

Private Fund Update

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House Ways & Means Chairman Dave Camp caught many by surprise last week by changing the tax treatment of carried interest in his proposal for tax reform. Big news this week (other than the impending storm) is the release of the President's FY 2015 budget, although certain backup information will be released next week. This update reviews:

- House Ways & Means Committee Chairman Dave Camp's tax reform proposal, which includes taxing carried interest as ordinary income rather than capital gains;
- The Senate hearing on Swiss banking laws being used for U.S. tax evasion;
- An update on the SEC's new initiative to examine never-before-examined registered investment advisers; and
- New SEC fraud charges being brought against a private equity fund manager.

Interesting items for the week ahead will include (assuming no major shutdown from the storm):

- Nomination hearings for the Federal Reserve Board and CFTC, including Stanley Fischer (Federal Reserve Vice-Chair) and Tim Massad (CFTC Chair);
- A House Financial Services Committee hearing on Dodd-Frank harming U.S. competitiveness; and
- Multiple Senate and House hearings on the President's FY 2015 budget.

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

House Ways & Means Committee

The big news of the week was the release of HWMC Chairman Dave Camp's (R-MI) [proposal for comprehensive tax reform](#). Among other things, the proposal reduces the corporate tax rate from 35% to 25% and flattens the code by reducing rates and collapsing today's brackets into two brackets of 10% and 25% for most taxable income. However, the proposal came down harder than many had expected on financial service companies, included taxing carried interest as ordinary income rather than capital gains, taxing publicly traded private equity funds as corporations rather than publicly traded partnerships, and imposing a significant tax on the largest banks. Here are links to an [executive summary](#), [section by section analysis](#), and [draft legislation](#) for the proposal, as well as [materials from the Joint Committee on Taxation](#) regarding the proposal.

Here are links to responses to Chairman Camp's proposal from the [Association for Corporate Growth](#) and the [Private Equity Growth Capital Counsel](#).

[Hearing on the President's Budget](#) – On Thursday, Treasury Secretary Jacob Lew will testify before the HWMC on the President's FY 2015 budget.

House Financial Services Committee

[Hearing on Dodd-Frank and International Competitiveness](#) – On Tuesday, HFSC will hold a hearing on how the 2010 Dodd-Frank Act might be harming U.S. competitiveness in the international arena. The Committee Memorandum notes that "Regulatory disparities between the U.S. and other nations could result in opportunities for regulatory arbitrage, which could lead to industry, jobs, and capital leaving the United States." Witnesses are:

- Louise Bennetts, Associate Director, Financial Regulation Studies, Cato Institute
- Alon Hillel-Tuch, Co-Founder and CEO, RocketHub
- Peter J. Wallison, Fellow in Financial Policy Studies, AEI
- Christopher Brummer, Professor, Georgetown Law

Witness testimony is not yet available, but the Committee Memorandum is [here](#).

The HFSC will also hold a [hearing on data security](#) this week.

[Hearing on Dodd Frank's Impact on Asset-Backed Securities](#) – Last week, HFSC held a hearing on Dodd-Frank's impact on asset-backed securities which examined, among other things, the impact of the Volcker Rule as it applies to ABS. The text of a draft bill to remedy this situation is [here](#). The hearing also covered credit risk retention, disclosure and reporting requirements for ABS and reps, and warranties in ABS shelf offerings. Witnesses were:

- [Meredith Coffey](#), EVP, Loan Syndications and Trading Association
- [Adam J. Levitin](#), Professor, Georgetown University Law Center
- [Tom Quaadman](#), Vice President, Center For Capital Markets Competitiveness, U.S. Chamber of Commerce
- [Paul Vanderslice](#), Managing Director, Citigroup, on behalf of the CRE Finance Council
- [Neil Weidner](#), Partner, Cadwalader, Wickersham & Taft, on behalf of the Structured Finance Industry Group

The Committee Memorandum is [here](#).

