

Investment Management Alert

April 16, 2013

SEC Counsel Highlights Fund Managers' Marketing Departments and Deal Fees as Potential Broker Activities

In a speech to the American Bar Association on April 5, 2013, David Blass, Chief Counsel of the Securities and Exchange Commission's Division of Trading and Markets, expressed concern that the solicitation activities conducted by many private fund advisers' internal marketing departments could raise questions concerning the need for the investment advisers¹ or their staff members to register as a broker-dealer. In addition, Mr. Blass characterized the "transaction-structuring fees" that many private equity managers charge portfolio companies as transaction-based compensation that, absent a complete management fee offset to the private fund client, could require registration as a broker-dealer.

While Mr. Blass indicated that he is open to discussing a new rule that could exempt certain private fund adviser marketing practices, his speech, especially when coupled with the recent enforcement action against Ranieri Partners LLC for retaining an unregistered broker-dealer,² indicates that the SEC staff may find inspection deficiencies or even take enforcement actions against private fund managers and their internal marketing staff for their solicitation of investors and deal-related fees.

Marketing by Investment Adviser Employees

Mr. Blass stated that private fund advisers' internal marketing personnel's activities and method of compensation may require them to register as a broker-dealer. While the determination of broker-dealer status is fact intensive, he stated that investment adviser personnel risk being viewed as unregistered broker-dealers when (i) they are paid transaction-based compensation or bonuses related to their success in marketing advised funds³ or (ii), even in the absence of the payment of transaction-based compensation, their primary or only function is to market interests in the fund. He stated that the presence of a marketing department within a private fund adviser that functions as a "dedicated sales force" strongly indicates broker-dealer activity "regardless of how the personnel are compensated."

Mr. Blass stated that it could be difficult for an investment adviser to private funds to fall within the conditions of the currently available safe harbor exemption applicable to persons associated with issuers,⁴ but he is interested in hearing "whether a broker-dealer registration exemption written specifically for private fund advisers is needed or would be helpful." Mr. Blass hinted that any exemption would likely be conditioned on the method of compensation of the internal staff and may subject private fund advisers to additional limitations.

Transaction-Structuring Fees

Mr. Blass also expressed concerns regarding fees "the manager directs a portfolio company of the fund to pay directly or indirectly to the adviser or one of its affiliates in connection with the acquisition or disposition (including an initial public offering) of a portfolio company or a recapitalization of the portfolio

company.” He viewed those fees as providing the investment adviser with a “salesman stake” in the transaction causing the adviser to be in the business of effecting a transaction in securities, which is the definition of a broker. He stated that the same concerns may not be present, however, when the management fee is offset by the amount of the transaction-structuring fee.

Conclusion

While this speech is only meant to reflect the views of Mr. Blass, it likely portends additional SEC scrutiny of private fund advisers with respect to the activities of their internal marketing departments and the practice of collecting transaction structuring fees, possibly including enforcement actions. Private fund advisers with dedicated marketing staffs and private equity fund managers that charge transaction-structuring fees may wish to review their practices in light of this speech, especially as regards whether the marketing staff receives transaction-based compensation and whether there is a full management fee offset for fees received from portfolio companies. Advisers with dedicated marketing staffs should carefully monitor developments in this area, especially the development of a separate exemption from broker-dealer registration for the marketing staffs of advisers to private funds.

Mr. Blass’s speech is available [here](#).

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