EDWARDS ANGELL PALMER & DODGE

eapdlaw.com

Client Advisory | *July 2009*

Regulation of Private Investment Fund Managers Advances — Treasury Introduces Registration and Investor Protection Legislation

The Treasury Department has released proposed legislation that would require registration under the Investment Advisers Act – as well as substantial disclosure obligations – for most managers of private investment funds, including venture capital and private equity funds. The Private Fund Investment Advisers Registration Act of 2009 would eliminate the exemption from investment adviser registration generally relied on by managers of private investment funds.[1] It would also require fund managers to provide the Securities and Exchange Commission detailed information about the operation of those funds. The Investor Protection Act of 2009 would give very broad discretion to the SEC to impose new compliance and disclosure requirements on all investment advisers, whether or not registered, that would not be limited to "retail" clients.[2]

Matthew C. Dallett, Partner

Coming from the Obama Administration, these proposals will likely supersede the three previous bills already in the legislative process. All the proposals address the same principal regulatory interest: providing regulators with better information about fund activities. Because they would trigger registration for private fund managers, they would also result in additional compliance burdens. One of those earlier bills takes a somewhat different approach – requiring registration of private funds as well as their managers – and SEC representatives have stated that this is also under consideration.

The following table summarizes the aspects of the Treasury proposals that are of most interest to U.S. private fund managers and compares the proposed Hedge Fund Transparency Act (S. 344), introduced by Senators Chuck Grassley and Carl Levin in January 2009.

1. The "14-client exception" applies to investment advisers that (i) have fewer than 15 clients during a 12-month period and (ii) don't hold themselves out to the public as investment advisers.
2. Under existing law, "investment adviser" includes most persons and entities that manage securities portfolios for third parties, whether or not required to register. Unregistered advisers are already subject to the anti-fraud provisions of the Advisers Act.

	Private Fund Investment Advisers Registration Act	Investor Protection Act [3]	Hedge Fund Transparency Act
Registration of Advisers / Fund Managers	Would eliminate the 14-client exception from Advisers Act registration, other than for advisers with no place of business in the United States. Accordingly, all domestic advisers with at least $30 million under management would be required to register with the SEC.		No explicit change. However, the new registration requirement for private funds with at least $50 million in assets (see below) would trigger Advisers Act registration by their advisers under existing law.
Registration of Private Investment Funds			Would require Investment Company Act registration for private funds with assets of at least $50 million.
Recordkeeping and Disclosure Requirements	The SEC would be authorized to require registered advisers to maintain records and submit reports relating to private funds they manage as appropriate "for the assessment of systemic risk." These records and reports "shall include but shall not be limited to . . . amount of assets under management, use of leverage (including off-balance sheet leverage), counterparty credit risk exposure, trading and investment positions, and trading practices."[4] The SEC would be authorized to make rules requiring registered advisers to provide "such reports, records and other documents to investors, prospective investors, counterparties, and creditors of any private fund . . . as may be necessary or appropriate in the public interest and for the protection of investors or the assessment of systemic risk." Records of private funds would be subject to SEC examination to the same extent as those of their advisers. The legislation would also loosen current restrictions on the SEC's ability to obtain information about particular advisory clients outside of an enforcement proceeding.	The SEC would have expansive power to "gather information" related to the protection of investors. (This would presumably allow examination of materials going beyond the Advisers Act record-keeping requirements.) The SEC would also be required to "facilitate . . . simple and clear disclosures to investors regarding the terms of their relationships with investment professionals."	Registered private funds would be required to file annual reports identifying their "beneficial owners,"[5] primary accountant and primary broker and providing information on fund structure, assets, and financial institution relationships.

3. The SEC would be authorized to apply the new regulatory provisions to all investment advisers, including those not registered under the Advisers Act.
4. These records and reports would be shared by the SEC with the Federal Reserve and the Financial Services Oversight Council, and the proposed legislation provides that they would "be kept confidential." However, the SEC would not be permitted to withhold information from Congress, any federal department or agency, or any self-regulatory authority.
5. The bill's sponsors have announced that this should be limited to those who "profit from the fees generated in operating the fund."

	Private Fund Investment Advisers Registration Act	Investor Protection Act [3]	Hedge Fund Transparency Act
Compliance Requirements	The legislation would allow the SEC to ascribe different meanings to defined terms when used in different parts of the Advisers Act. (For example, this would facilitate the SEC's distinguishing between separate account clients and fund investors.)	The SEC would be authorized to adopt rules "prohibiting sales practices, conflicts of interest, and compensation schemes for financial intermediaries including . . . investment advisers." Although the legislation is not specific, SEC representatives have stated that they are considering regulation of the trading and other activities of advisers to private investment funds.	Although not expressly addressed in the proposed legislation, registration under the Investment Company Act would involve very significant new compliance requirements for the fund, its affiliates, and its service providers. The extent of those requirements would largely be up to the SEC. The legislation would require all private funds (whether or not registered) to establish anti-money laundering programs.
Standards of Conduct		The SEC would be authorized to promulgate standards of conduct for brokers and dealers, as well as investment advisers. Since advisers are now subject to a higher standard than brokers, any such regulation should have limited effect on advisers.	
Liability		Would explicitly impose liability for aiding and abetting violations of the Securities Act (applicable to offerings of fund interests), the Investment Company Act and the Advisers Act, although only in the case of SEC enforcement, not private actions.	
Dispute resolution		The SEC would be authorized to restrict advisers' pre-dispute agreements for arbitration of claims under securities laws or SRO rules.	
Whistleblowers		Would establish elaborate rewards and protections for whistleblowers in securities law enforcement actions.	
Legislative Status	Not yet introduced in Congress	Not yet introduced in Congress	Referred to the Senate Committee on Banking, Housing, and Urban Affairs

This advisory is for guidance only and is not intended to be a substitute for specific legal advice. If there are any particular developments you would like to monitor, or you would like input into the process of regulatory reform, please contact the Edwards Angell Palmer & Dodge LLP attorney responsible for your affairs or one of the following members of the firm's Investment Companies / Hedge Funds and Fund Formation practice groups:

Heather M. Stone	617.951.3331	hstone@eapdlaw.com
James T. Barrett	617.239.0385	jbarrett@eapdlaw.com
Matthew C. Dallett	617.239.0303	mdallett@eapdlaw.com