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April 22, 2013

SEC Staff Warns That Advisers May Be Required to Register as Broker-Dealers

On April 5, 2013, David W. Blass, Chief Counsel of the Securities and Exchange Commission's Division of Trading and Markets, addressed the American Bar Association's Trading and Markets Subcommittee.[1] Mr. Blass' remarks focused on the concern that private fund advisers may be overlooking that they are engaged in activities requiring registration as broker-dealers.

Mr. Blass noted two particular scenarios where a private fund adviser may be required to register as a broker-dealer: (i) where the adviser "pays its personnel transaction-based compensation for selling interests in a fund" or has personnel "whose only or primary functions" are selling fund interests and (ii) where the adviser, its affiliates or its personnel "receive transaction-based compensation for purported investment banking or other broker activities" relating to fund portfolio companies.

With respect to the first scenario, Mr. Blass provided the example of the recent *Ranieri Partners* enforcement action, where the SEC found that Ranieri Partners paid a consultant, who was not a registered broker-dealer, transaction-based fees for soliciting investors.[2] He also provided a list of questions regarding the sale of fund interests that advisers should consider in determining whether they may need to register as a broker-dealer.

With respect to the second scenario, Mr. Blass stated that the Staff has observed advisers collecting fees (other than advisory fees) that call into question whether they should register as broker-dealers. For example, Mr. Blass noted instances where a manager directs a fund portfolio company to pay fees to the adviser or its affiliate in connection with the acquisition, disposition or recapitalization of such portfolio company. These fees can be described as compensation to the adviser or its affiliate for "investment banking activities," such as negotiating or structuring transactions or identifying or soliciting purchasers or sellers of the portfolio company's securities. Mr. Blass noted that this practice may be "common at advisers of certain types of funds, such as private equity funds that execute a leveraged buyout strategy" and that the Staff is open to discussing its broker-dealer analysis with interested parties. He stated that where such transaction fees offset the advisory fee, they could be viewed as a method of paying the advisory fee, which in his view would not raise a broker-dealer registration concern.

Mr. Blass noted that he is interested in hearing thoughts on whether there should be a broker-dealer registration exemption for private fund advisers. He stated: "I have in mind a potential exemption like the issuer exemption, but one written specifically for private fund advisers. Certainly, the receipt of transaction-based compensation is a problematic practice in this context, but what other parameters might apply if there was an express exemption written specifically for private fund advisers?"

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1 The full text of Mr. Blass' comments is available at: http://www.sec.gov/news/speech/2013/spch-040513dwg.htm.

2 *In re Ranieri Partners & Donald W. Phillips*, Exchange Act Release No. 69091, Investment Advisers Release No. 3568, Administrative Proceeding File No. 3-15234 (Mar. 8, 2013), http://www.sec.gov/litigation/admin/2013/34-69091.pdf.

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In his closing remarks, Mr. Blass reminded advisers that engaging in broker-dealer activities without registration can have serious consequences, such as sanctions and rescission in instances where securities transactions intermediated by an unregistered broker-dealer are rendered void.

The speech is a clear signal to the industry that the enumerated practices are now under regulatory scrutiny, although there also is an opportunity to engage in a regulatory dialogue to propose exemptions.