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ARTICLE

SQUARE PEGS DON'T FIT IN ROUND HOLES: THE IMPACT OF THE DODD-FRANK ACT'S ELIMINATION OF THE PRIVATE FUND EXEMPTION ON PRIVATE EQUITY FUND ADVISERS

Joshua C. Dawson[†] & *Paul J. Foley*[‡]

I. INTRODUCTION

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”)¹ was signed into law on July 21, 2010. The Dodd-Frank Act marked the most comprehensive change to financial law in the United States since the Great Depression.² The stated objective of the Dodd-Frank Act was “[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end ‘too big to fail’, to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes.”³ While these were laudable goals, especially in light of the financial crisis and ensuing Great Recession that preceded the Dodd-Frank Act’s adoption, good intentions do not necessarily yield intended results—especially when Congress is involved.

The Dodd-Frank Act contains over 848 pages of financial reform, and is broken up into sixteen different titles.⁴ This Article focuses on one such title—Title IV. Title IV of the Dodd-Frank Act removed the so-called “Private Fund Exemption”⁵ from registration under the Investment

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1. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010), available at <https://www.sec.gov/about/laws/wallstreetreform-cpa.pdf> [hereinafter *Dodd-Frank*].

2. *The Dodd-Frank Act: Too Big Not To Fail*, *ECONOMIST* (Feb. 8, 2012), <http://www.economist.com/node/21547784>.

3. *Dodd-Frank*, *supra* note 1.

4. *Id.*

5. See discussion *infra* Part II.

Advisers Act of 1940, as amended (the "Advisers Act").⁶ The removal of the Private Fund Exemption was intended to require private fund investment advisers, who had historically relied upon this exemption, to register as investment advisers under the Advisers Act.⁷ This change was Congress's attempt to address the Bernie Madoff Ponzi scheme,⁸ although the private fund Mr. Madoff professed to run did not, in fact, exist. More importantly, the investment adviser to Mr. Madoff's non-existent private fund was registered with the United States Securities and Exchange Commission (the "SEC"), had been examined by the SEC's staff, and the SEC apparently did not uncover the fact that no fund existed until later when Mr. Madoff confessed to the United States Federal Bureau of Investigation that he was simply running a fraudulent Ponzi scheme.⁹ So, Congress's "solution" to the Madoff scandal was to make existent private fund investment advisers register with the SEC and be subject to the same SEC rules and examinations that failed to uncover Mr. Madoff's fraud.

Title IV's elimination of the Private Fund Exemption also ineloquently lumped investment advisers to large private equity funds with investment advisers to large hedge funds.¹⁰ As a result of Title IV, both are generally now required to register as investment advisers with the SEC, despite the fact that hedge funds generally trade passively in publicly offered securities. Conversely, private equity funds generally invest in and provide operational and managerial assistance to private operating companies. These dramatically different investment activities make it impractical to regulate both types of funds under the one-size-fits-all Adviser's Act and the rules

6. Investment Advisers Act of 1940, 15 U.S.C. § 80b-1 to -21 (2012).

7. Kevin A. Zambrowicz, *Investment Adviser Regulation Post-Madoff: A Brave New World*, 6 J. BUS. & TECH. L. 373, 376 (2011), available at <http://digitalcommons.law.umaryland.edu/cgi/viewcontent.cgi?article=1165&context=jbt>.

8. *United States v. Madoff*, 586 F. Supp. 2d 240, 244-46 (S.D.N.Y. Jan. 12, 2009).

9. See Bernard L. Madoff Investment Securities, IARD # 2625, Application for Investment Adviser Registration (Form ADV) (Feb. 2005), available at http://www.adviserinfo.sec.gov/iapd/content/viewform/adv022005/Sections/iapd_AdvIdentifyingInfoSection.aspx?ORG_PK=2625&RGLTR_PK=50000&STATE_CD=&FLNG_PK=0262B11C0008014200BE1FE001EB5709056C8CC0; see also Donald C. Langevoort, *The SEC and the Madoff Scandal: Three Narratives in Search of a Story*, 2009 MICH. ST. L. REV. 899, 899-900, available at <http://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=1616&context=facpub>.

10. "Large" is over \$150 million in assets under management. 17 C.F.R. 275.203(m)-1 (2011) (providing that a manager with over \$150 million in assets under management must register with the SEC).

promulgated thereunder, which were largely designed with passive investment activity in publicly traded companies in mind.¹¹

This Article provides an overview of the primary challenges faced by investment advisers to private equity funds in the wake of the elimination of the Private Fund Exemption. Part II of this Article provides a general overview of, and background regarding, the Advisers Act and the Private Fund Exemption. Part III discusses a rule passed by the SEC in 2004 that effectively eliminated the Private Fund Exemption for hedge fund managers, but left it intact for private equity fund advisers. Part IV highlights the significant distinctions between hedge funds and private equity funds. Part V describes the implications of the Dodd-Frank Act's removal of the Private Fund Exemption on private equity fund advisers. Part VI provides a summary of certain issues that the elimination of the Private Fund Exemption has created for the SEC. Finally, Part VII discusses various potential solutions to the issues associated with the elimination of the Private Fund Exemption.

II. OVERVIEW OF THE INVESTMENT ADVISERS ACT OF 1940

The Advisers Act was signed into law in 1940 because Congress concluded that federal regulation of investment advisers, particularly questionable ones, was necessary in order to maintain the confidence and integrity of the country's national securities markets.¹² Prior to 1940,

11. Jason E. Brown, *Application of the Investment Advisers Act to Private Equity Advisers*, 44 REV. SEC. & COMMODITIES REG. 83, 83 (Apr. 2011) available at http://www.ropesgray.com/files/Publication/1433e480-fd70-48ba-aaaa-6eb0156ee532/Presentation/PublicationAttachment/8136970b-17bc-4b8c-b117-7030441f2734/Brown_RSCR_Final.pdf.

