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Private Fund Managers Will See Increased Regulation -- *Congress to Reconcile Differences Between House and Senate Bills*

Hedge fund managers will lose their principal exemption from investment adviser registration with the Securities and Exchange Commission (the "SEC") under bills passed by both houses of Congress. It appears that venture capital fund managers will be able to remain exempt from SEC registration, while the fate of private equity fund managers is unknown – to be decided in conference between House and Senate leaders.

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A larger number of advisers who are required to register will remain subject to State laws because the threshold for SEC registration will be raised. Also, all advisers, possibly including exempt fund managers, will be required to provide a substantial amount of information to the SEC.

These changes are contained in legislation adopted, with some differences, by the U.S. House and Senate.[1] The Senate Bill and the House Bill will now proceed to a House-Senate conference committee to reconcile the numerous differences between the two bills. The final legislation could be ready for President Obama's signature by early July.

The Senate Bill provides exemptions for advisers to venture capital funds, private equity funds and family offices, to be defined by the SEC within six months after the final legislation is enacted. The House Bill also provides an exemption for advisers to venture capital funds (to be defined by the SEC), but not for private equity fund managers.

Outlined on the following pages is a brief summary of the portions of the Senate Bill and the House Bill that relate to private investment funds and their advisers.

[1] The Senate passed the Restoring American Financial Stability Act of 2010 (the "Senate Bill") on May 20, 2010. The House had passed its own version, the Wall Street Reform and Consumer Protection Act of 2009 (the "House Bill") on December 11, 2009.

House Bill	Senate Bill	Comments
New Registration and Compliance Requirements		
Require registration under the Investment Advisers Act of 1940 (the "Advisers Act") of most advisers to "Private Funds" (subject to exceptions described below) by removing the private adviser exemption (which exempts from registration investment advisers that have fewer than 15 clients and do not hold themselves out to the public as investment advisers). A Private Fund is any fund that would be an investment company but for Section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940, such as hedge funds, private equity funds, venture funds, and other private pools of capital.	Same.	Once subject to registration with the SEC, investment advisers to Private Funds would be required to adopt compliance policies and procedures and maintain detailed books and records; make and maintain publicly available filings with the SEC (including form ADV, which requires disclosure of information about the adviser's assets under management, portfolio management operations, conflicts and fees); become subject to periodic SEC examination; and become subject to substantive rules regarding advisory agreements, fees, customer documentation, disclosure and custody. In addition, advisers to Private Funds would be subject to new information and reporting requirements.
The House Bill would institute a new exemption for advisers to private funds with less than $150 million under management, subject to such conditions as the SEC determines.	The threshold under which investment advisers who are required to register must remain subject to State laws and cannot register with the SEC is raised from assets under management of $25 million to $100 million. This applies to advisers who are required to register (i.e., do not have exemptions under both federal and State law). Such advisers would be subject to regulation under the laws of each state in which they do business (subject to the existing national de minimis threshold) and, consequently, if they have clients or investors in more than one state, might incur increased costs and be subject to increased regulatory burdens.	The focus of these two provisions is different; both (or neither) may end up in the final legislation.
Advisers to venture capital funds (to be defined by the SEC after the final legislation is enacted) would be exempt from registration (assuming no other types of clients). However, they would be subject to certain record keeping requirements, as discussed below.	Same.	The House Bill exempts only venture capital funds, while the Senate Bill exempts venture capital funds and private equity funds, effectively limiting the new private fund registration requirements to advisers to hedge funds. Note, however, that if the VC fund adviser has any other types of clients, it may be required to register.
No equivalent provision.	Advisers to private equity funds (to be defined by the SEC after the final legislation is enacted) would be exempt from registration.	