[Hearing on Reg NMS](#) – The Committee also held a hearing last week on [Reg NMS](#) – a set of rules passed by the SEC in 2005 aimed to improve market efficiencies. Witnesses were:

- Roel Campos, Partner, Locke Lord LLP; former SEC Commissioner, 2002-2007
- [Steven Lofchie](#), Partner, Cadwalader, Wickersham & Taft LLP
- [Erik R. Sirri](#), Professor of Finance, Babson College; former Director of SEC Division of Trading and Markets, 2006-2009
- [Chester Spatt](#), Professor of Finance, Tepper School of Business, Carnegie Mellon University; former SEC Chief Economist, 2004-2007

The Senate

Senate Banking Committee

[Hearing for Federal Reserve Nominees](#) – On Tuesday, SBC will hold a hearing for several individuals who have been nominated to become members of the Federal Reserve Board: Dr. Stanley Fischer (also to be Vice Chairman), Jerome H. Powell, and Lael Brainard.

[Meeting with Janet Yellen](#) – Last week, SBC held its rescheduled hearing with Janet Yellen, new Chair of

the Board of Governors of the Federal Reserve. Chairwoman Yellen's written testimony is [here](#) and a link a video of the hearing is [here](#).

Senate Finance Committee

[Hearing on President's Fiscal 2015 Budget](#) – SFC will hold a [hearing on Wednesday](#) regarding the President's FY 2015 budget. The sole witness is expected to be Treasury Secretary Jacob Lew. Secretary Lew's written testimony is not yet available.

Senate Agriculture Committee

[Hearing on CFTC Commission Nominees](#) – SAC holds a hearing on the three individuals who have been nominated to become CFTC Commissioners: Timothy G. Massad (to serve as Chairman), Sharon Y. Bowen, and J. Christopher Giancarlo.

Senate Permanent Subcommittee on Investigations

[Hearing on Offshore Tax Evasion](#) – PSCOI held a lengthy two-panel hearing entitled "[Offshore Tax Evasion: The Effort to Collect Unpaid Taxes on Billions in Hidden Offshore Accounts](#)" last week. The hearing discussed the use of foreign jurisdictions as tax havens facilitating U.S. tax evasion, focusing specifically on the status of efforts to hold Swiss banks and their U.S. clients accountable for unpaid taxes on billions of dollars in hidden assets. A link to the 181-page staff report is [here](#), and if you really want to dive in, links to exhibits to the staff report are [here](#) and [here](#). The video of the hearing is [here](#).

The Administration

All eyes in DC this week will be on the release of the President's FY 2015 budget. Of particular interest to fund managers will be the funding levels for the SEC and the CFTC. In each of the past several years there has been a significant gap between the President's requested funding level and the level coming out of the Republican-controlled House of Representatives. Along these lines, CFTC Acting Chairman Mark Wetjen [will testify before the House Appropriations Ag Subcommittee](#) on Thursday regarding the CFTC's FY 2015 budget.

With the political season heating up, OMB issued three veto threats last week against bills that ended up passing the House of Representatives: [H.R. 2804](#) (agency rulemaking procedures), [H.R. 899](#) (agency rulemaking procedures) and [H.R. 3865](#) (tax-exempt status of 501(c)(4) organizations).

Securities and Exchange Commission

New Initiative Aimed at Never-Before Examined Registered IAs - CORRECTION

The SEC's Office of Compliance Inspections and Examinations (OCIE) [announced that it is launching an initiative](#) directed at investment advisers that have never been examined, focusing on those that have been registered with the SEC for three or more years. The announcement includes [an open letter to Registered Investment Advisers and their compliance officers](#). OCIE's Examination Priorities list for 2014 is [here](#). **It should be noted that investment advisers to private funds are not part of this initiative.**

No Action Letter on M&A Brokers – Webinar

Two weeks ago, [David Blass, Chief Counsel of the Division of Trading and Markets, and his colleague Darren Vieira participated in a free webinar](#) sponsored by the Association for Corporate Growth and Venable, discussing SEC's recent No Action Letter on M&A brokers. A link to the webinar audio is [here](#).

Private Equity Fund Manager Charged with Fraud

The SEC [charged a private equity fund manager with fraud](#) in an expense allocation scheme. The SEC alleges

that the Arizona-based fund manager improperly paid more than \$3 million of the firm's expenses by using assets from 19 private equity funds that invest in private ethanol production plants. The fund manager did not disclose any such payment arrangement in fund offering documents. When the funds ran out of cash to pay the firm's expenses, the manager loaned money to the funds at unfavorable interest rates and unilaterally changed how they calculated investor returns to benefit themselves. A copy of the SEC order is [here](#).