12. Investment Advisers Act of 1940 § 201 (2012). Section 201 finds that:

Upon the basis of facts disclosed by the record and report of the Securities and Exchange Commission made pursuant to section 30 of the Public Utility Holding Company Act of 1935, and facts otherwise disclosed and ascertained, it is hereby found that investment advisers are of national concern, in that, among other things—

- (1) their advice, counsel, publications, writing, analyses, and reports are furnished and distributed, and their contracts, subscription agreements, and other arrangements with clients are negotiated and performed, by the use of mails and means and instrumentalities of interstate commerce;
- (2) their advice, counsel, publications, writings, analyses, and reports customarily relate to the purchase or sale of securities traded on national securities exchanges and in interstate over-the-counter markets, securities issued by companies engaged in business in interstate commerce, and securities issued by national banks and member banks of the Federal Reserve System; and

investment advisers that were in the business of exclusively rendering investment advice were not within the scope of the SEC's jurisdiction.¹³ For example, the Securities and Exchange Act of 1934, as amended (the "Exchange Act"),¹⁴ regulated securities market professionals by requiring brokers (i.e., those who trade securities on behalf of others for compensation)¹⁵ and dealers (i.e., those who buy from others or sell securities they own to others for compensation)¹⁶ to be registered and regulated as broker-dealers, and also provided for general oversight of the securities markets. However, the Exchange Act did not include those exclusively rendering securities investment advice in its purview.¹⁷ This created a gap in regulation that was ultimately filled through the enactment of the Advisers Act.¹⁸

The Advisers Act mandates that, unless otherwise excepted or exempted, investment advisers must register with the SEC.¹⁹ The Adviser's Act defines the term "Investment Adviser" to include:

any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for

(3) the foregoing transactions occur in such volume as substantially to affect interstate commerce, national securities exchanges, and other securities markets, the national banking system and the national economy.

Id.

13. THOMAS LEE HAZEN, *THE LAW OF SECURITIES REGULATION* 788 (rev. 5th ed. 2006).

14. Securities Exchange Act of 1934, Pub. L. 73-291, 48 Stat. 881 (1934), available at <http://www.legisworks.org/congress/73/publaw-291.pdf>.

15. BLACK'S LAW DICTIONARY 219 (9th ed. 2009) ("A person engaged in the business of conducting securities transactions for the accounts of others."); see 12 AM. JUR. 2D *Brokers* § 1 (2009) ("Two elements must be met to find that one is acting as a 'broker': (1) the person must act for compensation, and (2) the person must act on behalf of someone else.").

16. BLACK'S LAW DICTIONARY 457 (9th ed. 2009) ("A person or firm that buys and sells securities for its own account as a principal, and then sells to a customer.").

17. HAZEN, *supra* note 13, at 788.

18. *Id.*

19. Investment Advisers Act of 1940 § 203(c), 15 U.S.C. § 80-b3(c) (2006).

Except as provided in subsection (b) and section 203A, it shall be unlawful for any investment adviser, unless registered under this section, to make use of the mails or any means or instrumentality of interstate commerce in connection with his or its business as an investment adviser.

Id.

compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities. . . .²⁰

Unless otherwise excepted from this definition or exempted from registration, an individual or entity that fits within this definition is required, in addition to registering as an investment adviser with the SEC, to file periodic reports on Form ADV with the SEC,²¹ maintain specified books and records and make them available to the SEC upon request,²² and have its client contracts and interactions regulated by the SEC.²³ Investment advisers to private equity funds and investment advisers to hedge funds both fall within the definition of “investment adviser” under the Advisers Act.

Before the enactment of the Dodd-Frank Act, both investment advisers to private equity funds and investment advisers to hedge funds were able to rely upon the broad exemption from registration provided under the Private Fund Exemption.²⁴ Previously, an investment adviser was eligible to rely upon the Private Fund Exemption if it “(1) had fewer than fifteen clients during the previous twelve months, (2) did not publicly hold itself out as an investment adviser, and (3) did not advise registered investment companies,” such as mutual funds.²⁵ In order to fall below the fifteen-client requirement necessary to rely upon the Private Fund Exemption, investment advisers to both private equity funds and hedge funds took advantage of the, then in place, counting rule, which allowed investment advisers to “count as clients the funds they advised . . . and not individual

20. Investment Advisers Act of 1940 § 202(11), Pub. L. No. 112-90 (2012).

21. 15 U.S.C. § 80b-4 (2006).

22. 17 C.F.R. § 275.204-2(a) (2006); see HAZEN, *supra* note 13, at 799 (in addition to having to file Form ADV-S, an investment adviser is also required to keep current records that include “balance sheets, income statements, and a journal of accounts; copies of all communications sent and received relating to investment advice or the execution of orders; copies of all notices, letters, reports, and advertisements distributed by the adviser to more than ten customers, and records of all securities transactions.”).

23. 15 U.S.C. § 80b-5 (2006); see THOMAS LEE HAZEN, *PRINCIPLES OF SECURITIES REGULATION* 410 (3d ed. 2009) (“The Act prohibits contracts whereby the adviser’s compensation is dependent upon a share of the client’s capital appreciation or gain.” The Act also requires that an “advisory contract must by its terms preclude assignment of the contract unless the client or customer consents.”).

24. Advisers Act, § 203(b)(3), 15 U.S.C. § 80b-3(b)(3) (2006).

25. William K. Sjoström, Jr., *A Brief History of Hedge Fund Adviser Registration and Its Consequences for Private Equity and Venture Capital Advisers*, 1 HARV. BUS. L. REV. ONLINE 39 (2011), available at http://www.hblr.org/wp-content/uploads/2011/02/Sjoström_Online_Article3.pdf.

investors in the funds.”²⁶ The Private Fund Exemption was a popular exemption that was utilized by the vast majority of advisers to hedge funds, private equity funds, and venture capital funds prior to its elimination.

III. THE SEC’S 2004 HEDGE FUND RULE AND THE *GOLDSTEIN* DECISION

In 2004, the SEC proposed and finalized a new rule and amendments under the Advisers Act²⁷ that “require[d] advisers to certain private investment pools (‘hedge funds’) to register with the Commission”²⁸ The primary reason for this new rule was the SEC’s concern with the rapid growth of the hedge fund industry and the increased fraud related to that growth. Consequently, the rule became known as the “hedge fund rule.”²⁹ Importantly, the hedge fund rule did not require investment advisers to private equity funds to register with the SEC.

