



INVESTMENT MANAGEMENT UPDATE

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House Financial Services Committee Approves Bill to Require Registration of Private Fund Investment Advisers

On October 27, 2009, the House Committee on Financial Services approved the “Private Fund Investment Advisers Registration Act of 2009” (the “Bill”)¹ sponsored by Representative Paul Kanjorski (D-PA) by a vote of 67-1. The Bill would amend the Investment Advisers Act of 1940 (the “Advisers Act”) to require that advisers to private funds register with the Securities and Exchange Commission (the “SEC”) and be subject to new and significant disclosure and recordkeeping requirements. While the Bill is similar to the Obama administration’s recent proposal,² it differs in several key respects, including several exemptions from registration for certain advisers.

This update summarizes key provisions of the Bill, which include:

- new definitions of advisers required to register under the Advisers Act;
- exemptions from registration for certain non-U.S. advisers, venture capital fund advisers, small business investment company advisers and advisers to smaller private funds;
- wide-ranging requirements mandating disclosure to the SEC, the Board of Governors of the Federal Reserve System, investors and other parties;
- robust risk monitoring, recordkeeping and examination provisions; and
- expansion of the SEC’s rulemaking authority.

Private Fund Advisers Required to Register

The Bill would amend Section 203(b)(3) of the Advisers Act to eliminate the “fewer than 15 clients” exemption (except in respect of certain foreign private advisers, as

¹ “Private Fund Investment Advisers Registration Act of 2009”, H.R. 3818 (October 27, 2009)

² “Private Fund Investment Advisers Registration Act of 2009” (July 15, 2009). For more information on the administration’s proposal, see “Administration Releases Proposed Registration of Private Fund Investment Advisers” at <http://www.sidley.com/sidleyupdates/Detail.aspx?news=4091>

noted below) and thus require the registration of investment advisers of private funds unless otherwise exempted. A “private fund” is defined as an investment fund that would be an investment company under the Investment Company Act of 1940 (the “Investment Company Act”) but for the exceptions set forth in Sections 3(c)(1) and 3(c)(7) of that Act.

The revised Bill eliminates additional elements from the original draft that would have defined “private fund” to include any fund that is either organized in the United States or 10% or more of whose outstanding securities are owned by U.S. persons.

Exemption for Certain Private Fund Advisers

Advisers to private funds would be exempt from registration insofar as each such private fund has less than \$150 million in assets under management (“AUM”) in the United States, a significant increase from the current \$30 million threshold. Notwithstanding exemptions, the Bill authorizes the SEC to mandate recordkeeping and disclosure requirements for all advisers – registered or not – as it “determines necessary or appropriate in the public interest or for the protection of investors.”

Venture Capital Fund Adviser Exemption

As was the case in the prior draft of the Bill, advisers to “venture capital funds” would be exempt from registration; however, the determination of what qualifies as a “venture capital fund” is left to the discretion of the SEC.

Small Business Investment Company Adviser Exemption

The revised Bill would exempt advisers that solely advise small business investment companies under the Small Business

Investment Act of 1958.

Mid-Sized Private Fund Advisers

The Bill requires the SEC to take into account the size, governance and strategy of and the systemic risk level posed by so-called “mid-sized” private funds – without defining “mid-sized” – to determine appropriate registration and examination requirements for such advisers. Similarly, the Bill authorizes the SEC to set different disclosure requirements for different “classes” of private fund advisers.

Commodity Trading Advisor Exemption

The Bill provides that any commodity trading advisor that manages a private fund will not qualify for the exemption from SEC registration provided by Section 203(b)(6) of the Advisers Act.

Exemption for Foreign Private Advisers

The Bill would exempt “foreign private advisers” from registration under the Advisers Act. A “foreign private adviser” is defined as an adviser that:

- has no place of business in the United States;
- has had fewer than 15 U.S. clients in the preceding 12 months;
- has less than \$25 million of AUM attributable to U.S. clients (or higher amount specified by rule); and
- neither holds itself out to the public in the United States as an investment adviser nor acts as an investment adviser to an investment company registered under the Investment Company Act or a business development company as defined in the Investment Company Act.

