User Fees for Registered Investment Advisers

SEC Investor Advocate Rick Fleming called for the [imposition of user fees](#) on registered investment advisers (RIAs) to cover the cost of additional examiners. In an August speech at the annual Southwest Securities Conference, Fleming noted that the issue “primarily boils down to the fact that the SEC has not received sufficient resources to keep up with the burgeoning workload.” Fleming noted that “the amount of assets managed by investment advisers is on a steep ascent, climbing from \$20 trillion a decade ago to an estimated \$55 trillion by the end of Fiscal Year 2015. In comparison, staff in the SEC’s Office of Compliance Inspections and Examinations (OCIE) has grown only about 10% in the past decade. He hopes that the fees would be limited to “the use of those funds to expenses associated with investment adviser examinations.”

Major Speech on Private Equity Compliance Shortcomings

Andrew J. Bowden, Director of the Securities and Exchange Commission's [Office of Compliance Inspections and Examinations](#) 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)

ACG SEC Task Force/Survey of Private Equity Professionals

ACG announced [a strengthening of its SEC Task Force](#), which is an informal working group consisting of chief compliance, financial, and legal officers to help address growing concerns about the host of regulatory challenges faced by middle-market private equity funds. ACG’s SEC Task Force was designed to interact with the SEC on a variety of issues, including:

- SEC examinations;
- Investment Adviser Act compliance;
- JOBS Act/general solicitations;

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- Broker-dealer registration; and
 - Emerging issues, such as cybersecurity.

As part of the Task Force, ACG is conducting [a survey of private equity fund compliance officers, financial officers, and in-house counsel](#) to determine which regulatory issues are most pressing for private equity professionals.

EuroGrowth – October 15-16, 2014

ACG will be hosting [EuroGrowth 2014](#) on October 15-16 at the Grange St. Paul's Hotel in London, England. EuroGrowth is the leading source of middle-market Europe/U.S. networking and deal flow. An agenda for the conference is [here](#).

Small Business Investor Alliance (SBIA)

SBIA Summit for Middle-Market Funds – October 19-21

The SBIA is sponsoring the [Summit for Middle-Market Funds](#) on October 19-21 at The Breakers in Palm Beach, Florida. An agenda for the Summit is [here](#). The keynote address, "America's Fiscal Challenges and the Role Private Equity Plays in the Solution" will be given by Erskine Bowles, Campaign to Fix the Debt.

SBIC Regulations Class – November 13, 2014

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

Private Equity Growth Capital Council (PEGCC)

PEGCC Releases Q2 2014 Private Equity Fundraising Data

The PEGCC released a [Private Equity Trends report](#) showing that private equity activity experienced declines from Q1 of 2014, but overall remained strong. Fundraising nearly doubled to \$50 billion, indicating investors' continued appetite for the asset class. Investment and exit volumes fell from last quarter but exceeded second quarter levels over the past five and ten years, respectively. Total invested capital reached \$108 billion, while exit volume was \$46 billion. In addition, dry powder grew 7%, from \$412 billion in March to \$440 billion as of July 2014.

Miscellaneous

Lawsuit Filed Challenging SEC's Pay-to-Play Rules

Two state Republican committees have [filed a lawsuit](#) challenging the SEC's pay-to-play rule (IAA Rule 206(4)-5), which restricts political contributions by investment advisers. They are arguing that the SEC does not have the authority to regulate political contributions and also that the rule violates RIAs' First Amendment right to free speech.

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