No equivalent provision.	Family offices (to be defined by the SEC after the final legislation is enacted) would be excluded from the definition of "investment adviser." The definition and any related requirements would be consistent with regulatory relief granted in the past.	Previous SEC relief has typically required that the family office: • has no retail investors outside "the family;" • does not hold itself out to the public as an investment adviser; • has an advisory role that is a small percentage of the services it offers to the family; and • charges fees only to cover expenses and not to make a profit.
Similar.	The SEC would be given explicit authority to define the term "client" differently for different purposes; however, it would not be permitted to include Private Fund investors as "clients" for purposes of the anti-fraud rules.	With this authority, the SEC will be able to formalize a variety of existing staff positions. Most importantly, it will allow the SEC to require explicitly that fund investors receive investment adviser disclosures. The impact of the anti-fraud exception is uncertain since the SEC has already adopted an anti-fraud rule applicable to Private Fund investors.
Foreign private advisers (those that, during the preceding 12 months have had in total fewer than 15 clients and investors in the US in private funds advised by the investment adviser, and aggregate assets under management attributable to clients and investors in the US in private funds advised by the investment manager of less than $25 million) would be exempt from registration.	Foreign private advisers (those that do not hold themselves out generally to the public in the US as investment advisers, have no place of business in the US, have fewer than 15 clients domiciled in or that are residents of the US, and have assets under direct or indirect management (i.e., through funds) attributable to clients domiciled in or that are residents of the US of less than $25 million) would be exempt from registration.	This preserves for foreign advisers the existing fewer-than-15-client exemption and does not represent a significant change from current law.
The effective date is delayed for one year, although advisers would have the discretion to register earlier.	Same.	Not addressed by the legislation is how long advisers with less than the new threshold of assets under management ($100 or $150 million) that are now SEC-registered would have to transition to State registration.
New Reporting and Examination Requirements		
The SEC is authorized to require registered investment advisers to maintain records of, and submit reports regarding, the private funds they advise as the SEC determines is necessary or appropriate in the public interest and for the protection of investors, and as the SEC may determine is necessary for the assessment of systemic risk. The information could include the amount of assets under management, borrowings, off-balance sheet exposures, counterparty credit risk exposures, trading and investment positions.	The types of records required are generally the same as in the House Bill, with the addition of valuation policies and practices, types of assets held, side arrangements or side letters whereby certain fund investors obtain more favorable rights than others, and trading practices.	

Exempt advisers to venture capital funds would have to maintain records and provide reports as determined by the SEC to be necessary or appropriate in the public interest or for the protection of investors.		
The current client confidentiality provision of the Advisers Act (limiting the SEC's ability to require investment advisers to disclose the identity, investments or affairs of their clients) is deleted.	The current client confidentiality provision of the Advisers Act is amended to add an exception allowing the SEC to require any adviser to disclose the identity, investments or affairs of any client "for purposes of assessing potential systemic risk."	
The SEC may set different reporting requirements for advisers based on the different types or sizes of private funds they advise.	Same.	
Proprietary information that is disclosed to the SEC is confidential. Proprietary information is not subject to FOIA, and disclosure by the SEC to those outside of the SEC generally will require pre-approval, but information may not be withheld from Congress and may be shared on a confidential basis but by the SEC with other federal regulators. Proprietary information includes sensitive, non-public information regarding the investment or trading strategies of the investor adviser; analytical or research methodologies; trading data; computer hardware or software containing intellectual property; and any additional information that the SEC determines to be proprietary.	Same.	
Registered investment advisers will be required to provide reports, records and other documents to investors, prospective investors, counterparties and creditors as the SEC may prescribe as necessary or appropriate in the public interest and for the protection of investors or for the assessment of systemic risk.	No equivalent provision.	
An SEC examination requirement could be imposed under the less than $150 million exemption for Private Fund advisers.	The SEC would conduct periodic and special examinations of the records of a Private Fund maintained by a registered investment adviser as the SEC may prescribe from time-to-time.	

Definition of "Accredited Investor"		
No equivalent provision.	The net worth required to qualify as an accredited investor under the Securities Act of 1933 will be increased, primarily by excluding the value of a primary residence from the calculation. The SEC is instructed to conduct a review at least every four years to determine whether the accredited investor definition should be modified for the protection of investors or to further the public interest. The General Accounting Office will conduct a study during the three years following enactment of the final legislation on the appropriate criteria for accredited investors status and eligibility to invest in Private Funds.	
New Self Regulatory Organization		
No equivalent provision.	The General Accounting Office would be required to study the feasibility of forming a self-regulatory organization to oversee "private funds, private equity funds, and venture capital funds," and to issue a report within one year following enactment of the legislation.	

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