Americans for Financial Reform
1629 K St NW, 10th Floor, Washington, DC, 20006
202.466.1885

May 22, 2013

Dear Representative:

On behalf of Americans for Financial Reform[1], we are writing to express our opposition to H.R. 1105, "The Small Business Capital Access and Job Preservation Act." This legislation would exempt nearly all private equity fund advisers from the registration requirements in the Dodd-Frank Wall Street Reform and Consumer Protection Act. This exemption from registration has several serious negative consequences:

- Investors would lose key protections provided by registration under the Investment Advisers Act.
- Regulators would lose critical information necessary to monitor systemic risks.
- Elements in the bill that require that heavily leveraged private equity funds would still be registered would not provide effective protection against any of these outcomes.

Investors would lose key protections: Private equity funds manage trillions of dollars on behalf of investors and employ millions of people.[2] Despite their role in the financial markets, the job markets and as the managers of hundreds of billions of dollars in pension fund assets, before the passage of Dodd-Frank these firms operated with virtually no oversight. The Dodd-Frank Act imposed very modest reforms on private equity fund managers – requiring them to register with the SEC and provide basic disclosures to regulators and investors.

H.R. 1105 would exempt nearly all private equity fund advisers from registration, and therefore deny investors in these funds the protections that come with adviser registration . Registered investment advisers are required to file regular disclosures with the SEC and to provide clients and potential clients a written disclosure statement that includes information about business practices, fees, and conflicts of interest the adviser may have with its clients. In addition, investment advisers have a duty to act as fiduciaries in dealings with their clients. This means advisers must hold the client's interest above their own in all matters. They are required to avoid conflicts of interest and, if conflicts cannot be avoided, they must describe those conflicts to investors and explain how they will maintain their impartiality.

---

[1] Americans for Financial Reform is a coalition of more than 250 national, state, and local groups who have come together to advocate for a fairer and safer financial system. Members of AFR include consumer, civil rights, investor, retiree, community, labor, faith based, and business groups along with academics and independent experts.

[2] http://blogs.wsj.com/deals/2012/07/30/private-equity-industry-hits-3-trillion-in-assets/; http://dealbook.nytimes.com/2012/04/04/looking-for-the-next-generation-in-private-equity/

Nearly all private equity funds would escape registration and protections under this bill: H.R. 1105 would exempt private equity fund advisers from the registration requirements created by Dodd-Frank unless each fund managed by the adviser had outstanding borrowings that exceed two times the fund's invested capital commitments. This exception to the private equity fund exemption appears intended to require private equity funds with excessive leverage to register. However, in practice it will be largely meaningless.

There are two reasons that this provision will be ineffective. First, the stereotypical private equity transaction is a leveraged buyout, where the debt incurred to purchase a portfolio company is borrowed by the portfolio company and not the private equity fund. Second, private equity funds generally do not incur - or very much minimize - fund-level debt due to requirements imposed by tax-exempt investors that are, nevertheless, required to pay taxes on income from debt-financed investments.[3]

As a result, it is very unlikely that the exception to the private equity exemption in H.R. 1105 would capture more than a negligible number of private equity fund managers.

Regulators would lose key information necessary to monitor systemic risk: H.R. 1105 directs the SEC to replace the recordkeeping and reporting requirements for private equity funds established in Dodd-Frank with a weaker, less effective regime. Section 404 of Dodd-Frank gave the SEC authority to establish recordkeeping and reporting requirements "as necessary and appropriate in the public interest and for the protection of investors, or for the assessment of systemic risk by the Financial Stability Oversight Council." The statute directed the Commission to include a variety of details, such as counterparty credit exposure and valuation practices, in private fund adviser reports designed to facilitate systemic risk oversight. The exemption from the registration and reporting in H.R. 1105 would exempt private equity funds from the disclosure regime Congress laid out in Dodd-Frank to allow regulators to monitor systemic risks.

Opponents of private equity fund registration have argued in the past that private equity funds should not be required to register because the funds do not pose a systemic threat. In truth, while fund-level debt has never been the focus of concern for those who worry about the systemic threats posed by these funds, their overall investment strategies do pose significant system risks.

