

October  
2014



Association for Corporate Growth

# ACG SEC TASK FORCE SURVEY

“A CALL TO ACTION”

ASSOCIATION FOR CORPORATE GROWTH



## TABLE OF CONTENTS

	<b>Page</b>
<b><i>About The Association for Corporate Growth (ACG)</i></b> .....	<b>2</b>
<b><i>About ACG's SEC Task Force</i></b> .....	<b>2</b>
<b><i>Executive Summary</i></b> .....	<b>3</b>
<b><i>Survey Methodology</i></b> .....	<b>3</b>
<b><i>Key Survey Findings</i></b> .....	<b>5</b>
1. Middle-Market PE Officers Are Concerned With A Broad Range of Issues .....	5
A. SEC Examinations.....	6
B. Investment Advisers Act Compliance.....	6
C. Valuations.....	6
D. Confusion About General Solicitation Rules .....	7
E. Legislation .....	8
F. Fees and Expenses .....	8
G. Broker-Dealer Registration for Private Equity Firms .....	9
H. Cybersecurity .....	9
2. SEC Presence Exams Appear To Have Improved Over Time .....	10
3. The SEC Could Improve Its Outreach To The Middle Market PE Industry .....	111
4. Respondents Want The Task Force To Carry Out A Broad Range Of Activities.	133
<b><i>Conclusions &amp; Next Steps</i></b> .....	<b>13</b>
<b><i>Appendix</i></b> .....	<b>15</b>

## ***About The Association for Corporate Growth (ACG):***

Founded in 1954, The Association for Corporate Growth®, the global organization focused on driving middle-market growth is comprised of 14,500 members who are investors, lenders, owners, executives and advisers to growth companies in the middle market. With 57 chapters across the globe, ACG provides the financial, human and intellectual capital and opportunities middle-market firms need to grow their businesses, reach new markets, expand capacity and better serve their communities and customers. ACG's mission is to drive middle-market growth.

PitchBook, an independent research firm, reports that 90% of the merger-and-acquisition transactions completed in 2011, 2012 and 2013 involved companies with enterprise values of less than \$400 million. The National Center for the Middle Market (NCMM) at The Ohio State University defines the middle market as companies with annual revenues from \$10 million to \$1 billion. Research from the NCMM shows that middle-market businesses account for approximately 46% of the jobs in the United States, while comprising only 3% of all companies. The middle market is clearly a driver of economic growth and an important business sector that is often overlooked.



## ***About ACG's SEC Task Force:***

ACG's members include more than 1000 private equity firms that provide financial, intellectual and human capital to middle-market businesses.

ACG formed the SEC Task Force in 2013 to address the increasingly complex regulatory system imposed on the private equity industry. As regulations under the Dodd-Frank Wall Street Reform and Consumer Protection Act began to be implemented, ACG members discovered that both in Congress and at the Securities Exchange Commission (SEC), many legislators and regulators were not completely familiar with the private equity industry and the middle-market ecosystem. This included a clear understanding of the private equity business model that typically calls for investing in privately held businesses with funds provided by investors such as public and private pension funds whose beneficiaries include retirees. The Task Force is comprised of chief compliance, finance and legal officers. It works collaboratively to address pressing compliance issues and other regulatory concerns by creating a dialogue within the industry.

## ***Executive Summary:***

ACG initiated the SEC Task Force Survey to help identify the top compliance and regulatory concerns impacting its members, many of which are small and mid-sized private equity firms. ACG undertook the survey to better understand the regulatory challenges facing fund compliance and financial officers, so that it could better and more effectively represent the interests of its members when interacting with legislators and regulators.

The survey reveals four primary findings:

- Middle-market private equity officers are concerned with a broad range of regulatory issues;
- SEC presence exams appear to have improved over time;
- The SEC could adopt measures to improve its outreach to the middle market private equity industry; and
- Respondents want the ACG SEC Task Force to carry out a broad range of activities.

None of these findings come as a surprise. Rather, the findings confirm much of what ACG has been hearing from its members. The data in this report further demonstrates the need for enhanced communication and engagement with legislators and regulators regarding compliance issues faced by middle-market private equity practitioners.

The results in these pages reconfirm the need for a robust ACG SEC Task Force, as well as continued and productive dialogue with regulatory bodies such as the SEC. ACG is absolutely committed to achieving both goals.

