

## [Securities Regulation Daily Wrap Up, TOP STORY—Sen. Warren debuts bill to reform private equity industry, \(Jul. 19, 2019\)](#)

Securities Regulation Daily Wrap Up

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The Stop Wall Street Looting Act emphasizes tax and bankruptcy laws but also contains significant provisions on investment companies, investment advisers, and credit risk retention.

Senator and presidential candidate Elizabeth Warren (D-Mass) introduced the Stop Wall Street Looting Act as the latest in a string of bills she has promoted during the last several years aimed at reforming corporate America. Her latest bill seeks to bring greater transparency to the private fund industry while also enhancing related investor protections. Previously, Sen. Warren had introduced in the 115th Congress the Accountable Capitalism Act ([S. 3348](#)) and the Anti-Corruption and Public Integrity Act ([S. 3357](#)). Senator Warren was joined in announcing the private equity bill by 13 other senators and representatives, including fellow presidential candidates Sens. Kirsten Gillibrand (D-NY) and Bernie Sanders (I-Vt).

**Workers, leveraged loans, and risk.** According to a [press release](#) issued by Sen. Warren, the bill would "empower[] workers and investors" and help to protect markets regarding high risk forms of debt. "For far too long, Washington has looked the other way while private equity firms take over companies, load them with debt, strip them of their wealth, and walk away scot-free—leaving workers, consumers, and whole communities to pick up the pieces," said Senator Warren.

One day after introducing the bill, Sen. Warren and Rep. Alexandria Ocasio-Cortez (D-NY) [announced](#) that they had sent a [letter](#) to Sun Capital Partners, Inc. seeking clarification about whether the firm plans to cease severance payments to employees at Shopko, which Sun Capital gained control of in 2005. "Under Sun Capital's control since 2005, Shopko has been saddled with debt, starved of investment, and stripped of its assets, making profits for Sun Capital but doing grave damage to the retailer and ultimately robbing Shopko workers of their jobs and promised payments," said the lawmakers' letter.

An [economic analysis](#) of the Stop Wall Street Looting Act prepared by the Center for Economic and Policy Research said the bill would bring disparate economic interests into closer balance. "By aligning the interests of Wall Street investment funds with those of the Main Street businesses that produce and distribute goods and services, your proposal reduces the risky use of financial leverage by private equity and other investment funds and brings the debt of target companies into line with their business requirements," said the report.

The Stop Wall Street Looting Act is aimed primarily at reforming key tax laws that enable the private fund industry, including those on carried interest. The bill also contains bankruptcy law provisions that would impact executive pay at private equity firms. Securities regulation, by contrast, is a comparatively small portion of the bill, but these provisions could have significant impact.

**Private fund disclosures.** Title V of the Stop Wall Street Looting Act includes provisions that seek to enhance the transparency of private funds. For example, under Section 501 of the bill, which would add a new section to the Investment Company Act, the Commission would have to adopt rules within one year of enactment to implement required disclosures that private funds would have to make consistent with GAAP. Disclosures would be made annually, and the disclosures would be made public. The Commission also would have to review its required disclosures every five years to ensure they comport with current trends in the private equity industry.

The disclosure obligations would apply to a "private fund," which means a company or partnership that would be an investment company but for exceptions contained in Investment Company Act Sections 3(c)(1) and 3(c)(7), acts as a control person, and is neither a venture capital fund nor a specific type of institution under the

Community Development Banking and Financial Institutions Act of 1994. The bill would require a private fund to disclose 22 substantive items that would fall into roughly ten categories:

- Basic information regarding the name of the fund and its owners;
- Information about assets under management;
- Equity contributions by general and limited partners;
- Amounts of debt and whether creditors are located in the U.S. or overseas;
- Performance and other financial metrics;
- Information regarding "target firm[s]," which the bill would define as a corporations that are acquired via a change in control transaction.
- Data on the types of equity owners (e.g. broker-dealers, registered investment companies; private funds not registered with the SEC);
- Information about the fund's fee structure;
- Total claimed carried interest; and
- Material changes in risk factors at the fund level.

The Stop Wall Street Looting Act also would require certain disclosures to be made by investment advisers to private funds. Section 503 of the bill would require that an investment adviser make detailed disclosures to investors about other private funds managed by the investment adviser.

**Fiduciary duties not waivable.** The Commission's rulemaking authority under Investment Advisers Act Section 211(h) would be augmented to require the Commission to ban certain practices by investment advisers. Specifically, Section 502(b) of the Stop Wall Street Looting Act would require the Commission to issue rules that bar an investment adviser from requiring a person, as a condition of providing investment advice, to sign an agreement waiving fiduciary duties owed by the investment adviser.

**Credit risk retention.** Title VI of the Stop Wall Street Looting Act would amend Exchange Act Section 15G to ensure that managers of collateralized debt obligations are included in the definition of "securitizer." The bill also would add a provision to Section 15G to clarify that language within this section of the Exchange Act requiring a securitizer to retain some of the credit risk for an asset the securitizer does not (or has never) held means that the securitizer must obtain that portion of the credit risk for that asset. Moreover, the new provision would clarify that references in Section 15G to assets transferred by the securitizer include transfers *caused* by the securitizer (emphasis added). The SEC's Regulation RR implemented the Dodd-Frank Act credit risk retention provisions contained in Section 15G via a joint rulemaking with federal banking and housing regulators.

**Carried interest.** Senator Warren's bill also would attempt to close what is often called the carried interest loop hole, a topic of primary interest to hedge funds and private equity firms. Title IV of the Stop Wall Street Looting Act contains language nearly identical to that of the Carried Interest Fairness Act of 2017, which consisted of companion bills sponsored in the 115th Congress by Sen. Tammy Baldwin (D-Wis) and then-Rep. Sander Levin (D-Mich) (See, [S. 1020](#) and [H.R. 2295](#)).

The Baldwin-Levin bills would have closed the carried interest loophole by requiring re-characterization of gains or losses from investment services partnerships (ISPIs) as ordinary income (loss) instead of allowing more favorable capital gains treatment. The Levin and Baldwin bills also included a qualified capital interest exception that would avoid re-characterization if certain requirements are met. Senator Baldwin and Rep. Levin [emphasized](#) that their bill would raise \$15.6 billion in revenue, based on an estimate by the non-partisan Joint Committee on Taxation.

The Baldwin-Levin bills were rejected by Republicans who drafted the Tax Cuts and Jobs Act in favor of a less stringent provision contained in Section 13309 of the [conference report](#) on the TCJA that extended the applicable holding period from one year to three years.

Companies: Shopko; Sun Capital Partners, Inc

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