

## INVESTMENT FUNDS ALERT

### HOUSE COMMITTEE APPROVES REGISTRATION AND REPORTING REQUIREMENTS FOR INVESTMENT ADVISERS

On October 27, 2009, the House Financial Services Committee approved an amended version of the Private Fund Investment Advisers Registration Act of 2009 (the "Registration Act") for progression to the floor of the House of Representatives. Like earlier legislation proposed by the Obama administration, the Registration Act would, if enacted, (1) require many investment advisers to register with the Securities and Exchange Commission (SEC) under the Investment Advisers Act of 1940 ("Advisers Act"), (2) expand reporting requirements for investment advisers and (3) expand the SEC's discretion to interpret the Advisers Act. The Registration Act differs from the administration's proposal by including additional exemptions from the registration requirements, limiting the ability of the SEC to interpret investors in a private fund to be a "client" under the Advisers Act and requiring the SEC to adjust the monetary thresholds for "qualified clients" for inflation. In recognition of the challenges for many investment advisers to comply with the proposed new requirements, the Registration Act would not become effective until one year after its enactment.

#### REGISTRATION

The Registration Act would require investment advisers to register under the Advisers Act by eliminating exemptions upon which investment advisers commonly rely. 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 Registration Act, 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.

In addition, the Registration Act 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, including most hedge and private equity funds.

The Registration Act would, however, exempt, or require the SEC to promulgate a rule to exempt, the following investment advisers from registration: (1) investment advisers to private funds with assets in the United States of less than \$150 million, (2) investment advisers to venture capital funds and (3) investment advisers who provide investment advice solely to licensed small business investment companies. Investment advisers to funds listed in (1) and (2) would still be subject to the reporting and record retention requirements discussed below.

## **REPORTING**

An investment adviser to a private fund would be subject to additional reporting, recordkeeping and disclosure requirements to the SEC and other third parties. The Registration Act would provide the SEC with 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 protection of investors or for the assessment of systemic risk as the Commission determines in consultation with the Board of Governors of the Federal Reserve System” and to provide the Board and other entities that have responsibility for systemic risk 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.” The SEC will also be allowed to require other information that it deems necessary, including different reports for different classes of private fund advisers. The SEC is permitted to share the information it collects with the Board, but the SEC would not be compelled to disclose any report or information in the Registration Act to the public.

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.

A registered investment adviser that advises a private fund would also 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.”

### **EXPANSION OF SEC DISCRETION TO INTERPRET THE ADVISERS ACT**

The Registration Act also would expand the SEC’s discretion in interpreting and enforcing the Advisers Act. The Registration Act would allow the SEC to “ascribe different meanings to terms used” in different sections of the Advisers Act as the SEC “determines necessary to effect the purposes” but would prohibit the SEC from deeming an investor in a private fund to be a “client” under the Advisers Act. It would also allow the SEC to classify persons and matters within its jurisdiction based on the size, scope, business model, compensation scheme or systemic risk posed by persons.

### **INFLATION ADJUSTMENT TO QUALIFIED CLIENT STANDARD**

Under the Advisers Act and related SEC rules, a registered investment adviser is not allowed to be compensated based upon the capital appreciation of the funds under management unless the clients charged such compensation (or their investors, in the case of private funds) are “qualified clients,” i.e., a person who satisfies certain asset or investment thresholds. The Registration Act would require the SEC to adjust any monetary thresholds in the definition of qualified clients for the effect of inflation within one year of the date of passage of the Registration Act and every five years thereafter.

## CONCLUSION

Even though the compliance date for any final legislation that would require investment advisers to register is not likely to occur in the near future, registration for most investment advisers to private funds seems to be inevitable. Given this likelihood, unregistered investment advisers to private funds should consider devoting resources to their compliance practices now. In particular, investment advisers should consider: (1) appointing or determining who would serve in the role of chief compliance officer; (2) reviewing existing disclosure documents to determine what additional disclosures would be required upon registration; (3) conducting a compliance risk assessment; and (4) reviewing and revising, as necessary, existing compliance policies and procedures to ensure that required compliance mechanisms are in place (including proxy voting, codes of ethics and information security policies).

To view a comparison of the current version of the Advisers Act to an as-amended version, please [click here](#).

## CONTACT INFORMATION

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