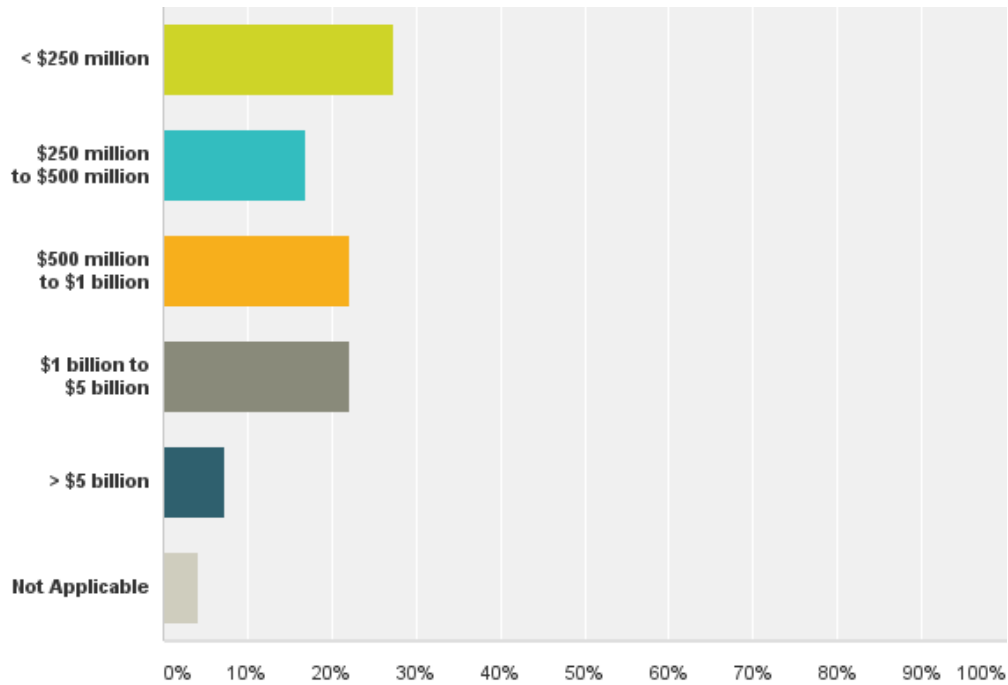
## ***Survey Methodology:***

ACG sent a survey tool to members at approximately 780 U.S. private equity firms. The survey targets chief compliance, financial and operations officers, as well as in-house legal counsel who were asked about how they could better navigate the inhibitive rules and regulations. A total of 203 responses were received, of which approximately 180 were from investment advisers – the survey’s target. Of the responses received from investment advisers, approximately 71% were registered under the Investment Advisers Act of 1940.

ACG made a special effort to make the survey available to smaller funds. This push was successful and we are pleased with the number of smaller funds that responded. More than two-thirds (69%) of the investment advisers who responded had less than \$1 billion in assets under management. We believe this represents one of the largest surveys of middle-market private equity funds to date. See Figure 1 and Figure 2 which represent the makeup of the survey respondent pool.

(Figure 1)

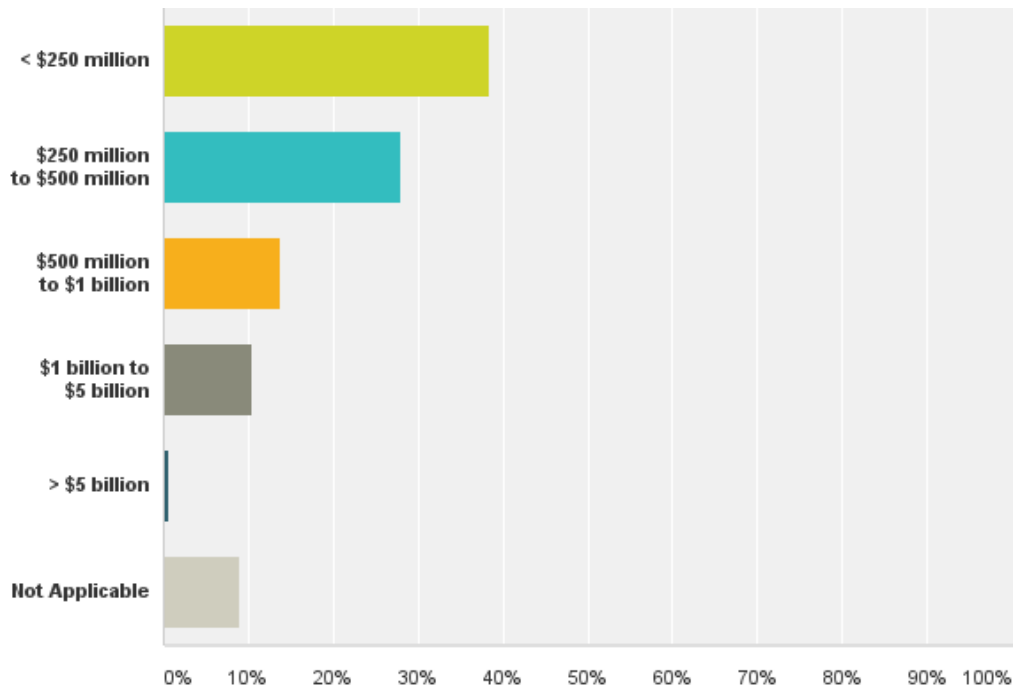
**Q2: Which Best Describes Your Firm's Total Assets Under Management**



In addition, the vast majority of respondents (88%) indicated that their most recent fund was less than \$1 billion.

