

Minority Views on H.R.5424
The “Investment Advisers Modernization Act of 2016”

H.R. 5424 seeks to provide regulatory relief to investment advisers to private funds, particularly private equity funds, which would reduce transparency and make it harder for the Securities and Exchange Commission (SEC) to protect investors in those funds. The bill also fails to address the needs of investors for greater protections and disclosures, as evidenced by recent SEC exams and enforcement actions.

In the Dodd-Frank Act, we sought to bring transparency and oversight over the shadow banking system, particularly for private equity funds and hedge funds. Specifically, we required advisers to these funds with more than \$150 million in assets to register with the SEC, comply with new recordkeeping, reporting, and audit requirements, and file systemic risk reports with the Financial Stability Oversight Council (FSOC).

H.R. 5424 would change this new regime by removing important investor protections including the requirements that such advisers: notify clients of a change in ownership or control of the adviser; deliver a plain language narrative brochure to clients each year; and disclose to the FSOC certain information on large private equity funds. Worse, H.R. 5424 would create a Madoff loophole by providing a broad exemption from the annual audit requirement for funds owned by investors who may have a tangential relationship with the adviser, such as a caterer or building manager.

H.R. 5424 is also problematic because it fails to address the problems that the SEC has uncovered as a result of its new oversight of private fund advisers. In 2013, the SEC found that in cases where it examined how fees and expenses are handled, it identified violations of law or material weaknesses in controls over 50% of the time. In 2014 and 2015, the SEC brought numerous enforcement actions against private equity fund managers for: misallocating expenses to funds; failing to disclose loans from clients; using funds to pay their operating expenses without authorization and disclosure; and failing to disclose fees and discounts from service providers. Finally, last month, the SEC Director of Enforcement highlighted a need for greater transparency into fees and expenses.

Considering that one-quarter of the equity in private equity funds comes from public pension funds—who invest on behalf of our nation’s teachers, police officers and firefighters—we should not be repealing important protections and failing to address the need for additional protections. CalPERS, the largest public pension fund in the U.S.; CalSTRS, which provides retirement benefits to California’s public school teachers; and the Institutional Limited Partners Association, which represents a large swath of investors in private equity funds, agree and oppose H.R. 5424

For all of these reasons, we oppose H.R. 5424.

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