Administration Proposes Mandatory Investment Adviser Registration for Private Fund Managers

The White House has announced proposed legislation to expand the registration requirements of the Investment Advisers Act of 1940 (the "Advisers Act") to previously-unregistered advisers of hedge funds and other pooled investment vehicles, including private equity funds and venture capital funds. The legislation extends the reach of the regulatory framework of the Advisers Act in pursuit of the administration's goals of greater transparency, financial system protection and investor protection. The proposed Private Fund Investment Advisers Registration Act of 2009 (the "Proposed Registration Act") makes only a few amendments to the Advisers Act; however, the amendments have the potential to have sweeping impact on the asset management industry.

The issue of extending the reach of the Advisers Act has been raised before. In 2005, the Securities and Exchange Commission (the "SEC") enacted rules requiring certain investment advisers of hedge funds to register with the SEC. The SEC's rule was based on a requirement that such advisers count the investors in those funds as clients of the investment adviser for purposes of the so-called "private adviser" exemption. In *Goldstein v. SEC*, the U.S. Court of Appeals for the District of Columbia Circuit struck down these registration rules based on its view that the SEC's interpretation of the meaning of "clients" under Section 203(b)(3) of the Advisers Act was inconsistent with the clear meaning of the statute. In sum, the investors in a hedge fund were not clients of the investment adviser solely by virtue of being the beneficial holders of interests in a hedge fund. The Proposed Registration Act is intended, in part, to reverse the holding in *Goldstein* and grant the SEC necessary power to oversee hedge funds and other pooled investment vehicles.

Elimination of the Private Adviser Exemption

The Proposed Registration Act would eliminate the private adviser exemption in the Advisers Act, which currently exempts advisers with 14 or fewer clients, and would require advisers to private investment pools with at least $30 million in assets under management to register with the SEC. The elimination of the private adviser exemption would instantly require many investment advisers who had previously relied on the exemption to register with the SEC.

These proposals would also eliminate the exemption from registration for certain commodity pool advisers registered with the Commodities and Futures Trading Commission (the "CFTC") if the commodity trading adviser acts as an investment adviser to a private fund (defined as a company that would be an investment company under the Investment Company Act of 1940, but for the exceptions contained in Section 3(c)(1) or Section 3(c)(7)). Commodity pool advisers would be required to register with both the SEC and CFTC.

SEC Authorization to Require Reporting by Investment Advisers

The Proposed Registration Act would give the SEC authority to require investment advisers to maintain records and submit reports relating to both the adviser and the funds it manages, in order to allow for the supervision of systemic risk by the Board of Governors of the Federal Reserve and the Financial Services Oversight Council. The reported information must include, for each private fund:

- the amount of assets under management,
- use of leverage (including off-balance sheet leverage),
- counterparty credit risk exposures,
- trading and investment positions, and
- trading practices.

Each adviser would maintain records of such information and make them available to the SEC upon request, and would be subject at any time to periodic, special, or other examinations by the SEC. Information provided by the SEC to the Board or Council would be kept confidential.

The Proposed Registration Act would also give the SEC authority to require investment advisers to provide reports, records and other documents relating to the private funds to investors, prospective investors, counterparties, and creditors, for the protection of investors or the assessment of systemic risk.

Broader Issues

Under these proposals, the SEC would have the authority to define the term "client" differently for different purposes of the Advisers Act, and clarify other aspects of the SEC's rulemaking authority with respect to registered investment advisers. In a clear adoption of the SEC's position in the *Goldstein* case and a reversal of the court's judgment, this provision would provide the SEC with expansive rule-making and interpretive powers.

Foreign advisers, however, will continue to benefit from a potential exemption from SEC registration to the extent that they have fewer than 15 U.S. clients, provided they do not in aggregate amount to more than $25 million in assets under management.

Additionally, the Hedge Fund Adviser Registration Act of 2009 is pending in the House of Representatives (the "House Proposal") and the Hedge Fund Transparency Act of 2009 is pending in the Senate (the "Senate Proposal"). The House Proposal eliminates Section 203(b)(3) of the Advisers Act, which is the private adviser exemption. The Senate Proposal takes a different approach, and would require hedge funds to register under the Investment Company Act of 1940. The Proposed Registration Act, the Senate Proposal and the House Proposal are variations and extensions of the SEC's long-standing attempt to require registration of advisers to hedge funds, which was previously seen in their ill-fated 2005 rules.

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The text of the Proposed Registration Act can be found at the Department of Treasury Web site:

http://www.ustreas.gov/press/releases/reports/title%20iv%20reg%20advisers%20priv%20funds%207%2015%2009%20fnl.pdf

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