(Figure 2)

**Q3: Which Best Describes The Size of Your Firm's Most Recent Fund?**



## Key Survey Findings:

### 1. Middle-Market PE Officers Are Concerned With A Broad Range Of Issues

The survey confirms ACG's initial thoughts: middle-market compliance and financial officers are now inundated with a broad range of regulatory issues. The survey listed 19 issues and asked respondents to identify which most concerned them (see Figure 3). More than 50% of the respondents cited the following six issues:

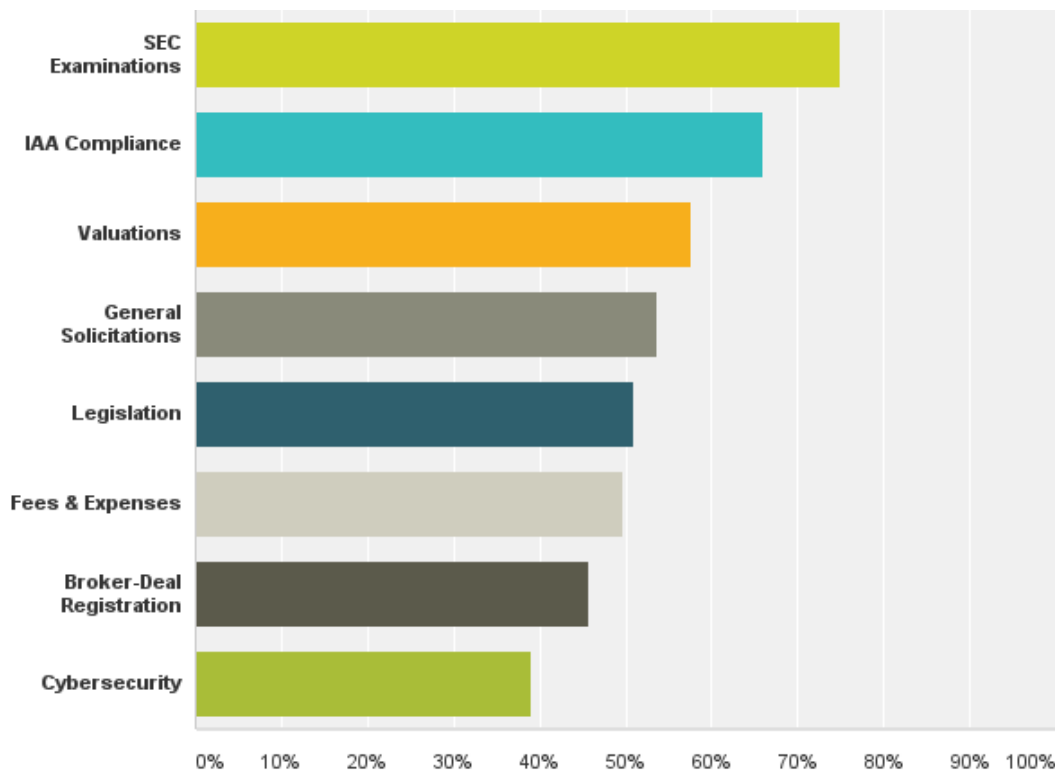
- a) SEC Examinations (75%)
- b) Investment Adviser Act Compliance (66%)
- c) Valuation Issues (58%)
- d) General Solicitation rules (54%)
- e) Legislation (tax reform, carried interest) (50%)
- f) Allocation of Fees and Expenses (50%)

Two additional issues were identified by nearly 40% of respondents:

- a) Broker-Dealer Registration for PE Funds (46%)
- b) Cybersecurity (40%)

(Figure 3)

#### Q4: What Regulatory Issues Are You Concerned With?



*\*See Appendix for full issues list*

Two respondents described the challenge in keeping abreast of multiple regulations simultaneously, the quick rate at which regulation changes and the cost of compliance.

*“Again, more than any one regulation, I think the cost of compliance will drive out small firms and create a barrier for new firms that would otherwise enter the market. This will empower the remaining GPs, lessening the bargaining power of LPs as well as decreasing opportunities for entrepreneurs who already feel shut out from public markets due to the high cost of compliance there.”*

**Anonymous**

*“More than any individual regulation, my main concern is the cost of compliance overall. While these costs may be easily absorbed by firms with billions under management, they are a significant burden to a \$150 million fund.”*

**Anonymous**

### **A. SEC Examinations**

Approximately 75% of respondents indicated they were concerned about SEC examinations. This is not surprising given the SEC’s 2012 initiative to conduct presence examinations of one quarter of all newly registered investment advisers in a two-year period. This initiative is now drawing to a close, but the data shows that SEC examinations remain at the forefront of respondents’ minds. Despite the high level of concern regarding SEC examinations, the responses suggest that over time SEC examiners have become more familiar with the private equity business model and have conducted better, more efficient examinations.

### **B. Investment Advisers Act Compliance**

Approximately two-thirds (66%) of respondents indicated that they are concerned about compliance with the Investment Advisers Act. This includes, among other things, record keeping and reporting requirements, compliance with pay-to-play regulations and the custody rule. In particular, respondents noted the aggregate burden—both in terms of money and time—of complying with a large number of rules and regulations and the disproportionate impact on small and midsize firms.

