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Private Equity Alert

David Blass Answers Questions with Respect to Broker-Dealer Registration of Private Fund Advisers

By Venera Ziegler

In April 2013, we issued a PE Alert addressing a speech by David Blass, Chief Counsel of the SEC's Division of Trading and Markets, regarding the potential need for broker-dealer registration of private fund advisers.* In his April speech, Mr. Blass focused his remarks on (i) whether the sale of fund interests by a private fund adviser's internal personnel requires broker-dealer registration and (ii) whether the receipt of transaction-based fees in connection with portfolio company transactions requires broker-dealer registration. On September 26, Mr. Blass participated in a Practising Law Institute webinar on broker-dealer issues in the private fund industry where he provided an update on the SEC's views.

Mr. Blass started by noting that his April speech was not intended to target the private equity industry but rather to raise awareness of the broker-dealer registration requirements. Mr. Blass stated that his speech was intended to start a dialogue with the private fund industry and to understand what issues the SEC needs to address, and that the SEC intends to apply a rule of reason to the analysis of the broker-dealer registration requirements.

In his April speech, Mr. Blass sought comments as to whether a private fund broker-dealer exemption would be useful. In his update, Mr. Blass stated that it is more likely that the SEC will provide informal guidance on this topic rather than modifying the broker-dealer registration regime.

Sales of Fund Interests

As a result of the increased dialogue between the SEC and the private fund industry, Mr. Blass stated that the SEC is now focusing on two issues in connection with the sales of fund interests by a private fund adviser's internal personnel and the applicability of the safe harbor exemption for "associated persons" of an issuer under Exchange Act Rule 3a4-1 (the so-called "issuer's exemption"). The first involves what other functions should be performed by such personnel in order to qualify for the issuer's exemption. In response to a question whether investor relations should be considered permitted other functions or sales of securities under the rule, Mr. Blass responded that typical investor relations activities, such as sending account statements, fielding complaints, and sending other communications, can be considered permitted other functions. The second issue involves what types of compensation arrangements of internal sales personnel would

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- Weil advised The Jordan Company in its acquisition of Watchfire Enterprises, Inc., a manufacturer of LED signs and digital billboards, from Harbour Group

trigger broker-dealer registration. Mr. Blass noted that while the SEC views sales by internal personnel whose compensation is completely correlated with the sales activities as requiring registration, the SEC intends to apply a rule of reason and consider the mix of other factors used to determine such individuals' compensation. Mr. Blass acknowledged, for example, that there may be times when the mix of the employees' functions may vary, including when the adviser is first launching a fund or during periods of strong performance when prospective investor interest is heightened.

Mr. Blass was also asked whether the SEC takes into account the sophistication of fund investors when analyzing whether broker-dealer registration is required. Mr. Blass answered that although the SEC has not considered the sophistication of investors in this context, the issue warrants consideration in determining whether the sale of fund interests by a private fund adviser's internal personnel requires broker-dealer registration.

Private Equity Transaction-Based Fees

Although the dialogue between the SEC and the private fund industry has increased, Mr. Blass stated that the SEC is still developing a better understanding of the nuances relating to whether the receipt of transaction-based fees in connection with the purchase and sale of portfolio companies requires broker-dealer registration. Mr. Blass noted that mergers and acquisition activities raise similar concerns. The SEC is considering providing an exemption from broker-dealer registration for M&A brokers, which typically facilitate transactions between buyers and sellers of operating businesses, with the buyer actively involved in the business after the acquisition. He stated that private equity fund sponsors might be able to benefit from such relief.

Mr. Blass also confirmed that these issues are applicable to private fund sponsors regardless of their location, and that private fund sponsors located outside the United States who market fund interests to U.S. investors should examine whether their activities require broker-dealer registration.

Use of Platforms

Mr. Blass said he wanted to draw attention to a new issue – whether the use of platforms for the sale of private securities requires broker-dealer registration. He stated that the SEC has been observing a growing number of platforms that cater to offerings conducted pursuant to Regulation D since the adoption of the Rule 506(c), which eliminates the prohibition against general solicitation and advertising in certain securities offerings conducted pursuant to Regulation D. Although Mr. Blass acknowledged that Section 4(b) of the Securities Act provides an exemption from broker-dealer registration with respect to securities offered and sold in compliance with Rule 506 of Regulation D for persons (or entities) who meet specific conditions, Mr. Blass stated that operators of such platforms need to examine their circumstances and determine whether broker-dealer registration is required.

Furthermore, Mr. Blass stated that platforms that create a secondary market for trading securities should examine whether registration under the Exchange Act is necessary. Mr. Blass emphasized the importance of proper and clear disclosure to investors seeking to participate in such platforms. He further stated that the SEC is looking into situations where platforms offering securities are working together with a registered broker-dealer to ensure that the broker-dealer is acting in accordance with its duties. Such platform operators need to give investors clear disclosure so that they understand the roles of the various parties and their respective responsibilities.

Please do not hesitate to contact us if you have any questions.

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*Available at http://www.weil.com/files/upload/Private_Equity_Alert_April_2013.pdf

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