In the adopting release for the hedge fund rule, the SEC amended the definition of “private fund,” thereby excluding certain investment advisers, who could continue to utilize the Private Fund Exemption, including those who advised private equity funds.³⁰ At the time, the SEC included the following in its press release:

[T]he term “private funds” is limited to investment pools with redemption features that offer investors a short-term right to withdraw their assets from management, based on their individual liquidity needs and other preferences, in a manner similar to clients that directly open an account with an adviser. This condition will ensure that the definition does not inadvertently include *private equity funds*, venture capital funds, or other funds that require long-term commitment of capital.³¹

The hedge fund rule was short lived. In 2006, the D.C. Federal Circuit Court, in *Goldstein v. SEC*,³² ruled that the hedge fund rule directly

26. *Id.*

27. *Registration Under the Advisers Act of Certain Hedge Fund Advisers*, Investment Advisers Act Release No. 2333 (Dec. 7, 2004), available at <http://www.sec.gov/rules/final/ia-2333.htm#IIE>.

28. *Id.*

29. *Id.* At the time the new rule was being proposed, the SEC had this to say: “In the last five years alone, hedge fund assets have grown 260 percent, and in the last year, hedge fund assets have grown over 30 percent.” *Id.*

30. *Id.*

31. *Id.* (emphasis added).

32. *Goldstein v. SEC*, 451 F.3d 873 (D.C. Cir. 2006).

conflicted with the purpose underlying the Advisers Act.³³ In so doing, the court invalidated the rule and tossed out the SEC's narrowly-tailored definition of "private fund" with it. After the *Goldstein* decision, the broad exemption provided under the Private Fund Exemption remained in place. But, "ironically, the private fund industry, [particularly, the private equity fund industry,] may have been better off had the SEC prevailed in *Goldstein*" due to the fact that if the SEC had won, then Congress might "not have revisited the hedge fund adviser registration issue in the Dodd-Frank Act."³⁴

IV. HEDGE FUNDS, PRIVATE EQUITY FUNDS, AND THE DIFFERENCE

In proposing and adopting the hedge fund rule in 2004, the SEC relied heavily on a report entitled *Implications of the Growth of Hedge Funds* (the "Report") to justify the need for investment advisers to hedge funds to be required to register with the SEC.³⁵ The Report not only described the fraudulent conduct of hedge fund advisers, but it also described both the similarities and the distinctions between hedge funds and private equity funds.

According to the Report, both private equity funds and hedge funds were "unregistered investment vehicle[s] in which investors pool money to invest in securities."³⁶ In addition, both private equity funds and hedge funds are also generally organized as limited partnerships.³⁷ Because they are both privately offered, they each also solicit investors directly, or through a registered broker-dealer, rather than through general solicitation, general advertising, or public offerings of the securities.³⁸ Due to the requirements associated with the private offering of securities,³⁹ both types of funds "typically include[d] high net worth individuals and families, pension funds, endowments, banks and insurance companies."⁴⁰ Finally, the Report found that like "hedge funds, many private equity funds establish offshore

33. Todd Zaun, *Goldstein v. Securities and Exchange Commission*, 1 PEPP. BUS. L.J. 111, 114 (2007), available at <https://law.pepperdine.edu/jbel/content/vol1/zaun-final.pdf>.

34. Sjostrom, *supra* note 25, at 40.

35. *Implications of the Growth of Hedge Funds*, SEC. & EXCH. COMM'N, (Sept. 2003), available at <http://www.sec.gov/news/studies/hedgefunds0903.pdf>.

36. *Id.* at 7.

37. *Id.*

38. *Id.*

39. See generally 17 C.F.R. §§ 230.500-.506 (2012).

40. *Implications of the Growth of Hedge Funds*, SEC. & EXCH. COMM'N, at 7 (Sept. 2003), available at <http://www.sec.gov/news/studies/hedgefunds0903.pdf>.

'mirror' funds that are typically managed by the general partner of the companion U.S. fund and have similar investments."⁴¹

The Report also described the characteristics in which private equity funds differ from hedge funds.⁴² First, "[p]rivate equity investors typically commit to invest a certain amount of money with the fund over the life of the fund, and make their contributions in response to 'capital calls' from the fund's general partner."⁴³ The Report also stated that because "private equity funds typically do not retain a pool of uninvested capital, their general partners make a capital call when they have identified or expect to identify a portfolio company in which the private equity fund will invest."⁴⁴ The Report further indicated that, unlike hedge funds, private equity funds are "long-term investments, provide for liquidation at the end of a term specified in the fund's governing documents, and offer little, if any, opportunity for investors to redeem their investments."⁴⁵ These and other material differences between private equity funds and hedge funds illustrate how it is difficult to regulate both types of funds under the same regulatory scheme.

V. TITLE IV OF THE DODD-FRANK ACT

As discussed above, Title IV of the Dodd-Frank Act eliminated the Private Fund Exemption.⁴⁶ The elimination of the Private Fund Exemption effectively requires investment advisers of private equity funds to register with the SEC, provided that their assets under management exceed \$150 million.⁴⁷ This has subjected investment advisers of large private equity funds and investment advisers of large hedge funds to a one-size-fits-all regulatory scheme under the Advisers Act. The result, particularly for investment advisers to private equity funds, has meant being subject to unnecessary, inapplicable, and, in some cases, dual regulation. Indeed, many industry observers question the benefits of investment advisers of

41. *Id.*

42. *Id.*

43. *Id.*

44. *Id.*

45. *Id.* at 7-8.

46. Sec. & Exch. Comm'n, *Rules Implementing Amendment to the Investment Advisers Act of 1940*, IA Release No. 3221, at 1 (2011), available at <http://www.sec.gov/rules/final/2011/ia-3221.pdf>.

47. *Id.* at 6 n.5.

private equity funds being regulated pursuant to the Advisers Act.⁴⁸ While observers question the public benefit of the registration of investment advisers to private equity funds, the compliance costs for private equity fund advisers are significant—often exceeding hundreds of thousands of dollars.⁴⁹ The following sub-sections highlight just a few of the reasons why regulating private equity funds in the same one-size-fits-all approach under the Advisers Act is unwarranted.

A. *Private Equity Funds Do Not Present a Systematic Risk*

The Small Business Investor Alliance (the “SBIA”) reported to Congress that private equity funds, “especially private [equity] funds with assets under management of less than \$500 million and unlevered funds, did not cause or contribute to the financial crisis.”⁵⁰ Further, the “typical private [equity] fund in the lower middle market invests over the course of three to five years in a portfolio of ten to twenty companies,”⁵¹ which has allowed the funds to spread risk among several different investments in many companies. Private equity funds also do not “create systematic risk by trading in synthetic financial instruments.”⁵² Rather, they “invest directly in small businesses.”⁵³ Finally, as has been articulated above, unlike many hedge funds and some mutual funds, private equity funds invest for the long term and investors in private equity funds understand “that [their] capital will be committed for an extended period of time.”⁵⁴ Because of this, private equity funds are “not subject to quarterly redemption events that can have a cascading effect in [the event of] a systematic market breakdown.”⁵⁵

48. Sarah N. Lynch, *House Republicans Question SEC Oversight of Private Equity Funds*, REUTERS (Feb. 13, 2013, 7:02:00 AM), <http://www.reuters.com/article/2013/09/13/us-house-sec-privateequity-idUSBRE98C0EO20130913>.