"Private equity" is a euphemism for leveraged buyouts, which involve the takeover of companies using small amounts of equity from investors and large amounts of debt taken on

---

[3] Pension plans, endowments, foundations and individual retirement accounts are a major source of assets invested in private equity funds. These are all tax-exempt investors. Tax-exempt investors may be subject to tax obligations if they incur "unrelated business income tax" (UBIT). One way that a tax-exempt investor could generate "unrelated business taxable income" (UBTI) is through the use of debt financing by a partnership in which the investor is a limited partner. As a result, it is common for private equity fund managers to make a promise to investors that the fund will not incur or will strictly limit fund-level debt. Tax-exempt investors that are willing to pay UBIT, will typically demand that private equity fund managers limit the portion of investments that could result in UBTI to 25% of capital committed. *See* Accommodating Tax-Exempt Investors: Understanding UBTI, Morgan Lewis *available at* http://www.morganlewis.com/documents/VCPEFdeskbook/VCPEFdeskbook_AccommodatingTaxExemptInvestors.pdf

by the target companies. Systemic risks arise from this model because leveraged buyouts result in highly-leveraged operating companies that are far more vulnerable to default during economic downturns. In turn, the debt issued to finance leveraged buyouts, often in the form of junk bonds and covenant-light loans, are risky investments. When issued in large quantities, these risky investments can lead to large, cascading losses for investors.

According to Moody's, "The relatively swift recovery of debt markets following the credit crisis masked the true risk of covenant-lite loans... In a more prolonged credit downturn, companies with lenient covenant terms would be more likely to default, and their lenders would likely recover less than would investors in defaulted companies with more restrictive covenants."[4]

Issuance of risky debt investments has soared since the financial crisis. CNNMoney reported earlier this month that junk bond yields are at their lowest point in history and covenant light loans "are nearing levels last seen during the financial crisis." [5] Given the increasing risks to the economy associated with these deals, it would be particularly unwise for Congress to exempt private equity funds from the reporting requirements in Dodd-Frank intended to provide regulators the information necessary to monitor systemic risks.

Finally, It is important to note also that the disclosure regime for private funds required by Title IV of Dodd-Frank has already been finalized by the SEC and the disclosure requirements distinguish among funds by type and size. [6] The SEC rules already provide for less stringent reporting requirement for private equity funds compared to other types of private funds. For example, private equity fund advisers are only subject to annual reporting requirements, whereas liquidity fund advisers that manage more than $1 billion in assets and hedge fund advisers that manage more than $1.5 billion in assets are required to file quarterly reports. Private fund advisers with less than $150 million are exempt altogether. And, private equity fund advisers with between $150 million and $2 billion in assets under management are exempt from a large portion of the detailed reporting requirements that apply to larger advisers.

H.R. 1105 undermines critical protections for private equity fund investors that reform advocates fought to include in the Dodd-Frank legislation. It would also exempt private equity advisers from recordkeeping and reporting requirements that provide regulators with critical information necessary to monitor systemic risks. For these reasons, we urge you to oppose H.R. 1105. For more information, please contact Heather Slavkin Corzo at hslavkin@aflcio.org or (305) 392-0220.

Sincerely,

Americans for Financial Reform

---

[4] Moody's Investor Services, *Announcement: Moody's: Covenant-Lite May Lead to Larger Investor Losses in Next Credit Downturn*, Moody's Global Credit Research (March 10, 2011), *announcement available at* http://www.moodys.com/viewresearchdoc.aspx?lang=en&cy=global&docid=PR_215517.
[5] http://money.cnn.com/2013/05/03/investing/bond-bubble/index.html
[6] Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, 76 Fed. Reg. 221, 71127 (Nov. 16, 2011) (to be codified at 17 C.F.R. pts. 275 & 279).

Following are the partners of Americans for Financial Reform.

All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.

- AARP
- A New Way Forward
- AFL-CIO
- AFSCME
- Alliance For Justice
- American Income Life Insurance
- American Sustainable Business Council
- Americans for Democratic Action, Inc

- Americans United for Change
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Center for Effective Government
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action
- Green America
- Greenlining Institute
- Good Business International
- HNMA Funding Company
- Home Actions
- Housing Counseling Services
- Home Defender's League
- Information Press
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Krull & Company
- Laborers' International Union of North America
- Lawyers' Committee for Civil Rights Under Law
- Main Street Alliance
- Move On
- NAACP
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)

- National Consumers League
- National Council of La Raza
- National Council of Women's Organizations
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Resource Center
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National Nurses United
- National People's Action
- National Urban League
- Next Step
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO National Network
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen
- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer's for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club
- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS
- U.S. Public Interest Research Group
- UNITE HERE
- United Food and Commercial Workers
- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now
- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

List of State and Local Partners

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL

- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville A
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)
- Cooperative Fund of New England, Wilmington NC
- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY
- Empowering and Strengthening Ohio’s People (ESOP), Cleveland OH
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center

- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- Neighborhood Economic Development Advocacy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network
- New Yorkers for Responsible Lending
- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY
- Nonprofits Assistance Fund, Minneapolis M
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG

Small Businesses

- Blu
- Bowden-Gill Environmental
- Community MedPAC
- Diversified Environmental Planning
- Hayden & Craig, PLLC
- Mid City Animal Hospital, Pheonix AZ
- The Holographic Repatterning Institute at Austin
- UNET