

INVESTMENT FUNDS ALERT

SEC ADOPTS FINAL RULE REQUIRING REGISTRATION OF HEDGE FUND MANAGERS



Registration. The final rule requires that an adviser to one or more “private funds” register with the SEC if the adviser manages at least \$25 million of clients’ assets and has more than 14 “clients” in any 12-month period. For this purpose, the final rule requires each investor in a private fund (and each indirect investor participating through a fund of hedge funds) to be counted as a separate client. Under the transition rules, we believe that certain redeemable interests that are not offered after the effective date will not be taken into account in determining whether a fund is a “private fund.”

Under the new rule, a “private fund” is one that:

- would be an investment company but for the exceptions in Sections 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940
- permits owners to redeem their ownership interests within two years of purchase (other than exclusively on the basis of extraordinary circumstances), and
- is offered based on the investment advisory skills, ability or expertise of the investment adviser.

(This definition is designed to include most hedge funds, while excluding private equity and venture capital funds and family offices.)

Transition Rules. The SEC also adopted final related rule amendments designed to address certain transitional issues. These rules:

- permit “grandfathered” hedge fund investors who do not satisfy the investor eligibility criteria for performance fees charged by registered advisers to maintain their existing hedge fund investments after registration by the fund’s adviser

- permit newly registered advisers to use past performance data from the pre-registration period without requiring that the adviser maintain all of the corroborating records normally required for registered advisers, and
- extend the deadline applicable to managers of funds of hedge funds for the provision of audited financial reports to investors from 120 days to 180 days after the end of each fiscal year.

The final rules contain special provisions designed to limit the scope and impact of the application of the Advisers Act in the case of offshore advisers to offshore funds that have more than 14 U.S. investors.

Implementation. Compliance with the new rule will be required by early 2006.

The complete text of the proposed rule and the SEC's commentary can be found at <http://www.sec.gov/rules/proposed/ia-2266.htm>.

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CONTACT INFORMATION

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