Updated Q&A on Form PF

The SEC's Division of Investment Management released [updated questions and answers regarding Form PF](#). The updated guidance makes clear that a private fund that would (except for the fact that fund documents allow the private fund to either employ large amounts of leverage or sell assets short) be categorized as a private equity fund may *not* categorize itself as a private equity fund (and must instead be deemed a hedge fund) even if the fund doesn't actually incur leverage or sell assets short. The actual Q&A is [here](#).

Commodity Futures Trading Commission (CFTC)

Re-Issuance of FAQ on Commodity Options

The CFTC staff [re-issued Frequently Asked Questions document](#) on the topic of Trade Option Form ([Form TO](#)) filing process and the circumstances which trigger the filing requirement. Section 721 of the Dodd-Frank Act added new § 1a(47) to the CEA defining "swap" to include "[an] option of any kind that is for the purchase or sale, or based on the value, of 1 or more...commodities...." However, a commodity option involving a physical (as opposed to a financial) commodity may avoid being fully regulated as a swap if it is: (1) a commodity option embedded in a forward contract; (2) a volumetric commodity option embedded in a forward contract; or (3) a trade option. The FAQ helps users decide whether or not they qualify for an exception.

Weekly Swaps Report

Here is a link to the CFTC's [Weekly Swaps Report](#) for the week ending February 14, 2014. 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.

Association for Corporate Growth (ACG)

InterGrowth 2014

Registration has opened for [InterGrowth 2014](#), which will be held April 28 – April 30, 2014 at the Aria Hotel in Las Vegas. To register online for InterGrowth click [here](#). The participants in the CEO panel at InterGrowth were just announced [here](#) and a list of capital providers who are attending is [here](#).

Private Equity Growth Capital Council (PEGCC)

2013 Annual Report

The PEGCC released its [2013 Annual Report](#). [In the detailed report](#), PEGCC notes its accomplishments and priorities for the year, which include its award winning *Private Equity at Work* public education campaign, producing and promoting unique research and analysis, defended attacks on the tax treatment of carried interest, House passage of H.R. 1105 (a bill exempting advisers to private equity funds from SEC registration requirements), and maintaining the deductibility of interest on corporate debt. Along with the report, the group also [released a short video](#) by PEGCC President and CEO Steve Judge.

Quarterly Trends Report Shows Increased PE Activity

The PEGCC also released its [Q4 2013 Trends Report](#), which shows a marked increase in private equity activity in Q4 2014. During the quarter, private equity investment and exit volumes increased by 14% and 44%,

respectively. The report also found that dry powder grew 2%, from \$384 billion in September 2013 to \$391 billion in December while equity financing increased to 44 %during the quarter, the highest rate since 2010.

Managed Funds Association (MFA)

Hedge Fund Glossary

The Managed Funds Association introduced an [online hedge fund glossary](#), which provides users with a complete set of key terms, phrases, and definitions specific to all aspects of the global hedge fund industry. The glossary is available [here](#).

Miscellaneous

Third Way Paper on Derivatives

Nonprofit Third Way released a report on derivatives entitled “[Derivatives: The Risks and Rewards](#).” The paper provides a basic overview of what derivatives are, why they matter, how derivatives are used to manage commercial and investment risks, some of the dangers of derivatives, and reviews two reforms put in place by Dodd-Frank to reduce the riskiness of the derivatives market.

Better Markets Financial Reform Newsletter

Financial reform group Better Markets released its [most recent newsletter](#), with links to several news stories as well as Better Markets’ recent media coverage. Relevant issues include too-big-to-fail, a fiduciary standard for financial advisers who offer retirement investment advice, and various settlements between regulators and large banks.

Academic Study on Direct Investing in Private Equity

Three professors [did the first large-sample study of direct private equity investments by institutional investors](#). The study examines seven large institutional investors over twenty years, and finds that even with the substantial fee discounts, there is little evidence of attractive relative performance by direct investments. In particular, co-investments underperform traditional fund investments perhaps due to fund managers’ selective offering of deals at market peaks as co-investments. The performance of both co-investments and solo investments deteriorates sharply in the 2000s, suggesting that any information advantage may have disappeared as the private equity industry became more competitive. Overall, our evidence suggests that institutional investors may find it difficult to capture the rents earned by private equity managers by investing directly.

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