49. *Id.*

50. *Legislative Proposals to Relieve the Red Tape Burden on Investors and Job Creators: Hearing on H.R. 1105 Before the H. Fin. Serv. Comm.*, 133d Cong. 3 (2013) (statement of Marc A. Reich, President, Ironwood Counsel on behalf of Small Business Investor Alliance), available at <http://financialservices.house.gov/uploadedfiles/hhr-113-ba16-wstate-mreich-20130523.pdf> [hereinafter *Reich Statement*].

51. *Id.*

52. *Id.*

53. *Id.*

54. *Id.*

55. *Id.*

B. Inapplicability of SEC Rules to Private Equity Funds

The Advisers Act, and the rules promulgated thereunder by the SEC, are primarily designed for investment advisers that invest passively in publicly traded securities, like most hedge fund managers, and are not designed for private equity fund advisers. While a few examples are provided below, other examples of this, which are outside the scope of this Article, include recordkeeping requirements that relate specifically to securities trading, trade error requirements, and various other requirements that are not relevant or, at the very least, should be different for private equity fund advisers.

First, as part of stringent recordkeeping requirements,⁵⁶ the SEC requires registered advisers to retain and archive email messages so that they may be retrieved, searched, and reviewed by the adviser's Chief Compliance Officer or a regulator.⁵⁷ According to testimony by the SBIA, the primary reason for these reviews is to "detect illegal activities such as insider trading in publically traded securities."⁵⁸ Due to the fact that private equity firms generally do not buy or sell public securities, this is a regulation that drives up compliance costs for private fund advisers without providing significant additional investor protection. Indeed, all registered investment advisers are required to adopt a code of ethics that is designed to detect and deter insider trading in public companies, which, unlike for hedge fund managers, is not a significant issue for most private equity fund advisers.

Another example is the SEC's custody rule.⁵⁹ The current version of the Custody Rule, adopted in 2009, requires private funds to hire third party "qualified custodians" to hold each client's funds and securities.⁶⁰ From a private equity standpoint, this rule served no purpose because the securities held by private equity funds are typically "little more than a stack of

56. 17 C.F.R. § 275.204-2 (2011); see INVESTOR PROTECTION IN LIGHT OF THE DODD-FRANK ACT 25 (Caroline S. Jensen ed. 2011).

57. Sec. & Exch. Comm'n, *Investment Adviser Use of Social Media*, 2 Nat'l Examination Alert 1, at 6 (2014), available at <http://www.sec.gov/about/offices/ocie/riskalert-socialmedia.pdf>.

58. *Reich Statement*, *supra* note 50, at 7.

59. 17 C.F.R. § 275.206(4)-2 (2010).

60. *Id.*; see INVESTOR PROTECTION IN LIGHT OF THE DODD-FRANK ACT, *supra* note 56, at 26 (stating that "[a]n adviser has custody of client funds or securities if it 'holds, directly or indirectly, client funds or securities, or has any authority to obtain possession of them in connection with advisory services it provides to clients.'" If an adviser has custody, then "[t]he adviser must maintain client funds and securities with 'qualified custodians,' such as a bank or a broker-dealer, and make due inquiry to ensure that the qualified custodian sends account statements directly to the clients.").

documents specific to a transaction.”⁶¹ Further, the securities that they typically hold are not “easily transferable or negotiable document[s] that would have some potential value in the hand of an unscrupulous third party.”⁶² Despite this, in March 2013, the SEC’s Office of Inspections and Examinations published a risk alert finding that non-compliance with the custody rule was among the most common issues found in routine examinations of private equity fund advisers.⁶³ Nearly three years after the passage of the Dodd-Frank Act, and nearly a year and a half after private equity advisers could no longer rely upon the Private Funds Exemption to avoid registration with the SEC and therefore became subject to the Custody Rule, SEC’s Division of Investment Management issued a “Guidance Update” that placed limits on the types of privately offered securities, particularly those most frequently held by private equity advisers, that must be custodied by qualified custodians.⁶⁴ The significant costs incurred by private equity fund advisers for compliance with the custody rule provisions, which the SEC has effectively acknowledged were unnecessary, are not known.

Third, the Advisers Act places a significant emphasis on the valuation of the securities managed by investment advisers. For example, Form ADV, the form which investment advisers use to register and are required to keep up-to-date, requires private fund advisers to “determine the current market value (or fair value) of the *private fund*’s assets.”⁶⁵ This is primarily because passive securities advisers tend to mark their securities to market and charge their management and performance fees based on the current market value of their assets under management.⁶⁶ Conversely, private equity

61. *Reich Statement*, *supra* note 50, at 6.

62. *Id.* at 6-7.

63. Office of Compliance Inspections & Examinations, *Significant Deficiencies Involving Adviser Custody and Safety of Client Assets*, 3 National Exam Program Risk Alert 1, 3 (Mar. 4, 2013), available at <http://www.sec.gov/about/offices/ocie/custody-risk-alert.pdf> (“The custody-related deficiencies NEP staff observed can be grouped into four categories: failure by an adviser to recognize that it has ‘custody’ as defined under the custody rule; failures to comply with the rule’s ‘surprise exam’ requirement; failure to comply with the ‘qualified custodian’ requirements; and failures to comply with the audit approach for pooled investment vehicles.”).

64. Sec. & Exch. Comm’n, *Division of Investment Management*, IM Guidance Update No. 2013-04 (Aug. 2013), available at <http://www.sec.gov/divisions/investment/guidance/im-guidance-2013-04.pdf>.

