

CONGRESSIONAL RECORD – 111th CONGRESS, SECOND SESSION
Senate – May 18, 2010

PRIVATE POOLS OF CAPITAL

Mr. REED. Mr. President, like many of my colleagues, I have several amendments that have been filed. At this moment, it is not possible to call up all the amendments, but I wish to speak to one of them and hope that prior to the conclusion of our debate, I will have the opportunity, and I hope my colleagues do have an opportunity, to call up amendments that are still important to the legislation and deserve consideration by the body.

My amendment would require registration with the Securities and Exchange Commission for private equity funds, hedge funds, and venture capital funds that are larger than \$100 million. It recognizes that large pools of capital without any connection to regulatory authority could pose a systemic risk. It is a function, as we found out, in some cases, that if they make erroneous judgments, that could cause a systemic problem.

This proposal has been embraced by a wide cross-section of interested and knowledgeable parties. It has the support of the Obama Administration. It has the support of the North American Securities Administrators Association, who represent State

securities regulators. It has the support of the Private Equity Council, the Managed Funds Association, Americans for Financial Reform, the AFL-CIO, and AFSCME. It has broad-based support, and I think it is part of the major effort of this legislation to increase transparency and, as a result, to preclude and prevent fraud, particularly when we are dealing with these large pools of private capital.

Private equity firms' activities can often make or break companies, resulting in a significant loss of jobs. We have seen of the 163 nonfinancial companies that went bankrupt last year, nearly half were backed by leveraged buyout firms.

There are startling examples of companies, going concerns that employ thousands of Americans, that are acquired by private equity companies. Their business model, in many cases, is to leverage that company by borrowing extensively and by using these proceeds to purchase the company and then hopefully to repay themselves handsomely. If they are at a point in which the company is burdened with too much debt, they will either attempt to sell it off or they are forced into

bankruptcy. The result, unfortunately, in many cases, is thousands of working men and women in this country lose their jobs. The company goes bust. There is nothing left.

This behavior has to, at least, be on the radar screen, if you will, of the regulators. They have to know that these funds above \$100 million are operating. There are many other examples we can cite.

The bill before us has one category. That is hedge funds. We have to recognize there are other major private pools of capital, venture capital funds and private equity funds that should also have to register. The other thing we have to recognize is that the regulatory capacity of any agency is limited. What we have seen over the last several years is a situation where regulators may have had the authority, but they did not have the resources, or they saw situations where certain activity was regulated and other activity was not.

What this amendment argues for is to ensure that we recognize both the potential dangers of large pools of private capital and the limitations of regulations to really

differentiate between the pools. That is why the amendment I propose provides no categorical exemptions for these private pools. The rationale is that I do not think, frankly, the regulators can keep up with private funds that can describe their business plan in a way to qualify for an exemption but very well might be conducting the same type of behavior that causes concerns.

So I have suggested, and it has been supported by a wide number of individuals and institutions, that we provide this broad-based registration requirement--firms above \$100 million would be required to have Federal registration. That is something, I think, that is important. Therefore, we have proposed the amendment.

The investors in these firms deserve, I think, our protection as well. The benefits to the financial system outweigh, in my view, the modest associated costs, and as a result I think we could and should move forward. Many of these firms, frankly, if you have \$100 million under management or for investment, and if you don't have good financial controls, I think we have to ask ourselves: Should these

firms be operating? Should they be allowed to continue to operate?

The second aspect of this, too, is that the infrastructure of compliance--the infrastructure of risk management--is built into these firms. If it is not, frankly, we should ask: Why are they still doing business? The cost of registration--and this is simply registration; simply telling the Federal regulators, the SEC, that we are doing business like this; we have a certain amount of assets under management or investments that we are managing, and several other items of basic information--has been estimated to be rather modest compared to the money under management and the other operational expenses of these firms.

So again, I think this is a valuable amendment. It is a valuable amendment that reinforces the basic tenets of this legislation--transparency, accountability, and giving our regulators an overall view of the financial situation--the money that is there, the types of business activities that are there--so that they can develop appropriate information for their regulatory endeavors.

The other point I would make is that if we were to stop the camera today and look at the financial scene, we might make judgments that, well, this entity is not very large, this particular entity doesn't do the type of business, et cetera. With the dynamism of our economy, which is a value, going forward 2 or 3 years, those firms could change dramatically, and something that seemed innocuous today could be systematically risky in the future. It might be called the same thing, but its functions are different.

I make a final point in this regard. In some respects, legislation that was considered here in the 1990s looked at derivatives, looked at securitization as a phenomenon that would be static and that wouldn't change. But we know it changed, and it changed in a way the regulators didn't anticipate and weren't prepared to anticipate. So mortgage funds in the 1990s were based on those old-fashioned 20 percent down, a FICO score of 680, income sufficient to amortize the mortgage over the lifetime. The mortgages they were securitizing in 2005-2006--no money down, no income statement, liar loans, et cetera--was a different product. And yet

we legislated for products and for business entities that transformed dramatically in the subsequent years.

We have to provide our regulators with the flexibility to not only deal with the problems of today but to fairly anticipate a dynamic and changing financial situation. That is at the heart of this legislation also. So I hope we have an opportunity to further debate this and to offer it and to ask colleagues for their consideration.

With that, I yield the floor to the Senator from Michigan.