Private Fund Update

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Both the Senate and House are in session this week, with the House Financial Services Committee holding three relevant hearings. This update includes:

- The SEC's recent action against a private equity fund for violating federal pay-to-play rules regarding political contributions;
- This week's Financial Services Committee hearings on SEC oversight, the Export-Import Bank, and Financial Stability Oversight Council;
- The results of last week's House Financial Services Committee markup on FSOC bills;
- The House Appropriations Committee's funding of the SEC and SBA; and
- A report by the Private Equity Growth Capital Council (PEGCC) finding that nearly three-fourths of PE professionals surveyed said that a majority of their portfolio companies are hiring.

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

House Financial Services Committee

HFSC will hold three relevant hearings on "Oversight of the SEC's Division of Trading and Markets," whether the Export-Import Bank should be re-authorized, and the annual report of the Financial Stability Oversight Council. Information for these hearings has not yet been posted, but each of these hearings could impact private funds.

Markup on FSOC Bills – Last week, the HFSC held a markup and ultimately passed two bills that would curtail the power of the Financial Stability Oversight Council (FSOC) to designate that entities are systemically important.

- H.R. 4881 – As amended, would place a one-year moratorium on the authority of FSOC to designate entities as systemically important. *The bill passed committee on a party-line vote of 32-27*.
- H.R. 4387, "FSOC Transparency and Accountability Act," would, among other things, require FSOC to hold open hearings and comply with the Federal Advisory Committee Act (which requires greater transparency of decision-making). *The bill passed committee on a party-line vote of 32-27*.

Earlier this month, the committee also completed a markup that had been postponed due to the death of the mother of Congresswoman Maxine Waters, the Committee's Ranking Member. There were two potentially relevant bills in that markup:

- H.R. 4697, "Small-Cap Access to Capital Act" – Revises the definition of a "well-known seasoned issuer" by reducing the dollar amount in worldwide market value of outstanding voting and non-voting common equity held by non-affiliates from $700 million to $250 million. *The bill passed committee on a party-line vote of 32-27*.
- H.R. 2629, "Fostering Innovation Act of 2013" – Requires the SEC to revise the definition of an "accelerated filer" to include issuers that have annual revenues of greater than $100,000,000 during the most recently completed fiscal year for which audited financial statements are available and have an aggregated worldwide market value of the voting and non-voting common equity held by its non-affiliates of $250,000,000 or more, but less than $700,000,000. *The bill passed committee on a vote of 32-28*.
- H.R. 4564, "Equity Crowdfunding Improvement Act of 2014" – Amends Title II of the JOBS Act regarding equity crowdfunding in several respects. Among other things, it makes clear that equity investments which are crowdfunded must be through an intermediary.

House Appropriations Committee

Markup of FY 2015 Budget – The Financial Services Subcommittee of the House Appropriations Committee held a markup for the FY 2015 budget for the SEC and SBA. 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.

The full committee votes on the bill this Wednesday, June 25.

The Senate

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 Banking Committee

Annual FSOC Report – On Wednesday, the SBC will hold a hearing for the annual report of the Financial Stability Oversight Council. The sole witness is the Secretary of the Treasury, Jacob Lew.

Hearing on High Frequency Trading – Last Wednesday, the SBC held a hearing on "High Frequency Trading's Impact on the Economy." Witnesses were:

- Hal S. Scott, Professor, Harvard Law School;
- Jeffrey Solomon, CEO, Cowen and Company
- Andrew Brooks, Head of U.S. Equity Trading, T. Rowe Price

A video of the hearing is here.

Senate Appropriations Committee

Subcommittee Markup Scheduled for Tuesday – The Financial Services and General Government subcommittee is scheduled to markup the FY 2015 appropriations bill on Tuesday, which will fund the SEC, SBIA, and other agencies. The draft text of the bill has not yet been released.

The Administration

Statement of Administration Policy – End Users of Swaps

OMB issued a Statement of Administration Policy opposing H.R. 4413, the Customer Protection and End User Relief Act. The bill would, among many other things, make clear that end users of derivatives do not need to post margin when engaging in certain swaps designed to mitigate commercial risks. The bill is scheduled to be voted on by the full House of Representatives later today.

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.

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 entitled "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).

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 Quarterly Trends Report

The PEGCC released its inaugural Private Equity Decision Makers Survey of 119 mid-to-senior level PE professionals. According to the survey, nearly three fourths (73%) of private equity professionals responsible for investment decisions say a majority of their portfolio companies are hiring and making new investments. According to the results, 54% of decision-makers at private equity firms believe the investment environment over the next twelve months will be either very or somewhat favorable while only 20% believe it will be unfavorable. When asked about the direction of the national economy, a majority (54%) said it is headed in the right direction.

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