### **C. Valuations**

Nearly 60% of those who responded indicated that they were concerned regarding valuations of their portfolio companies. A key area of concern identified is the lack of industry standards and/or best practices involving a firm’s valuation procedures and methodology. Another concern is the belief that the SEC might try to challenge audits performed by credible, third-party auditors.

## **D. Confusion About General Solicitation Rules**

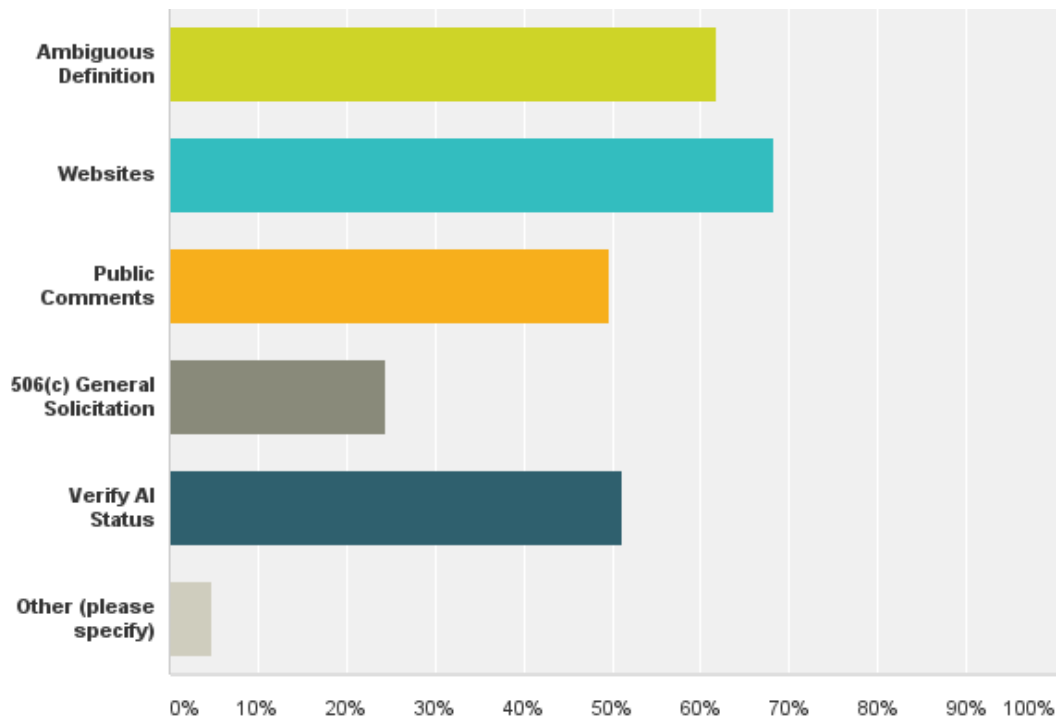
Approximately 54% of respondents indicated concern regarding the rules as to what is and is not considered a general solicitation. When asked to identify specific areas of concern, respondents identified a number of issues:

- Content permitted on a PE firm’s website (68%);
- The ambiguous definition of a “general solicitation” (61%);
- Verification of accredited investor status (52%); and
- Public comments and interviews (50%).

Fewer respondents (24%) were concerned about Rule 506(c) offerings (see Figure 4). This is likely because most private equity firms do not appear eager to undertake general solicitations for fundraising purposes.

(Figure 4)

### **Q23: Are You Concerned With Any Of The Following Issues Re: General Solicitations**



*“Inconsistency throughout the industry in terms of adopting/complying has been troublesome as well. For example, why do some funds continue to announce return results and why do we continue to see announcements that firms are fundraising (both of which are (arguably) in violation of regulations)?”*

**Anonymous**



## **E. Legislation**

Fifty percent of survey respondents indicated that uncertainty regarding federal legislation was concerning for the private equity industry. Tax policy is a key issue, with respondents concerned about potential changes to the tax treatment of carried interest and the deductibility of interest on corporate debt. Moreover, although there appears to be consensus that comprehensive tax reform should occur, there is significant uncertainty regarding the timing and provisions of tax reform. Respondents also expressed concern about legislation that has a broad impact across a fund's portfolio companies.

