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INVESTMENT FUNDS ALERT

OBAMA ADMINISTRATION PROVIDES GUIDANCE ON PRIVATE FUND INVESTMENT ADVISER REGISTRATION

The Obama administration provided a draft of the Private Fund Investment Advisers Registration Act of 2009 to the U.S. Congress on July 15, 2009. The proposed legislation would require investment advisers to hedge funds, private equity funds and certain other private funds as originally described in last month's plan for regulatory reform to register with the Securities and Exchange Commission (SEC) under the Investment Advisers Act of 1940 (the "Advisers Act"). In addition, an investment adviser to those funds would be subjected to broad record retention obligations and required to provide reports to the SEC and certain disclosures to third parties. Finally, the proposed legislation would clarify and expand the authority of the SEC over investment advisers.

REGISTRATION

The proposed legislation would require registration by eliminating exemptions upon which investment advisers commonly rely and would eliminate opportunities for regulatory arbitrage. Under current law, an investment adviser that (i) has fewer than 15 clients in any 12-month period, (ii) is not an investment adviser to a registered investment company or a business development company and (iii) does not hold itself out as an "investment adviser" is exempt from registration under the Advisers Act. Under the proposed legislation, that exemption would be available only to advisers that have no place of business in the United States and have less than $25 million in assets under management related to clients located in the United States or such higher amount as the SEC sets by rule. However, the proposed legislation would leave in place the current provision that registration under the Advisers Act is required only for advisers with $30 million or more total assets under management.

In addition, the proposed legislation would eliminate exemptions for investment advisers that offer advice only within a state or that are registered with the Commodity Futures Trading Commission if one of the clients of the adviser is a "private fund". Private funds would be defined to include funds that would be an investment company under the Investment Company Act of 1940 (the "Company Act") if it were not for the exceptions provided by Section 3(c)(1) or 3(c)(7) of the Company Act and such funds are either (1) organized under the laws of the United States or (2) have 10 percent or more of their securities owned by U. S. persons.

REPORTING

An investment adviser to a private fund (as defined above) would be subject to additional reporting and disclosure requirements to the SEC and other third parties. The SEC would be provided broad authority to require registered advisers to maintain records and submit reports to the SEC as are "necessary or appropriate in the public interest and for the assessment of systemic risk by the Board of Governors of the Federal Reserve System and the Financial Services Oversight Council" and to provide the Board and the Council the contents of those reports. Those reports would include (1) the amount of assets under management, (2) the use of leverage (including off-balance sheet leverage), (3) counterparty credit risk exposures, (4) trading and investment positions, (5) trading practices and (6) any other information that the SEC in consultation with the Board deems to be "necessary or appropriate in the public interest for the protection of investors or for the assessment of systemic risk."

An investment adviser to a private fund would also be required to maintain records of any private fund that it advises, as provided in SEC rules, and make the records of those private funds available for inspection by the SEC. The SEC could share the information it collects with the Board and the Council, but the SEC would not be compelled to disclose any report or information in the proposed legislation to the public.

A registered investment adviser that advises a private fund would 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."

CLARIFICATION OF SEC AUTHORITY

The proposed legislation also would clarify that the SEC could "ascribe different meanings to terms used" in different sections of the Advisers Act as the SEC "determines necessary to effect the purposes" of the Advisers Act. This provision would allow the SEC to deem an investor to be a client for many purposes of the Advisers Act, such as the restrictions on using solicitors or the requirement to deliver Part II of Form ADV. This clarification would reduce the risk of the SEC's application of its current rules to investment advisers to private funds being restricted under the reasoning that the United States District Court, District of Columbia Circuit applied in its SEC v Goldstein decision in 2006.

CONCLUSION

Many of the provisions of the proposed legislation are similar to the Private Fund Transparency Act of 2009 proposed by Sen. John Reed, D-R.I., earlier this year and the U.S. Department of the Treasury's plan for financial regulatory reform released in June. But, while the administration's reform plan created some ambiguity as to whether private funds would have separate obligations directly imposed on them, the proposed legislation would clearly only apply to investment advisers and not directly to the private funds themselves. Also, the proposed legislation does not include a separate "modest threshold" in assets under management for advisers to private funds and, instead, relies on pre-existing thresholds (which allow registration of advisers with $25 million under management and require it for those with $30 million under management who are not otherwise exempt).

The proposed legislation has not yet been formally introduced on the floor of the Congress. We will keep you informed as the proposed legislation and other bills move further through the administrative process.

[1] Many commodity trading advisors and commodity pool operators would not be required to register with the SEC under the proposed legislation, as many commodity pools would not fit the definition of a private fund.

[2] 451 F.3d 873 (D.C. Cir. 2006).

CONTACT INFORMATION

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