Systemic Risk and Investor Protection Disclosure

The Bill would amend Section 204 of the Advisers Act to require advisers to private funds to maintain records and submit

³ It is interesting to note that the current draft of the Bill specifies a “per fund” AUM threshold rather than a “per adviser” AUM threshold – theoretically exempting advisers that manage an unlimited number of smaller funds.

reports “as are necessary or appropriate in the public interest and for the protection of investors or for the assessment of systemic risk as the [SEC] determines in consultation with the Board of Governors of the Federal Reserve System.” This requirement has potentially broad reach and could include information with respect to AUM, use of leverage, counterparty credit risk exposure, trading and investment positions and such other information specified by rule.

The SEC would be further authorized to share such information with the Board of Governors of the Federal Reserve System or any other entity that the SEC determines has systemic risk responsibility. These fund records and reports would be deemed records of the adviser for Advisers Act recordkeeping requirement purposes. Further underscoring these potentially far-reaching disclosure requirements, the proposed legislation also strikes Section 210(c) of the Advisers Act that had, with narrow exceptions, withheld authorization for the SEC to require investment advisers to disclose the identity and affairs of any client of such adviser.

Maintenance of Records and Examinations

The Bill would empower the SEC to promulgate rules and regulations regarding the maintenance of records by advisers to private funds and the examination of such records. The latter authorization notably does not specifically require that examinations be “reasonable” as is currently the case under Section 204(a) of the Advisers Act.

Disclosures to Investors and Other Parties

The Bill would authorize the SEC to require investment advisers to provide records and reports of any private fund advised by such adviser to investors, prospective investors, counterparties and creditors as is necessary or appropriate in the public interest, for investor protection purposes or for systemic risk assessment.

Confidentiality

The Bill provides that the SEC shall not be compelled to disclose the information collected under the above-mentioned provisions. The SEC would, however, be required to disclose information in response to requests from Congress, other federal agencies or self-regulatory organizations insofar as the information sought falls within the scope of their respective jurisdictions.

Rulemaking Authority

The Bill would amend Section 211 of the Advisers Act to clarify and significantly expand the SEC’s rulemaking authority. The SEC would be empowered to “prescribe different requirements for different classes of persons or matters” and “ascribe different meanings to terms (including the term ‘client’)” used in the Advisers Act.

Interestingly, the Bill explicitly precludes the SEC from redefining “client” to require a “look-through” to the investors in a private fund – the key component of the prior hedge fund adviser registration rule that was adopted by the SEC in 2004 and overturned by the D.C. Circuit Court in 2006.⁴ This provision is significant because it clarifies the principle that the fund, and not the investors, is the client of the adviser – eliminating any implication that a fund adviser’s fiduciary duty extends beyond the fund to any individual investor.

Transition

The Bill would take effect one year after its enactment. The Bill would also require the SEC and CFTC to jointly propose, within twelve months of the Bill’s enactment, rules regarding the form and content of the reports required of advisers registered with both agencies. Moreover, the Comptroller General is mandated to study and report on the annual costs

⁴ *Goldstein v. SEC*, 451 F.3d 873 (D.C. Cir. 2006).

associated with the registration and reporting requirements mandated under the Bill.

Going Forward

The Bill was approved by the House Financial Services Committee but still requires a full House vote before proceeding to the Senate. The recordkeeping and disclosure

requirements of the Bill may be impacted if legislation creating a “systemic risk regulator” is enacted and, if so, how such regulator is structured. Moreover, even if enacted in its present form, the implications of the Bill depend to a considerable extent on subsequent promulgation of rules and regulations by the SEC.

If you have any questions, please call on the Sidley Austin lawyer with whom you have regular contact.

To receive future copies of Investment Management Update via email, please send your name, company or firm name and email address to Amy Hinkler at ahinkler@sidley.com.

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