## **F. Fees and Expenses**

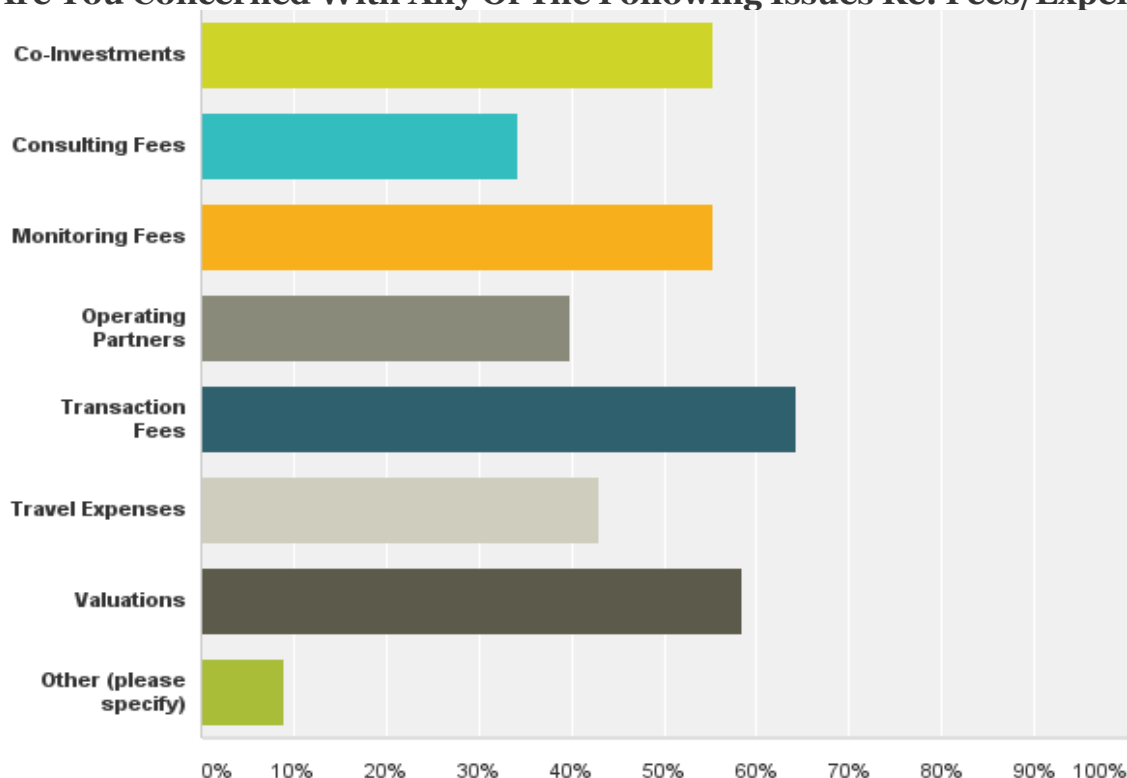
The allocation of fees and expenses between the general partner of a fund and the limited partners is highly negotiated and memorialized in a formal limited partnership agreement, or LPA. Nevertheless, perhaps in light of the SEC's recent comments regarding potential ambiguities in fund LPAs, respondents identified the following areas that they are focused on regarding fees and expenses (see Figure 5):

- Transaction Fees (64%)
- Monitoring Fees (56%)
- Co-Investments (55%)

Respondents were less focused on travel expenses (43%), operating partners (40%), and/or consulting fees (34%).

**(Figure 5)**

**Q22: Are You Concerned With Any Of The Following Issues Re: Fees/Expenses:**



## **G. Broker-Dealer Registration for Private Equity Firms**

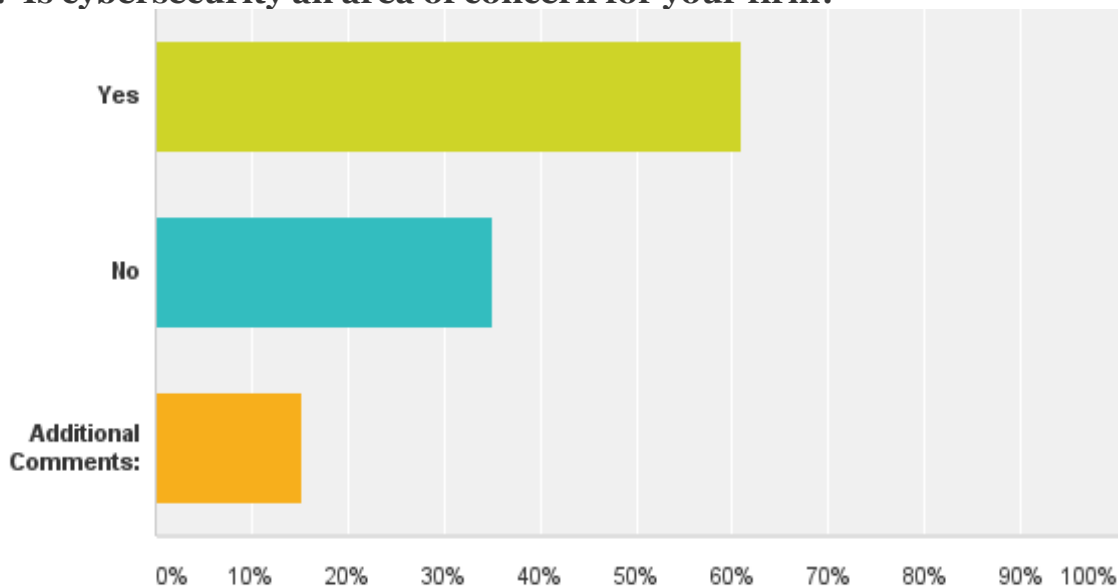
Over 45% of the respondents indicated that they are concerned about potentially having to register as a broker-dealer. This is based upon a 2013 speech in which the SEC indicated that private equity firms might be required to register as a broker-dealer based upon (i) in-house marketing efforts, and/or (ii) transaction fees charged in connection with the sale or disposition of a portfolio company.

