PRIVATE FUNDS AND BROKER-DEALER REGISTRATION: COMMENTS BY THE CHIEF COUNSEL OF THE SEC'S DIVISION OF TRADING AND MARKETS

The Staff of the Securities and Exchange Commission (the "SEC") has over the past few months been sounding the drumbeat regarding the need for private fund managers to consider their potential obligation to register as broker-dealers under the Securities Exchange Act of 1934. Most recently, at the end of last week, David W. Blass, the Chief Counsel in the SEC's Division of Trading and Markets, spoke about this issue and reiterated the Staff's view that a central factor in determining whether a private fund manager needs to register is the manager's receipt of transaction-based compensation.[1] As Mr. Blass said, "receipt of transaction-based compensation is a hallmark of being a broker." He indicated that the determination of whether the personnel of private fund managers should register as a broker-dealer is a fact-intensive inquiry.

Mr. Blass identified two primary areas of concern in the private fund area: marketing interests (securities) in a private fund to investors, and soliciting or negotiating fee-generating securities transactions, including transactions involving portfolio companies. In the context of marketing fund interests, he discussed the recent *Ranieri*[2] enforcement action, which, in addition to highlighting the limited scope of the so-called "finder's" exemption, further reinforced the significance of transaction-based compensation in the eyes of the SEC.

Among other indicia of broker-dealer registration cited by Mr. Blass are fees paid by portfolio companies to funds and/or fund managers for merger, acquisition and/or financing assistance to the portfolio companies. While Mr. Blass acknowledged that such practices may be common in the private fund area, he noted that such activities – negotiating transactions, identifying and soliciting purchasers and sellers and structuring transactions in exchange for fees during acquisitions, dispositions or recapitalizations of portfolio companies – may raise broker-dealer registration concerns as they "involve transaction-based compensation that is linked to the manager effecting a securities transaction." Mr. Blass noted, though, that transaction fees that offset or wholly reduce the amount of the advisory fee payable to the fund may not raise broker-dealer registration concerns.

The issue of broker-dealer registration in the private fund area appears to be an evolving one. We read the SEC Staff's recent comments as suggesting that the Staff might draft a rule or interpretive guidance on private fund sales activity. We are highlighting the Staff's recent statements to raise awareness that the SEC is focusing on potential broker-dealer registration implications in connection with the activities of private fund managers and their personnel. Due

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1 David W. Blass, A Few Observations in the Private Fund Space, Address Before the Trading and Markets Subcommittee of the American Bar Association, Washington, D.C. (Apr. 5, 2013), *available at* http://www.sec.gov/news/speech/2013/spch040513dwg.htm.

2 *Ranieri Partners LLC*, Exchange Act Release No. 69091 (Mar. 8, 2013).

to the inherently factual nature of broker-dealer status issues, we suggest that private fund managers consult with counsel before taking any action to deal with the issues that arise from their specific circumstances. Please contact us about any questions you might have regarding this issue.

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If you have any questions regarding this memorandum, please contact Howard L. Kramer (202-303-1208, hkramer@willkie.com), Gordon Caplan (212-728-8266, gcaplan@willkie.com), Neil W. Townsend (212-728-8272, ntownsend@willkie.com) or the Willkie attorney with whom you regularly work.

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