

June 17, 2009

Regulation of Private Fund Advisers Imminent

On June 17, 2009, the U.S. Department of the Treasury released President Barack Obama's plan to overhaul the U.S. financial regulatory system entitled "Financial Regulatory Reform — A New Foundation: Rebuilding Financial Supervision and Regulation" (the "Plan").¹ Among other things, the Plan proposes the registration of certain private fund advisers, required disclosures by private funds advised by an SEC-registered adviser and strict regulation of private funds that may pose a threat to financial stability. The announcement of the Plan comes just one day after Senator Jack Reed introduced the Private Fund Transparency Act of 2009, which also calls for the registration of private fund advisers.

The Obama Administration's Plan

Registration of All Private Fund Advisers

Citing both the need to gather information on private funds to assess the potential systemic implications of the activities of private funds and investor protection concerns, the Plan proposes that all advisers to private funds "whose assets under management exceed some modest threshold" be required to register with the U.S. Securities and Exchange Commission (the "SEC") under the U.S. Investment Advisers Act of 1940, as amended (the "Advisers Act"). Although the proposal does not define "private fund" for these purposes (nor does it state whether the requirement would be limited to advisers to investment companies relying on the exceptions provided in Sections 3(c)(7) and 3(c)(1) of the U.S. Investment Company Act of 1940, as amended), it is clear that the registration requirement would apply equally to all types of private fund advisers (including advisers to hedge funds, buyout funds and venture capital funds).

Private Fund Requirements

Regulatory Requirements. Under the Plan, private funds advised by an SEC-registered adviser will be subject to recordkeeping requirements; disclosure requirements with respect to investors, creditors and counterparties; and certain undefined "regulatory reporting requirements." In addition, the SEC will be authorized to conduct regular, periodic examinations of such funds to monitor compliance with these requirements. Although some of these fund-

¹ "Financial Regulatory Reform—A New Foundation: Rebuilding Financial Supervision and Regulation" (June 17, 2009) available at <http://www.ustreas.gov/news/index1.html>.

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level required disclosures may be duplicative of the disclosure a registered adviser is required to make with respect to the funds it manages, some items clearly go beyond what a registered adviser would be required to disclose in its Form ADV. Only once additional details emerge will we know how much more extensive these disclosure requirements may be.

Confidential Reporting. In addition, each private fund advised by an SEC-registered adviser will be required to report to the SEC on a confidential basis such fund's amount of assets under management, borrowings, off-balance sheet exposures and "other information necessary to assess whether the fund or fund family is so large, highly leveraged or interconnected that it poses a threat to financial stability." Implementation of this proposal will hopefully clarify what such "other information" might entail so that private funds are not subject to unlimited or ill-defined information requests and can prepare their recordkeeping procedures and organize their back office policies accordingly.

Potential Regulation of Private Funds as Financial Holding Companies

The Plan proposes that the SEC share private funds' confidential reports with the Federal Reserve, in its new role as systemic risk regulator. The Federal Reserve would then determine whether any of these funds meet the criteria for Tier 1 Financial Holding Companies (broadly defined by the Plan as any financial firm whose combination of size, leverage and interconnectedness could pose a threat to financial stability). If a fund satisfies such criteria, the fund would then be subject to regulation as a Tier 1 Financial Holding Company (a "Tier 1 FHC"), which would mean being subject to the jurisdiction of the Federal Reserve and its consolidated supervision of Tier 1 FHCs. Among other regulations to which it would be subject, a private fund deemed a Tier 1 FHC would be subject to the "prudential standards" for Tier 1 FHCs, which include capital, liquidity and risk management standards that are stricter than those applicable to other financial firms.

Broker-Dealer Reform

To increase fairness for investors, the Plan proposes that broker-dealers offering investment advice be subject to fiduciary duties to investors and that the regulation of investment advisers and broker-dealers be harmonized. Stating that an investment adviser and a broker-dealer providing "incidental advice" appear in all respects identical from the vantage point of the retail customer, the Plan calls for new legislation to bolster investor protections and bring consistency to the regulation of these two types of financial professionals by:

- requiring that broker-dealers who provide investment advice about securities to investors be subject to the same fiduciary obligations as registered investment advisers;
- requiring such broker-dealers to provide simple and clear disclosure to investors regarding the scope of the terms of their relationships with investment professionals; and
- prohibiting certain conflict of interests and sales practices that are contrary to the interests of investors.

Permanent Role for the SEC's Investor Advisory Committee

SEC Chairman Mary Schapiro recently announced the formation of an Investor Advisory Committee to give investors a greater voice in the SEC's work. The Plan calls for the Investor Advisory Committee to be made permanent by federal statute. The Investor Advisory Committee's charter contemplates a broad role for the Committee, including: (i) advising the

SEC on matters of concern to investors in the securities markets; (ii) providing the SEC with investors' perspectives on current, non-enforcement, regulatory issues; and (iii) serving as a source of information and recommendations to the SEC regarding the SEC's regulatory programs from the point of view of investors.

The Private Fund Transparency Act of 2009

On June 16th, Senator Jack Reed (D-RI) introduced the Private Fund Transparency Act of 2009 (the "Private Fund Act") in the Senate. The Private Fund Act would eliminate the "private adviser exemption" under Section 203(b)(3) of the Advisers Act and would require all private fund advisers managing in excess of \$30 million to register with the SEC under the Advisers Act. Similar to the Plan, the Private Fund Act would authorize the SEC to gather information on private funds that are advised by an SEC-registered adviser in order to assess what risks such funds may pose to financial stability and share such information on a confidential basis with other federal agencies.

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Although neither the Plan nor the Private Fund Act provide a specific time frame by which advisers would be expected to register with the SEC, fund advisers that are not yet registered should begin to familiarize themselves with the substantive requirements of the Advisers Act in anticipation of registration.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues discussed in this memorandum may be addressed to any of the following:

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