65. Form ADV: Instructions for Part 1A, at 9, available at <http://www.sec.gov/about/forms/formadv-instructions.pdf>.

66. Ryan C. Fuhrmann, *Hedge Fund Fees: Exotic Expenses*, FORBES (July 16, 2013, 11:09:00AM), <http://www.forbes.com/sites/investopedia/2013/07/16/hedge-fund-fees-exotic->

advisers do not typically charge their management and performance based fee on the current value of the portfolio company interests in which they invest, but rather charge their management fees based on the actual amount invested and their performance fees on the amount actually realized when the interests are sold.⁶⁷ While private equity fund advisers have been found to attempt to inflate their assets under management when fundraising,⁶⁸ the Advisers Act's valuation requirements do not effectively address this concern. Therefore, they create additional work and increase compliance costs for private equity fund advisers without providing meaningful additional protection to the public.

Finally, the Advisers Act requires that an "adviser must seek to obtain the execution of transactions for clients in such a manner that the client's total cost or proceeds in each transaction is the most favorable under the circumstances."⁶⁹ This is known as the best execution rule. Under the best execution rule, "an adviser should consider the full range and quality of a broker's services when placing brokerage, including, among other things, execution capability, commission rate, financial responsibility, responsiveness to the adviser, and the value of any research provided."⁷⁰ The best execution rule assumes that multiple brokers have access to the same securities investments, such as broker-dealers do with publicly traded securities, and the primary distinguishing factor among brokers is the execution of the transaction. While private equity funds may utilize business brokers to help them find and complete investments in portfolio companies, these brokers often have exclusive rights to assist the applicable portfolio company with the sale of its equity. Further, the availability of equity interests in portfolio companies in which private equity fund

expenses/ ("Hedge funds are built to outperform an index by a wide margin, and those that do so are generally able to charge a 2% management fee (2% of the hedge fund's assets) as well as a performance fee for as much as 20% of the annual gains.").

67. *Fees for Hedge Funds and Private Equity Down to 1.4 and 17*, ECONOMIST (Feb. 8, 2014), <http://www.economist.com/news/finance-and-economics/21595942-cost-investing-alternative-assets-fallingslowly-down-14-and-17> ("Tweaks around how profits are calculated have also favoured investors: whereas private equity bosses once got a share of profits made on each investment, they are now more likely to get paid based on the performance of an entire decade-long fund. Not only does this delay their bonuses, it puts them at risk if bumper profits are wiped out by dud deals.").

68. Andrew J. Bowden, Director, Office of Compliance Inspections and Examinations, Remarks at the Private Fund Compliance Forum 2014 New York, NY (May 6, 2014), available at <http://www.sec.gov/News/Speech/Detail/Speech/1370541735361>.

69. Securities and Exchange Commission, *Regulation of Investment Advisers*, at 25 (Mar. 2013), available at http://www.sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf.

70. *Id.*

advisers typically invest is usually quite limited, and portfolio companies often place more emphasis on what a private equity investor brings to the table with regard to potential managerial and business execution experience than on the price that the private equity investor is offering. This is yet another requirement under the Advisers Act that has little apparent utility for private equity fund advisers or the investors they serve, but registered private equity fund advisers are required to seek best execution when dealing with business brokers, who are far different from the public securities brokers envisioned by the rule.⁷¹

C. Dual Regulation

In 1958, Congress enacted an amended form of the Small Business Investment Act of 1953 (the “SBA Act”).⁷² The SBA Act created a market for “small business investing by establishing a program to stimulate and supplement the flow of private equity capital for the sound financing of business operations for growth and expansion.”⁷³ Pursuant to the SBA Act, the Small Business Administration (the “SBA”) was created to “to maintain and strengthen the Nation’s economy by enabling the establishment and viability of small businesses, and by assisting the economic recovery of communities after disasters.”⁷⁴ After various amendments to the SBA Act in 1958, the SBA became responsible for establishing a “sound regulatory structure, *designed for private equity investing*, that provides a robust body of rules and safeguards for the industry.”⁷⁵ While the SEC provides an exemption from registration under the Advisers Act to advisers that provide advice to Small Business Investment Companies (“SBICs”), this exemption is limited to investment advisers who exclusively advise SBICs.⁷⁶ Therefore, if an investment adviser advises both SBICs and private equity funds, that investment adviser’s advisory activities with regard to the SBICs must also comply with the Advisers Act and the rules promulgated thereunder.⁷⁷

71. See *supra* text accompanying note 43.

72. 15 U.S.C. § 14A (2010).

73. Reich Statement, *supra* note 50, at 8.

74. *Final Plan for Retrospective Analysis of Existing Rules*, U.S. SMALL BUS. ADMIN. (Jan. 23, 2012), available at

<http://www.sba.gov/sites/default/files>

/SBAFinalPlanRestropectiveAnalysisofExistingRules23Jan12.pdf.

75. Reich Statement, *supra* note 50, at 8 (emphasis added).

76. Investment Advisers Act of 1940 § 203(b)(7) (2011), 15 U.S.C. § 80b-3(b)(7) (2011).

77. Reich Statement, *supra* note 50, at 8.

This dual regulation by the SBA and the SEC often results in inconsistent and sometimes conflicting regulation. In addition, it does little to protect investors, and does not reduce the likelihood of systematic risk. Instead, it reduces the amount of capital available for private equity funds to invest in small businesses, thus reducing the overall effectiveness of the private equity funds and the mission of the SBA.

An example of duplicative regulation is SBA and SEC examinations. The SBA requires that all advisers of SBICs comply with financial and compliance audits.⁷⁸ These SBA audits and financial examinations are conducted at least every two years and include: (1) whether licensees are complying with the SBA Act and implementing regulations; (2) the financial condition of licensees and SBA's financial vulnerabilities, and (3) the accuracy of information submitted to the SBA.⁷⁹ The SEC also requires registered investment advisers to comply with its inspections and examinations.⁸⁰ The SEC's Office of Compliance Inspections and Examinations (the "OCIE") has created particular examinations that are designed to: (1) improve compliance; (2) prevent and detect fraud; (3) monitor risk; and (4) inform regulatory policy.⁸¹ The SEC has set a goal to examine these advisers at least once every three years even though, as discussed below, the SEC has fallen well short of that goal.⁸² While the SBA limits its examinations to the SBICs managed by the adviser, the SEC's examinations also cover the SBICs managed by the adviser and the SEC. One adviser to an SBIC estimated that the cost to be examined by the SEC after being examined by the SBA was hundreds of thousands of dollars.⁸³

Dual examinations and regulation of SBICs make even less sense when considering the similarities and the limited differences between the SEC and SBA financial audit standards.⁸⁴ The SEC and SBA financial audits have

78. Small Business Administration, *Improved Examination Quality Can Strengthen SBA's Oversight of Small Business Investment Companies*, Report No. 13-22, available at [http://www.sba.gov/sites/default/files/oig/\[c\]Audit%20Report%2013-22%20Improved%20Examination%20Quality%20Can%20Strengthen%20SBA's%20Oversight%20of%20Small%20Business%20Investment%20Companies.pdf](http://www.sba.gov/sites/default/files/oig/[c]Audit%20Report%2013-22%20Improved%20Examination%20Quality%20Can%20Strengthen%20SBA's%20Oversight%20of%20Small%20Business%20Investment%20Companies.pdf).

