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# Corporate Law Departments Committee Bulletin

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## Congress to Require Public Registration of Previously Private Investment Funds

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Until now, private equity, investment and hedge funds have dodged disclosure and registration requirements imposed on so many other securities firms. However, four proposals have been submitted to Congress this year that would impose regulation and registration of hedge funds and private equity funds for the first time. Each would require registration and filing by these funds, or their advisers.

### Current Law

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Private funds, such as hedge funds, venture capital funds, private equity funds, and investment pools, would be regulated by the Investment Company Act of 1940 (the "Investment Company Act") and the Investment Advisers Act of 1940 (the "Investment Advisers Act") but for several critical exemptions.

A fund avoids classification as an investment company under the Investment Company Act if it has fewer than 100 holders of its debt or equity securities.

In addition, the fund can avoid being defined as an investment company, and therefore be exempt from the Act, if its investors are "qualified purchasers." Such persons are, among other things, those with \$5 million in investments, or entities that own and invest at least \$25 million.

The Investment Company Act generally requires the registration of funds and governs their operation. In addition, the Investment Company Act mandates extensive regulation by the Securities and Exchange Commission (the "SEC") of the financial practices, disclosures and investor relations of the funds.

The Investment Advisers Act governs the activities of the separately organized entities that provide the actual investment advice to the private funds. This Act also provides for the registration and regulation of operations.

Non-exempt advisers with less than \$25 million under management register with states; those with more than \$30 million register with the SEC; and those managing amounts between these thresholds may elect either state or SEC registration. The SEC has established regulatory standards of investment advisor fiduciary duties to protect investors.

The Investment Advisers Act provides that while an adviser to a fund is an "investment adviser", such a person need not register so long as it serves fewer than 15 clients and none are registered investment companies. Advisers to private funds may claim that the fund is its sole client; therefore, the registration and regulation of the Act does not apply.



### Proposed Laws

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Since the beginning of the year, Congress has received four proposed laws that would regulate private investment funds or their advisers.

#### 1. Private Fund Investment Advisers Registration Act of 2009

This bill was announced July 15 by the U.S. Department of Treasury, and would amend the Investment Advisers Act. Specifically, the law would require that all U.S.-based investment advisers with more than \$30 million in assets under management to register with the SEC.

The law would eliminate the current exemption in the Investment Advisers Act that waives registration requirements for advisers with fewer than 15 clients, and does not hold itself out publicly as an investment adviser, and does not provide investment advice to a publicly-registered investment company.

The law also provides for a new narrow exemption for certain foreign private advisers that, among other things, have no place of business in the United States, have fewer than 15 clients in the United States, and have U.S. assets of less than \$25 million.

The law would also eliminate current exemptions for advisers that operate solely within a single state, as well as advisers registered with the Commodity Futures Trading Commission.

The bill also extends the ability of the SEC to establish record keeping, reporting and supervisory requirements of private investment funds. Funds subject to these rules are those that are now exempt under the 100-holder rule of 3(c)(1) or the "qualified investor" rule of 3(c)(7) of the Investment Company Act. Therefore, the funds, as well as the advisers, might be subject to scrutiny for the first time.

The legislation would make U.S. laws more consistent with other proposals in the European Union that similarly enhance private fund registration and regulation as part of a series of international agreements to address the financial crisis.

#### 2. Hedge Fund Transparency Act of 2009

This bill was introduced last January by Senators Charles Grassley and Carl Levin. This bill would amend the Investment Company Act to require registration of private investment funds as investment companies. Specifically, the bill would eliminate the 100-holder exemption of 3(c)(1) and the "qualified investor" exemption of 3(c)(7). Funds with more than \$50 million in assets would need to register with the SEC, maintain books and records according to SEC regulations, and file annual publicly-available disclosure statements. The disclosures would include, among other things, certain investor information, the value of assets, affiliation with a financial institutions, and minimum investment requirements.

The information would be publicly available. Funds requiring registration would also require anti-money laundering policies and compliance programs to monitor any significant cash transaction. However, compliance with the Investment Company Act would be otherwise substantially waived.

#### 3. Private Fund Transparency Act of 2009

This bill was introduced by Senator Jack Reed. The bill would eliminate the private adviser exemption, as would the bill from the Obama administration.

However, this bill would give the SEC less discretion to issue additional investment adviser rules. The bill is otherwise substantially similar to the proposal by the Obama administration.



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### 4. Hedge Fund Adviser Registration Act of 2009

This proposal in the House of Representatives would eliminate the private fund exemptions in the Investment Advisers Act as would the Obama proposal and Senator Reed's bill. The bill, sponsored by Representatives Michael Castle and Michael Capuano, would not expend SEC rule-making authority to the same extent as the Obama legislation.

### **Consequences of Registration under the Investment Advisers Act**

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Based on the proposed legislation and current laws, investment advisers to private investment funds might be subject to the following reporting requirements:

1. Location, general size of fund.
2. Number of employees and their functions.
3. Description of the types of clients, such as high net individuals, other funds, banks, or charitable organizations.
4. Method of compensation, such as fixed fees versus receipt of a percentage of assets under management.
5. Categories of activities and investment strategies, such as selection and management of portfolio investments, investments in funds of funds, marketing timing, and classification of investments as equity, debt, annuities, commodities, or futures.
6. Other business activities of the registered investment adviser, such as securities brokerage, real estate brokerage, insurance brokerage, or any business other than providing investment advice.
7. The activities of affiliated partners, such as broker dealers, insurance brokers, real estate, and other business activities.
8. Co-investment by the investment adviser in client transactions.
9. Compensation of third parties for client referrals and use of third party research.
10. Identity of owners (including indirect owners) and executive officers of the investment adviser.
11. History of violations of financial regulations by the investment adviser, as well as any criminal history.

If the SEC rules under this law resemble those currently, much of the information disclosed would be publicly available; other items, though not available to the public, might be available to other Federal agencies.

Additional procedures and oversight might include the following, depending on final SEC regulations:

1. Inspection by the SEC or other regulatory body.
2. Requirements for maintaining records.
3. Disclosure obligations to potential investors, current investors, creditor and other third-parties.
4. Regulation of investment adviser advertising, including the disclosure of prior performance information of the funds.
5. Disclosure and consent by the client to transactions in which the adviser acts as a principal with his client, absent disclosure and consent.