

# Private Fund Update

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Both the Senate and House are in session this week as both chambers try to wrap up what they can before the August recess. This update includes:

- The SEC's Investor Advocate's call for greater scrutiny of Investment Advisors;
- Last week's meeting of the SEC's Investor Advisory Committee;
- The Small Business Investor Alliance's recent comment letter on the SBA's Model Limited Partnership Agreement for the SBIC debenture program; and
- Today's expected House vote on FY 2015 financial services appropriations, including the SEC's budget.

**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 113<sup>th</sup> Congress

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### House of Representatives

House Financial Services Committee

HFSC will hold a total of four hearings this week, none of which are directly relevant to private funds. The hearings are on 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.

[Hearing on Reforming the Federal Reserve](#) – Last week, the HFSC held a hearing titled "[Legislation to Reform the Federal Reserve on its 100-year Anniversary](#)." The hearing focused on [proposed legislation](#) that would, among other things, require the Federal Reserve to conduct

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a cost-benefit analysis when it adopts new rules, require transparency about the Federal Reserve's bank stress tests, and require the Federal Reserve to disclose the salaries of highly paid employees. Witnesses were:

- [Dr. John B. Taylor](#), Mary and Robert Raymond Professor of Economics, Stanford University
- [Dr. Mark A. Calabria](#), Director, Financial Regulation Studies, Cato Institute
- [Ms. Hester Peirce](#), Senior Research Fellow, Mercatus Center, George Mason University
- [Dr. Simon Johnson](#), Professor of Economics, Massachusetts Institute of Technology

The Committee Memorandum is [here](#) and a link to a video of the hearing is [here](#).

[Oversight of the SEC's Division of Trading and Markets](#) – Last month, 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](#), and a link to the video of the hearing is [here](#).

#### House Appropriations Committee

[SEC FY 2015 Budget](#) – On Monday, the full House of Representatives is expected to consider the Financial Services appropriations bill, [H.R. 5016](#), which includes 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. Other funding 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.

#### House Small Business Committee

[Hearing on Cash Accounting](#) – Last week, the HSBC held a hearing to examine cash accounting, its utilization by small businesses, and whether the current policies should be changed to allow small firms more flexibility in choice of accounting methods. Witnesses were:

- [Donald Williamson](#), Executive Director, Kogod Tax Center, American University
- [Sarah Windham](#), Senior Tax Manager, Dixon Hughes Goodman, on behalf of the South Carolina Farm Bureau
- [Terry Durkin](#), Owner, Durkin Associates, on behalf of the National Association of Enrolled Agents
- [Stephen Mankowski](#), Partner, EP Caine & Associates CPA, LLC, on behalf of the National Conference of CPA Practitioners

The hearing memo is [here](#) and a link to a video of the hearing is [here](#).

## **The Senate**

#### Senate Banking Committee

[Hearing in Monetary Policy](#) – On Tuesday, the SBC will hold its semiannual hearing on monetary policy with the Chairwoman of the Federal Reserve, Janet Yellen.

[Hearing on Systemically Important Banks](#) – On Wednesday, the SBC will hold a hearing titled "[What Makes a Bank Systemically Important?](#)" Witnesses will be:

- Dr. Richard Herring, Professor, The Wharton School, University of Pennsylvania

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- 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

[Hearing on Electronic Trading](#) – Last week, the HBC held a two-panel hearing titled "[The Role of Regulation in Shaping Equity Market Structure and Electronic Trading](#)." Witnesses were:

Panel One:

- [Jeffrey Sprecher](#), Founder, Intercontinental Exchange, Inc.
- [Kenneth Griffin](#), Founder, Citadel LLC
- [Kevin Cronin](#), Global Head of Trading, Invesco, Ltd
- [James Angel](#), Professor, Georgetown University School of Business

Panel Two:

- [Thomas Wittman](#), EVP, The NASDAQ OMX Group, Inc.
- [Joe Ratterman](#), CEO, BATS Global Markets, Inc.
- [David Lauer](#), President and Managing Partner, KOR Group LLC

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

Senate Finance Committee

[Hearing on Trade, Technology and Manufacturing](#) – On Thursday, the SFC will hold a hearing titled "[The Role of Trade and Technology in 21<sup>st</sup> Century Manufacturing](#)." A list of witnesses has not yet been provided.

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](#).

## Securities and Exchange Commission

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### **Investor Advocate Calls 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

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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](#).

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## 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.

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## Small Business Investor Alliance (SBIA)

### 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

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indemnification provisions.

## Private Equity Growth Capital Council (PEGCC)

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### 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)

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### 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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