79. *Id.* at 7.

80. *Study on Enhancing Investment Adviser Examinations*, SEC. & EXCH. COMM'N, available at <http://www.sec.gov/news/studies/2011/914studyfinal.pdf>.

81. *Id.* at 2.

82. See discussion *infra* Part VI.

83. *Reich Statement*, *supra* note 50, at 8.

84. 17 C.F.R. § 275.206(4)-2 (2010); 13 C.F.R. § 107.20 (2010).

exactly the same asset verification process.⁸⁵ Other than the manner in which certain financial information is presented, the only material difference between financial audits conducted pursuant to generally accepted accounting practices (“GAAP Audits”), which are required by the SEC, and SBA financial audits is the more conservative asset valuation in certain circumstances under SBA.⁸⁶ Performing a GAAP Audit, or, alternatively, a surprise audit to comply with the Custody Rule, is a significant expense that is borne by the fund’s investors without providing any investor protection in addition to that provided by SBA financial audits.

VI. THE EFFECT ON THE SEC

The SEC was required by section 914 of the Dodd-Frank Act to conduct a study on enhancing investment adviser examinations.⁸⁷ This study was published by the SEC in 2011 and among its findings it noted that the investment adviser examination program faced significant capacity challenges.⁸⁸ In particular, it found that OCIE’s staff was unlikely to keep

85. SBA Audits are required to be conducted pursuant to generally accepted audit standards (“GAAS”), as such auditors conducting an SBA Audit verify the assets of the SBIC in exactly the same manner as they would in a SEC GAAP Audit. This verification process is one of the primary reasons for the Custody Rule’s audit requirement. Therefore, SBA Audits provide the same level of investor protection and asset verification as GAAP Audits. *Compare* Small Business Administration, *Appendix 14: Accounting Standards and Financial Reporting Requirements for Small Business Investment Companies* 125 (1999), available at https://www.sba.gov/sites/default/files/files/inv_standards.pdf, with Securities & Exchange Commission, Office of Compliance Inspections and Examinations, *Examination Priorities for 2014*, at 4 (2014), available at <http://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2014.pdf>, and 17 C.F.R. § 275.206(4)-2(a)(4) (2010), and *Commission Guidance Regarding Independent Public Accountant Engagements Performed Pursuant to Rule 206(4)-2 Under the Investment Advisers Act of 1940*, Investment Advisers Act Release No. 2969, at 3 (Dec. 30, 2009).

86. The primary differences between valuation under a GAAP Audit and valuation under an SBA Audit are that (1) an increase in value above investment cost may be reflected in the reported value only if it has a specific permitted basis under the SBIC licensee’s valuation policy; (2) liquidity discounts, which are prohibited under the GAAP, must be considered for inclusion in reported value; and (3) the reported value of interest-bearing securities is not adjusted for changes in interest rates. *Compare* Small Business Administration, *Appendix 15: Valuation Guidelines for Small Business Investment Companies* 145-46 (1999), available at https://www.sba.gov/sites/default/files/files/inv_valuation.pdf, with Federal Accounting Standards Advisory Board, *FASAB Handbook of Federal Accounting Standards and Other Pronouncements SFFAS 1-12, as amended* (June 30, 2014), available at http://www.fasab.gov/pdffiles/2014_fasab_handbook.pdf.

87. See generally *Study on Enhancing Investment Adviser Examinations*, *supra* note 80.

88. *Id.* at 23.

pace with the growth of registered investment advisers.⁸⁹ This study was prophetic in the sense that the SEC has continued to battle these particular challenges as the different pieces of the Dodd-Frank Act have gone into effect.

The SEC, through its 2015 budget proposal, suggested to Congress that it was inadequately funded to keep pace with the complexities of the securities markets and the broad responsibilities bestowed upon it.⁹⁰ Among those responsibilities, the SEC is currently overseeing approximately 11,000 investment advisers, 10,000 mutual funds, as well as reviewing the disclosures and financial statements of approximately 2,500 exempt reporting advisers to hedge fund and other private funds.⁹¹ As noted in Part III, these numbers are likely to continue to grow during the near future due to the growth of use of private funds.

Among the more important items that are discussed in the budget proposal is the need for more examiners to examine private funds to ensure compliance with federal laws. In theory, these are important initiatives, but the issue for the SEC in this regard is that it has historically only “focused on public asset managers such as mutual funds that have been highly regulated since 1940,” not private funds.⁹² The SEC Chair reported to a U.S. House of Representatives appropriations panel that the SEC only examined around nine percent of registered investment fund advisers in 2013.⁹³ The 2015 proposed budget also reported that more than forty percent of the registered advisers have never been examined.⁹⁴

To correct this issue, the SEC has proposed enormous budget increases over the past four years.⁹⁵ The overall proposed budget for 2015 requested

89. *Id.*

90. SEC. & EXCH. COMM’N, FY 2015 CONGRESSIONAL BUDGET JUSTIFICATION, FY 2015 ANNUAL PERFORMANCE PLAN, FY 2013 ANNUAL PERFORMANCE REPORT 5, 56, <http://www.sec.gov/about/reports/secfy15congbudgjust.pdf> [hereinafter *FY 2015 Congressional Budget Justification*].

91. *Id.* at 4.

92. Greg Roumeliotis & Sarah Lynch, *Exclusive: SEC Forms Squad to Examine Private Funds – Sources*, REUTERS (Apr. 7, 2014), <http://www.reuters.com/article/2014/04/07/us-sec-privatefunds-idUSBREA360M420140407>.

93. *Id.*; see *FY 2015 Congressional Budget Justification*, *supra* note 90, at 4.

94. *FY 2015 Congressional Budget Justification*, *supra* note 90, at 56.

