Private Equity Regulatory Update

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Industry Update

- Financial CHOICE ACT Proposes to Exempt Private Equity Fund Advisers from Registration and Reporting Requirements of Advisers Act
- SEC Subpoena Serves as a Reminder to Fully Disclose IRR Calculations and Assumptions

Industry Update

Financial CHOICE ACT Proposes to Exempt Private Equity Fund Advisers from Registration and Reporting Requirements of Advisers Act

On April 19, 2017, the U.S. House Financial Services Committee released an updated version of the Financial CHOICE Act (the "**Act**") to be further discussed by the committee. The Act is legislation originally introduced in mid-2016 by Representative Jeb Hensarling to amend a number of financial regulations, including the Dodd-Frank Act. Among other things, section 858 of the Act would amend the Investment Advisers Act of 1940, as amended (the "**Advisers Act**") to exempt private equity fund advisers from the registration and reporting requirements of the Advisers Act. The Act does not define the term "private equity fund," but rather requires the SEC to define the term by issuing final rules within six months of the enactment of the relevant section of the Act.

- **See a copy of the Act**

SEC Subpoena Serves as a Reminder to Fully Disclose IRR Calculations and Assumptions

As Apollo Global Management, LLC ("**Apollo**") reported in its most recent 10-K, the SEC has subpoenaed Apollo for information concerning its disclosure of IRR calculations for certain private equity funds.[1] While Apollo did not disclose the nature of the SEC's concerns, this case serves as a reminder that a private equity firm's IRR calculations can come under intense scrutiny by both regulators and investors.

IRR calculations are important to many private equity funds for several reasons. First, they form the basis of the fund's track record used for marketing and investor reporting purposes. Second, they are typically used in the carried interest "waterfall" that determines the amount of carry to which the fund manager is entitled. The industry, however, lacks a formal standard for calculating IRRs and firms vary in their approaches toward calculating such figures. Absent sufficient disclosure, therefore, there is risk that investors may not appreciate the specific methodology being used in the IRR calculations. Accordingly, in

[1] **Notes to Consolidated Financial Statements, 10-K of Apollo Global Management, LLC, dated February 13, 2017**

its routine examinations of private equity firms, the SEC has often included inquiries relating to IRRs, including how such figures are calculated and reported.

As such, private equity firms may wish to use the Apollo subpoena as an opportunity to review their disclosures regarding their IRR calculations and assumptions. For example, in light of the increasing prevalence of, and attention to, subscription line financing, firms that use these credit lines may wish to review the effect of subscription line financing on their IRR calculations and whether any specific disclosure is advisable.

Davis Polk

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