## **H. Cybersecurity**

Cybersecurity is an emerging issue for respondents. When asked to identify whether they were familiar with the SEC's April 2014 Risk Alert on cybersecurity for registered investment advisers, 69% percent of respondents indicated they were aware of it (see Figure 6). Moreover, in a stand-alone question, 61% of respondents indicated that cybersecurity was an area of concern for their firm.

**(Figure 6)**

**Q20: Is cybersecurity an area of concern for your firm?**



*"The [cybersecurity] alert was effective in forcing us and other GPs to address this critical risk area."*

**Anonymous**

## 2. SEC Presence Exams Appear To Have Improved Over Time

The data indicate that SEC presence examinations appear to have improved over time due to the examiners' increasing familiarity with the private equity business model. In the survey, ACG asked respondents to identify whether their firm had been examined by the SEC and, if so, when the examination took place. Respondents that had been examined were asked to provide detailed comments regarding the quality and nature of their examination. Of the 158 people who responded to the question, 57 (36%) indicated their firms had been examined by the SEC while 101 (64%) had not been examined.

Many of the respondents whose firms were examined in 2012 and early 2013 indicated that their examiners were not familiar with the private equity business model. Respondents stated:

*"It was their first exam and the SEC admitted they knew nothing so the exam was pretty easy, we were just educating them."*

**Anonymous: August, 2012 examination**

*"Most of the examination consisted of us educating the examiners on the PE industry."*

**Anonymous: Mid-2013 examination**

Respondents whose firms were examined in 2014 generally indicated that their examination was conducted efficiently, and/or they comment that the examiners appeared familiar with private equity.

*"They were eager to learn and they had much more knowledge than I expected."*

**Anonymous: May, 2013 examination**

*"The SEC staff were surprisingly knowledgeable regarding private equity, so they either had direct experience or meaningful training."*

**Anonymous: August, 2013 examination**

It is worth noting that many respondents indicated that SEC staff conducting the examination was professional and courteous.

*"Very professional and overall fair minded."*

**Anonymous: 2014 examination**

*"Both examiners were very reasonable, and treated us politely and with respect."*

**Anonymous: August, 2013 examination**

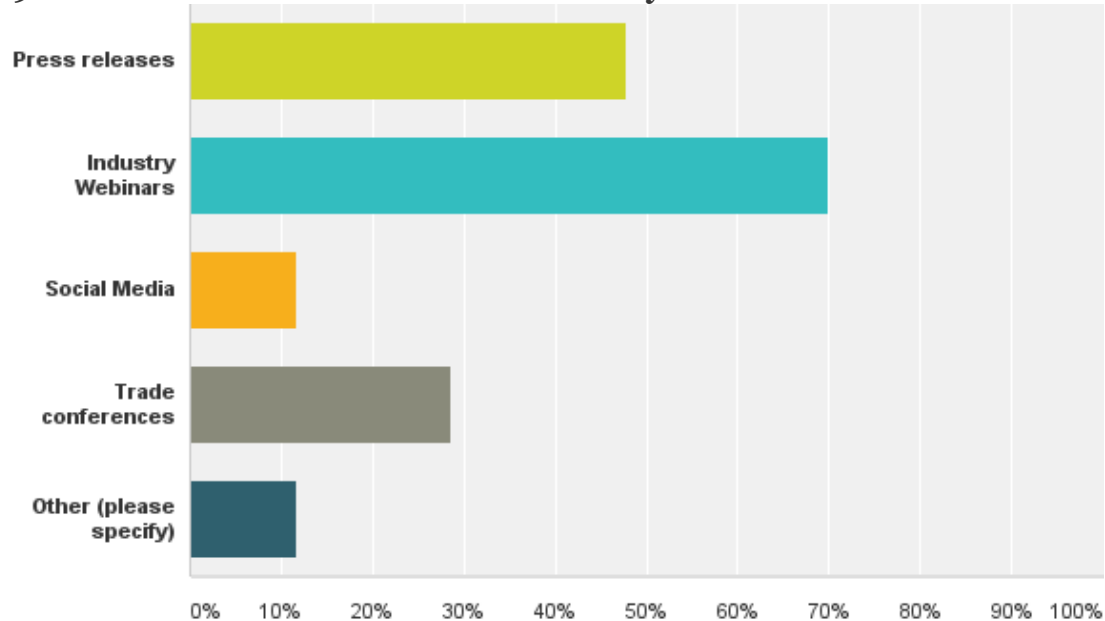
One respondent stated that the examiners were "more combative than necessary."

### 3. The SEC Could Adopt Measures To Improve Its Outreach To The Middle-Market Private Equity Industry

The ACG survey asked respondents, among other things, to identify ways the SEC might be able to communicate important items more effectively with the middle-market private equity industry. The top response suggested that the SEC have more webinars with industry organizations (69%) (see Figure 7). Other potential actions include press releases (47%), trade conferences (28%) and greater use of social media (12%).