95. SEC. & EXCH. COMM’N, FY 2012 CONGRESSIONAL BUDGET JUSTIFICATION 11, 15, <http://www.sec.gov/about/secfy12congbudgjust.pdf> (An overall proposed budget increase for 2012 of \$305,936,000, a 23% increase over 2011. The Compliance Inspections and Examinations proposed budget increase for 2012 was \$63,856,000, a 27% increase over 2011.); SEC. & EXCH. COMM’N, FY 2013 CONGRESSIONAL BUDGET JUSTIFICATION 14, <http://www.sec.gov/about/secfy13congbudgjust.pdf> (An overall proposed budget increase for

\$1.7 billion, which is a proposed increase of 33% from 2013 and a 16% increase from 2014.⁹⁶ Of that \$1.7 billion, \$373,433,000 is requested for compliance inspections and examinations, which represents an increase of 38% from 2013 and a 24% increase from 2014.⁹⁷ With those proposed funds, the SEC stated that one of its top priorities will be to hire 316 additional examiners to increase the percentage of investment advisers examined each year, the rate of first-time examinations, and the examination coverage of investment advisers and newly registered fund advisers.⁹⁸

The likelihood of the SEC being granted its proposed 2015 budget is slim. From fiscal year 2004 through fiscal year 2014, the SEC's budget has increased more than 55%.⁹⁹ Due to this rapidly increasing budget, the SEC will most likely see a result similar to its 2014 budget request. In 2014, the SEC requested \$1.674 billion, but only received \$1.47 billion from Congress.¹⁰⁰ This represents about 80% of what the SEC requested. If that holds true for 2015, then the SEC will continue to be inadequately funded and will be unable to properly examine a meaningful percentage of the currently registered investment advisers.

VII. POTENTIAL SOLUTIONS

This Article discusses three potential solutions. Each recommendation provides a different perspective on how to address the complex issues relating to private equity fund advisers. The different recommendations

2013 of \$206,219,000, a 15% increase over 2012. The Compliance Inspections and Examinations proposed budget increase for 2013 was \$43,870,000, a 16% increase over 2012.); SEC. & EXCH. COMM'N, FY 2014 CONGRESSIONAL BUDGET JUSTIFICATION, FY 2014 ANNUAL PERFORMANCE PLAN, FY 2012 ANNUAL PERFORMANCE REPORT 16-17, <http://www.sec.gov/about/reports/secfy14congbudgjust.pdf> (An overall proposed budget increase for 2014 of \$256,486,000, an 18% increase over 2013. The Compliance Inspections and Examinations proposed budget increase for 2014 was \$73,914,000, a 26% increase over 2013.); SEC. & EXCH. COMM'N, FY 2015 CONGRESSIONAL BUDGET JUSTIFICATION, FY 2015 ANNUAL PERFORMANCE PLAN, FY 2013 ANNUAL PERFORMANCE REPORT 16, <http://www.sec.gov/about/reports/secfy15congbudgjust.pdf> (An overall proposed budget increase for 2015 of \$236,341,000, a 16% increase over 2014. The Compliance Inspections and Examinations proposed budget increase for 2014 was \$72,761,000, a 24% increase over 2014.).

96. *FY 2015 Congressional Budget Justification*, *supra* note 90, at 16.

97. *Id.*

98. *Id.* at 5.

99. *Memorandum on Oversight of the SEC's Agenda, Operations, and FY 2015 Budget Request*, H.R. Rep. Comm. on Fin. Svcs. (Apr. 24, 2014), *available at* http://financialservices.house.gov/uploadedfiles/042914_fc_memo.pdf.

100. *FY 2015 Congressional Budget Justification*, *supra* note 90, at 15.

present what the authors believe to be the best solutions for combining Congress's interest in minimizing systematic risk to the financial markets with the forms of regulation least harmful to private equity fund advisers.

A. *Investment Adviser Act Registration Exemptions for Private Equity Funds*

On March 13, 2013, Congressman Robert Hurt introduced the Small Business Capital Access and Job Preservation Act ("H.R. 1105").¹⁰¹ In general the bill provides that:

[N]o investment adviser shall be subject to the registration or reporting requirements of this title with respect to the provision of investment advice relating to a private equity fund or funds, provided that each such fund has not borrowed and does not have outstanding a principal amount in excess of twice its invested capital commitments.¹⁰²

H.R. 1105 provides a broad exemption for private equity fund advisers, but it does not alter the SEC's "authority [under the Dodd-Frank Act] to require that all private fund advisers maintain records and make them available to the SEC for the protection of investors or for the assessment of systemic risk by the Financial Stability Oversight Council."¹⁰³ H.R. 1105 will require the SEC to create new final rules defining what records private equity fund advisers will be required to maintain.¹⁰⁴ H.R. 1105 will also require the SEC to define what a "private equity fund" is, which it failed to do in its final rules issued after the enactment of the Dodd-Frank Act.¹⁰⁵

H.R. 1105 would allow private equity fund advisers to avoid needless and burdensome registration with the SEC. H.R. 1105 would also allow private equity funds to avoid creating costly reports to comply with Investment Adviser Act requirements. The proposed legislation would also remove dual regulation problems for those private equity fund advisers that are currently subject to both the SBA and SEC. Finally, and most importantly to the SEC, H.R. 1105 would still require private equity investment advisers to maintain certain detailed records and make them available to the SEC if suspicious

101. H.R. 1105, 113th Cong. (2013), available at <http://www.gpo.gov/fdsys/pkg/BILLS-113hr1105rfs/pdf/BILLS-113hr1105rfs.pdf>.

102. *Id.*

103. H.R. REP. NO. 113-276, at 3 (2013), available at <http://www.gpo.gov/fdsys/pkg/CRPT-113hrpt276/pdf/CRPT-113hrpt276.pdf>.

104. H.R. 1105.

105. *Id.*

behavior should arise or a complaint is received. On a fundamental level, H.R. 1105 supports a public policy of providing for more funds to be available to small businesses, and thereby providing needed capital for economic growth.

H.R. 1105 passed through the House of Representatives on December 4, 2013, but was strongly opposed by House Democrats.¹⁰⁶ The final vote was 254 for and 159 against.¹⁰⁷ The House vote probably foreshadows how Senate Democrats will receive the bill. The bill has also received criticism from the Office of the President in a Statement of Administration Policy, which stated that the proposed legislation would undermine the “protection and regulatory oversight implemented by the Securities and Exchange Commission (SEC) under Title IV of the [Dodd-Frank Act].”¹⁰⁸ Even if H.R. 1105 does not become law, it does provide an example of what an exemption for private equity fund advisers might look like.

