PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP

NEW YORK
1285 Avenue of the Americas
New York, NY 10019-6064
+1 212 373 3000

WASHINGTON, D.C.
2001 K Street NW
Washington, DC 20006-1047
+1 202 223 7300

LONDON
Alder Castle, 10 Noble Street
London EC2V 7JU
United Kingdom
+44 20 7367 1600

TOKYO
Fukoku Seimei Building, 2nd Floor
2-2, Uchisaiwaicho 2-chome
Chiyoda-ku, Tokyo 100-0011
Japan
+81 3 3597 8101

BEIJING
Unit 3601, Fortune Plaza Office
Tower A
No. 7 Dong Sanhuan Zhonglu
Chao Yang District, Beijing 100020
People's Republic of China
+86 10 5828 6300

HONG KONG
12th Fl., Hong Kong Club Building
3A Chater Road
Central Hong Kong
+852 2846 0300

July 22, 2009

Obama Administration Proposes Registration of All Private Fund Advisers

On July 15, 2009, the U.S. Department of the Treasury, on behalf of President Obama's Administration, released the "Private Fund Investment Advisers Registration Act of 2009" (the "Private Fund Act"),[1] which would require investment advisers to "private funds" (including hedge funds and private equity funds) with more than $30 million of assets under management to register with the U.S. Securities and Exchange Commission (the "SEC") under the U.S. Investment Advisers Act of 1940 (the "Advisers Act"). Once registered, the adviser would be subject to more onerous reporting and substantive requirements than registered advisers currently face. The Private Fund Act also expands the SEC's rulemaking authority in a manner that would enable the SEC to transform obligations an adviser might currently have with respect to its private funds to obligations to the underlying individual investors in such private funds.

Elimination of Private Adviser Exemption. The Private Fund Act eliminates the current "private adviser" exemption from registration under Section 203(b)(3) of the Advisers Act available to advisers with fewer than 15 "clients" (defined to include limited partnerships and other collective investment vehicles commonly used by private fund sponsors) in the preceding 12 months.[2] In lieu thereof, the legislation provides a limited exemption from registration for a "foreign private adviser" that (a) has no place of business in the United States; (b) during the preceding 12 months has had (i) fewer than 15 clients in the United States and (ii) assets under management attributable to clients in the United States of less than $25 million; and (c) neither holds itself out generally to the public in the United States as an investment adviser, nor acts as an adviser to any investment company registered under the U.S. Investment Company Act of 1940 (the "Investment Company Act").

Private Funds. Advisers to "private funds" with in excess of $30 million under management would be required to register. A "private fund" would include any investment company relying on the exceptions from registration provided by Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act that is either organized under the laws of the United States or that has 10% or more of its securities owned by U.S. persons. Thus, despite the introduction of a foreign private

---

[1] For a copy of the proposed legislation, please see http://www.treas.gov/press/releases/reports/title%20iv%20reg%20advisers%20priv%20funds%207%2015%2009%20fnl.pdf

[2] The Private Fund Act also eliminates the exemption from registration available under Section 203(b)(6) of the Advisers Act for certain commodity trading advisors registered with the Commodity Futures Trading Commission if the commodity trading advisor acts as an investment adviser to a "private fund."

adviser exemption, many non-U.S. advisers could be required to register as a result of participation by U.S. persons in their funds.

Enhanced Obligations of Registered Private Fund Advisers. An investment adviser required to register under the Private Fund Act would be subject to all of the current requirements applicable to registered advisers, such as filing a Form ADV and updating it periodically, appointing a chief compliance officer, establishing compliance policies and procedures reasonably designed to prevent violations of the securities law and complying with a series of other substantive requirements of the Advisers Act, as well as the following additional requirements:

- *Recordkeeping*. The adviser would be required to submit to the SEC such reports regarding each private fund it advises (which, as defined, would include any alternative investment vehicle and coinvestment vehicle organized by a fund sponsor) 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 (the "Board") and the Financial Services Oversight Council (the "Council"). Such reports would include:
  - the amount of assets under management (presumably the focus of this disclosure would be the value of the invested capital under management rather than aggregate commitments or contributions to such private fund);
  - use of leverage (including off-balance sheet leverage);
  - counterparty credit risk exposures;
  - trading and investment positions (it is unclear whether this would require the disclosure of specific names of issuers); and
  - trading practices.

  Giving the SEC broad latitude to require additional information, such reports may also include "such other information" as the SEC, in consultation with the Board determines "necessary or appropriate in the public interest and for the protection of investors or for the assessment of systemic risk." The Private Fund Act does not elaborate what such "other information" might entail and perhaps is deliberately open-ended to afford the SEC as much flexibility as possible. However, even the suggested disclosures go beyond what a registered adviser would currently be required to disclose about the private funds it advises. Importantly, the legislation eliminates Section 210(c) of the Advisers Act which currently prohibits any requirement to disclose the identity of or information about an adviser's client.

- *SEC Examinations*. The records of each private fund advised by the investment adviser — which would be "deemed to be the records and reports of the investment adviser" — would be subject at any time to periodic, "special" and other examinations by the SEC. "Special" examinations may imply more than a routine SEC audit of an adviser, but the scope of such an exam is unclear in the draft legislation.
- *Record Sharing*. The SEC would make available to the Board and the Council copies of all reports and documents filed with the SEC as the Board or the Council may consider necessary to assess the systemic risk of a private fund and determine whether a private fund should be designated a "Tier 1 Financial Holding Company." A fund designated a Tier 1 Financial Holding Company would be subject to the Board's

jurisdiction and subject to the prudential standards for such holding companies, which include strict capital, liquidity and risk management standards. The process for determining whether an adviser's private funds pose a systemic risk remains nebulous. All such reports obtained by the Board or the Council from the SEC would be kept confidential. However, the draft legislation also provides that the SEC would not be authorized to withhold such information from Congress or any other Federal department or agency, which leaves the potential for dissemination of such information.

- *Disclosure*. In addition to providing reports to the SEC, a registered adviser would be required to provide such reports, records and other documents to investors, prospective investors, counterparties and creditors of any private fund advised by such registered adviser 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." The Private Fund Act does not elaborate on how broadly "necessary or appropriate" might be construed or whether such disclosures would extend beyond what is typically disclosed to such persons based on best practices.

Expanded SEC Authority. Significantly, the Private Fund Act authorizes the SEC to define "client" differently for different purposes under the Advisers Act. The authority to redefine "client" as the individual investor within a private fund rather than the fund itself was critical to the demise of the SEC's most recent attempt to require the registration of private fund advisers. In its 2006 *Goldstein* decision,[3] the D.C. Court of Appeals found that the SEC lacked the authority to redefine "client" as an individual investor for purposes of applying the private adviser exemption under Section 203(b)(3) of the Advisers Act. In surprisingly bold dicta, the Court of Appeals also stated that "The adviser owes fiduciary duties only to the fund, not to the fund's investors." If the SEC's authority is reshaped as proposed in the Private Fund Act, in theory, the SEC could designate an individual investor — as opposed to the fund itself — as a "client," and thus redefine the scope of a registered adviser's duties to the individual investors in a collective investment vehicle.

* * *

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:

Marco V. Masotti	(212) 373-3034	Robert M. Hirsh	(212) 373-3108
Yvonne Y.F. Chan	(212) 373-3255	Mitchell L. Berg	(212) 373-3048
Stephanie R. McCavitt	(212) 373-3558	Jennifer A. Spiegel	(212) 373-3748

[3] Goldstein v. S.E.C., 451 F.3d 873 (D.C. Cir. 2006).