(Figure 7)

#### Q29: How Could The SEC More Effectively Communicate Information?



Respondents also made several suggestions as to how the SEC could more effectively reach the industry on compliance/regulatory matters. Suggestions include:

- a. “Direct communications to registrants. They have the email contact info necessary to do this;”
- b. “Compliance/policy mailings to RIAs;”
- c. “More CCO outreach programs.”

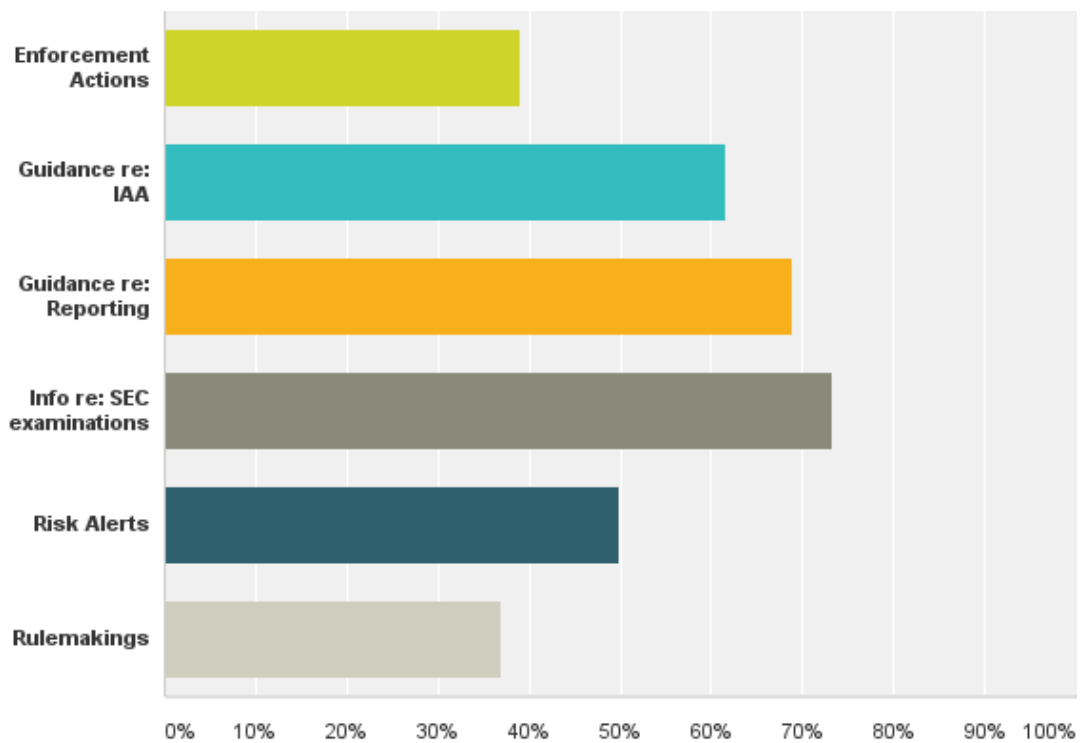
Respondents were also asked to identify what information from the SEC would be of most interest (see Figure 8). Top responses to this question were:

- d. Information Regarding SEC Examinations (73%)
- e. Guidance Regarding Reporting Issues (68%)
- f. Guidance Regarding IAA Compliance (61%); and
- g. Risk Alerts (50%)

Respondents were less interested in information about enforcement actions (40%) and rule-making (38%).

**(Figure 8)**

**Q30: What Types of Information Are You Most Interested In?**



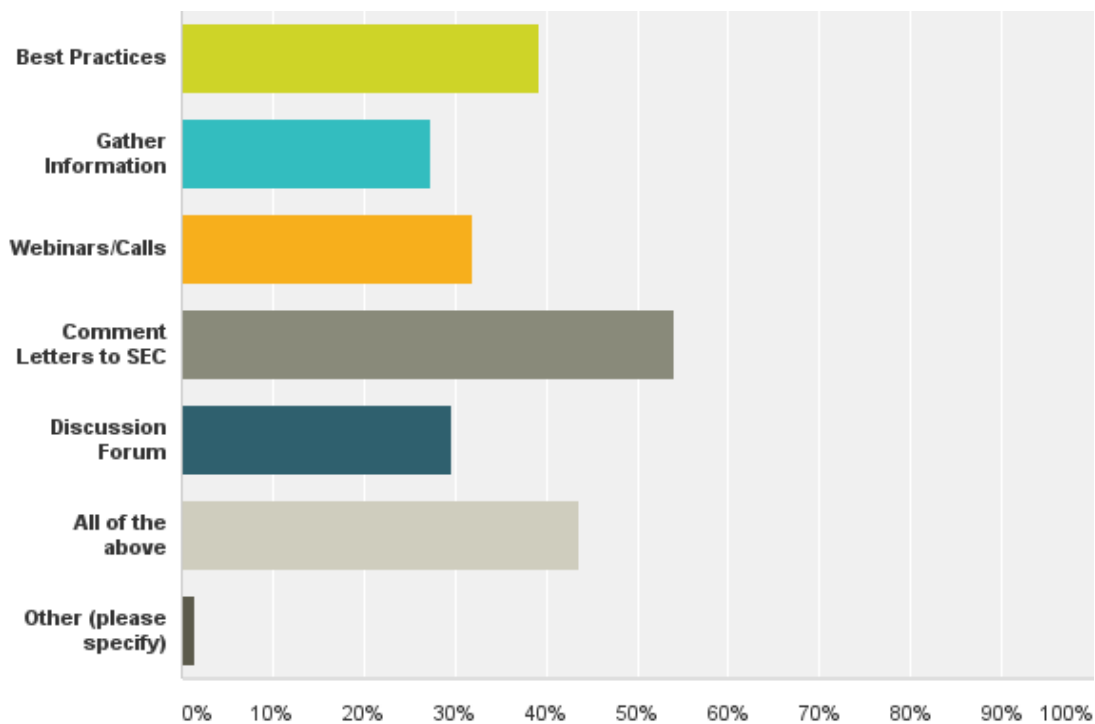
#### 4. Respondents Want The SEC Task Force To Carry Out A Broad Range Of Activities