B. Investment Advisers Create a Self-Regulatory Organization

In 2008, then Secretary of Treasury Henry Paulson headed up a study that resulted in a report and recommendation entitled *The Department of the Treasury Blueprint for a Modernized Financial Regulatory Structure* (the “Treasury Report”).¹⁰⁹ In the Treasury Report, Paulson recommends that a Self-regulatory Organization (“SRO”) be established for investment advisers because there was a growing trend of investor confusion on the differences between investment advisers and broker-dealers.¹¹⁰ In light of this, the Treasury Report’s discussion on why an SRO would be good for the investment adviser industry is particularly relevant to this Article. The Treasury Report makes the following arguments in favor of an SRO:

Self-regulation in financial markets and services is often characterized as the first line of defense in preserving market integrity and protecting against fraud and abuse. A self-regulatory system can help to cover any gaps in federal

106. HOUSE OF REPRESENTATIVES, *Final Vote Results for Roll Call 622*, (Aug. 14, 2014, 5:21:00PM), available at <http://clerk.house.gov/evs/2013/roll622.xml>.

107. *Id.*

108. EXEC. OFFICE OF THE PRESIDENT, STATEMENT OF ADMINISTRATIVE POLICY: H.R. 1105—SMALL BUSINESS CAPITAL ACCESS AND JOB PRESERVATION ACT (2013), available at http://www.whitehouse.gov/sites/default/files/omb/legislative/sap/113/saphr1105r_20131203.pdf.

109. DEP’T OF THE TREASURY, BLUEPRINT FOR A MODERNIZED FINANCIAL REGULATORY STRUCTURE (2008), available at <http://www.treasury.gov/press-center/press-releases/Documents/Blueprint.pdf>.

110. *Id.* at 125-26.

regulation and can typically respond to market developments more quickly than can government oversight. Whereas government regulators are mainly focused on antifraud enforcement, SROs can adopt and amend industry rules that address a wider range of activity and professional conduct. As private bodies, SROs may adopt rules and aspire to standards that extend beyond statutory or regulatory requirements while at the same time maintaining a flexibility that can help to better protect investors and encourage innovation in the offering of financial services and products.

In general, SROs can impose governance standards, set rules, and undertake enforcement and disciplinary proceedings with respect to their members: SROs carry out continuing education and training of professionals at member firms in technical competence as well as ethics; administer professional tests and issue certifications; conduct examinations of professionals for compliance with both SRO and federal rules; and sanction firms that fail to comply (including barring firms and individuals from the industry). SROs also arbitrate disputes and provide additional sources for investor education and information. These and other functions are typically enhanced through the direct market knowledge and expertise that SROs possess, which can help lead to rules that better address specific issues, or identify solutions to emerging issues before they become widespread.

A self-regulatory system can also lead to more cost-efficient regulation. Although a federal regulator typically oversees SROs and SRO rulemaking, the industry directly bears the costs of regulation, which results in significant savings to taxpayers. An SRO can raise revenues through registration, membership, and other fees paid by its members, which the SRO can then use to support its monitoring, enforcement, and training programs. This private source of funding for SROs may even be more flexible than that for government regulators, which typically depend upon Congress and an annual appropriations process.¹¹¹

The SRO proposal has some compelling aspects because it would allow the investment advisory industry to be basically autonomous, with direct SEC supervision over only the SRO and not over the individual advisers. Like the exemption proposal, an SRO has the potential of reducing the

111. *Id.* at 122-23.

amount of useless or duplicative regulation, as the SRO can create narrowly tailored rules that are specific to the investment adviser industry. Further, the lack of SEC investment adviser examinations, noted earlier in this Article, has actually created less investor protection—rather than more. An SRO can provide that line of protection for investors, because of its exclusive concentration on investment advisers. In addition to the potential benefits, Paulson also addressed some of the potential negative aspects of an SRO:

Self-regulation is not free of criticism. First and foremost is the potential for redundant or duplicative regulatory burdens, whether with respect to the industry's federal regulator or one or more additional SROs. Self-regulation is also susceptible to a wide range of conflicts of interest, including the potential that the SRO may have a financial interest in its members or their business activities.¹¹²

To date, the SEC has only entertained the idea of an SRO for investment advisers. However, it has not adopted an SRO approach, but rather continued with its direct supervision approach, which has been hampered by funding issues and the generally slow pace of government regulation. The SRO approach has a number of flaws, but if properly executed could provide better investor protection than the current regulatory scheme.

C. Increased Funding for the SEC

Increased funding may appear to be an obvious approach, but may be unrealistic. There is continuing skepticism from Congress concerning the budgets being proposed by the SEC.¹¹³ Congress demands that the SEC be more efficient, while the SEC pleads with Congress that without more funding the premise of the Dodd-Frank Act, of protecting the integrity of the financial markets, will not be achieved.

Both sides have strong arguments in their favor, but political compromise does not seem likely. The SEC has recently invested heavily in new technologies that it hopes will make it more efficient.¹¹⁴ Despite this, in order to become more effective, the SEC will most likely need to hire additional personnel; but with a unionized, government workforce, it may be difficult to enact policies to incentivize its most productive workers. Government agencies tend to talk about what they could do with more

112. *Id.* at 123.

113. *See supra* notes 95-98 and accompanying text.

114. *FY 2015 Congressional Budget Justification, supra* note 90, at 52.

money; however, based on the current political environment, it looks like the SEC will need to find ways to do more with less. Moreover, additional funding does little to solve the unique issues related to the private equity fund advisers.

VIII. CONCLUSION

The past four years have seen significant changes to investment adviser regulation. The Dodd-Frank Act was a reaction to a major financial crisis, but it was and is too broad in its scope. Private equity fund advisers did not create the financial crisis and should not be punished with overregulation. The recommendations to create an SRO and to give more funding to the SEC to continue the current regulatory trend are unlikely to make an immediate impact on the current regulatory environment. Conversely, a broad exemption for private equity fund advisers from registration as investment advisers would have an immediate impact. As discussed in this Article, a number of strong public policy reasons exist for such an exemption and trying to fit private equity fund advisers under a one-size-fits-all approach offers little benefit. Small businesses make up the backbone of our economy and private equity funds provide much needed capital to them. Congress and the SEC should not continue to try to fit the square peg of private equity fund advisers into the round hole of the Advisers Act.