

Private Fund Update

June 30, 2014



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Both the Senate and House are in recess in a holiday-shortened week. This update includes:

- SIFMA's recent guidance on "Reasonable Steps" for verifying Accredited Investor status in Rule 506(c) general solicitations;
- The conflict between the Senate and House over FY 2015 funding of the SEC;
- A report by the Private Equity Growth Capital Council (PEGCC) describing private equity investment broken down by state and Congressional district;
- The SEC's recent action against a private equity fund for violating federal pay-to-play rules regarding political contributions;
- The SEC's recent order for a tick size pilot plan; and
- Last week's Financial Services Committee hearings on SEC oversight, the Export-Import Bank, and Financial Stability Oversight Council.

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, the full House of Representatives passed [H.R. 4413](#), the [Customer Protection and End User Relief Act by a vote of 265-144 with 22 members not voting](#). Among other things, the bill reauthorizes the CFTC, and resolves a conflict between rules promulgated by the CFTC and the prudential regulators by confirming that end users do not need to post initial or variation margin for certain swaps to hedge commercial risk and directs the CFTC to examine the effect of high-frequency trading.

[House Financial Services Committee](#)

HFSC held three relevant hearings last week:

[Oversight of the SEC's Division of Trading and Markets](#) – The Capital Markets subcommittee held a hearing with [Stephen Luparello](#), Director, of the SEC's Division of Trading and Markets. The T&M oversees regulation of broker-dealers. A copy of the Committee Memorandum is [here](#).

[Examining Reauthorization of the Export-Import Bank](#) – The full committee held a long, two panel hearing examining whether the Export-Import Bank should be re-authorized. Witnesses were:

Panel One

- [Mr. Richard H. Anderson](#), CEO, Delta Air Lines, Inc.
- [Dr. Veronique de Rugy](#), Senior Research Fellow, Mercatus Center, George Mason University
- [Captain Lee Moak](#), President, Air Line Pilots Association
- [Mr. Steven Wilburn](#), Chief Executive Officer, FirmGreen Inc.

Panel Two

- [The Honorable Fred P. Hochberg](#), Chairman President, Export-Import Bank
- [The Honorable Osvaldo Gratacos](#), Inspector General, Export-Import Bank
- [Mr. Mathew J. Scire](#), Director, Financial Markets and Community Investment, GAO
- [Dr. Douglas W. Elmendorf, Director](#), Congressional Budget Office

A copy of the Committee Memorandum is [here](#), and a link to a video of the long hearing is [here](#).

[Annual Report of the Financial Stability Oversight Council](#) – Treasury Secretary Jacob Lew [delivered written testimony](#) and also delivered the [2014 Annual Report of FSOC](#). A copy of the Committee Memorandum is [here](#) and a video of the hearing is [here](#).

House Appropriations Committee

[Passage of SEC FY 2015 Budget](#) – The House Appropriations Committee approved the FY 2015 budget for the SEC and SBA last week by a vote of 28-21. The bill funds the SEC at \$1.4 billion, \$50 million above the FY 2014 enacted level but \$300 million below the President's requested level. The bill also funds the SBA at \$862 million, and provides up to \$4 billion in FY 2015 SBIC loan guarantees. Other priorities [identified in the Report accompanying the bill](#) (pages 69-73) include money market funds, JOBS Act rulemaking, cross-border swaps and the Volcker Rule.

The Senate

Senate Banking Committee

[Annual FSOC Report](#) – Last Wednesday, the SBC held a hearing for the annual report of the Financial Stability Oversight Council. The sole witness was the Secretary of the Treasury, Jacob Lew. Secretary Lew's written testimony is [here](#), and a video of the hearing is [here](#).

Senate Permanent Subcommittee on Investigations

Hearing on High Frequency Trading – Last week, the Permanent Subcommittee on Investigations held a two-panel hearing titled "[Conflicts of Interest, Investor Loss of Confidence and High Speed Trading in U.S. Stock Markets](#)." The hearing focused on potential conflicts of interest between the obligation of brokers to provide their customers with best execution of their orders and the brokers' receipt of payments from other brokers for order flow. Witnesses were:

Panel One

- [Bradley Katsuyama](#), President, IEX Group
- [Robert Battalio](#), Professor, Notre Dame

Panel Two

- [Thomas Farley](#), President, NYSE Group
- [Joseph Ratterman](#), CEO, BATS Global Markets
- [Joseph Brennan](#), Principal, The Vanguard Group, Inc.
- [Steven Quirk](#), SVP, TD Ameritrade

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

Senate Appropriations Committee

[Subcommittee Markup](#) – The Financial Services and General Government subcommittee held a markup of the FY 2015 appropriations bill last Tuesday, which funded 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

One Year Anniversary of Climate Action Plan

The President celebrated the one-year anniversary of his [Climate Action Plan](#) by [speaking at the League of Conservation Voters annual Capital Dinner](#). The President recently released his [One-Year Progress Report](#) for the Climate Action Plan, describing various initiatives the Administration has undertaken regarding Climate Change over the past year.

Securities and Exchange Commission

Private Equity Fund Charged with Violating Pay-to-Play Rules

The SEC charged a private equity firm with [violating federal "pay-to-play" rules](#) by continuing to receive advisory fees from multiple public pension funds after one of the fund's covered associates had made political contributions in excess of the permitted amount. This is the first time that the SEC has brought a case under the pay-to-play rules, [SEC Rule 206\(4\)-5](#). A summary of the SEC's action is [here](#).

SEC to Implement Tick Size Pilot Program

The SEC announced that it has ordered the national securities exchanges and FINRA to [jointly develop a targeted 12 month pilot program that will widen minimum quoting and trading increments \(tick sizes\) for certain small capitalization stocks](#). The Commission plans to use the program to assess whether these changes would enhance market quality to the benefit of U.S. investors, issuers, and other market participants. Decimalization of the U.S. equity markets occurred more than a decade ago. Prior to decimalization, the minimum pricing increment had been 1/8 of a dollar (12.5 cents) and 1/16 of a dollar (6.25 cents). Minimum pricing increments are important because they affect the nature and extent of displayed liquidity in a stock as well as the transaction costs of investors and others when they seek to access displayed liquidity.

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

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- 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).

2014 Policy Agenda

ACG released its [2014 policy agenda](#), which includes the organization's legislative and regulatory priorities. Top legislative priorities include H.R. 1105 (private equity fund registration under IAA), H.R. 2274 (M&A broker legislation), and protecting deductibility of interest on corporate debt in case of comprehensive tax reform. Top regulatory issues include broker-dealer issues for private equity funds, JOBS Act implementation, and improving the efficiency of SEC examinations.

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.

Securities Industry and Financial Markets Association (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.

If you would like to opt out of receiving this communication, just let me know.