ACG is strengthening its SEC Task Force to better educate and inform middle-market private equity compliance officers, financial officers and in-house counsel. The survey identified several potential activities for the Task Force and asked respondents to identify where they thought the Task Force should focus its efforts (see Figure 9). Potential actions identified were:

- a. Providing Input to the SEC on Proposed Guidance and Regulations (55%)
- b. Developing Best Practices for Fund Advisers (38%)
- c. Holding Regular Webinars/Conference Calls on Relevant Topics (32%)
- d. Providing a Forum to Discuss Compliance and other Relevant Issues (29%)
- e. Serving as a Clearinghouse for Regulatory Information (27%)
- f. All of the Above (44%)

(Figure 9)

#### Q31: Where Should The ACG SEC Task Force Focus Its Efforts?



Forty-four percent of respondents suggested that the SEC Task Force undertake all of the endeavors identified above. This strongly suggests the need for a forum where middle-market private equity compliance officers, financial officers and in-house counsel can meet and speak regularly, develop best practices and engage frequently with the SEC on issues of regulatory concern.

*“Interpreting the regulations to understand how they apply to our business model has been difficult. Inconsistency throughout the industry in terms of adopting/complying has been troublesome as well.”*

**Anonymous**

#### Conclusions & Next Steps:

In the final analysis of the data, the message is simple - ACG's SEC Task force will serve three primary purposes: Advocate, Educate and Facilitate. If the middle market is to continue as an engine of economic growth, middle-market private equity practitioners must work together in good faith with legislators and regulators. Reasonable regulations should be installed to protect investors. However, it is imperative that these regulations achieve the objective they were designed to address and not be so burdensome from a time and expense standpoint that they inhibit capital from flowing into this important part of the market. To that end, these findings will help ACG and the ACG SEC Task Force continue to bring awareness, education and engagement on regulatory issues of concern to the middle-market private industry as a whole.

For more information on the ACG SEC Task Force or to join, please contact:

Amber Landis  
Director, Public Policy  
[alandis@acg.org](mailto:alandis@acg.org)

Kristin Gomez  
Vice President, Communications & Marketing  
[kgomez@acg.org](mailto:kgomez@acg.org)

Scott Gluck  
Counsel, Venable LLP  
[sgluck@venable.com](mailto:sgluck@venable.com)

## Appendix:

### ACG SEC WORKING GROUP - SURVEY FOR PE FUNDS

Q4: What regulatory issues are you concerned with? (check all that apply)		
Answer Options	Response Percent	Response Count
Alternative Investment Fund Managers Directive (AIFMD)	39.1%	70
Anti-Money Laundering (AML)	24.0%	43
Broker-Dealer Registration for PE Funds	45.8%	82
Cybersecurity	39.1%	70
Fair and Accurate Credit Transactions Act (FACTA)	21.8%	39
Foreign Corrupt Practices Act (FCPA)	16.8%	30
General Solicitation (firm website, marketing materials, etc.)	53.6%	96
Improper Allocation of Fees and Expenses	49.7%	89
Investment Advisors Act Compliance (Custody Rule, Recordkeeping, Reporting, etc.)	65.9%	118
Legislation (tax reform, carried interest, etc.)	50.8%	91
M&A Brokers/Small Business Brokers	12.3%	22
Office of Foreign Assets Control (OFAC)	7.8%	14
Pay-to-Play Regulations (political contributions)	24.6%	44
Placement Agents/Finders	21.2%	38
Proper disclosure of fees to investors or perspective investors	35.8%	64
SEC Examinations	74.9%	134
User Fees on Registered Investment Advisers to Fund SEC Examiners	25.1%	45
Valuation of Portfolio Companies/Accounting	57.5%	103
Volcker Rule/Banks Disallowed from Investing in PE	17.3%	31
Others (please specify)		5
	<i>answered question</i>	<b>179</b>
	<i>skipped question</i>	<b>24</b>