



House Committee Votes Overwhelmingly to Expand Advisers Act Registration Requirements

October 30, 2009 - The House Financial Services Committee has approved by a vote of 67-1 legislation that would, among other things, subject many advisers to hedge funds or certain other private investment companies to registration under the Investment Advisers Act of 1940 (the "Advisers Act"). Specifically, the Committee voted on October 27, 2009 to approve an amended version of H.R. 3818 (the "Private Fund Investment Advisers Registration Act of 2009"), which was originally published in draft form by Congressman Paul Kanjorski, on October 1, 2009 and subsequently introduced on October 15.^[1]

This Alert discusses some of the key provisions of H.R. 3818, as approved by the Committee. In view of the overwhelming Committee vote in favor of this legislation and general administration support, this legislation has substantial momentum.

Repeal of Certain Exemptions From Investment Adviser Registration

Repeal of the "15 Client" Exemption

H.R. 3818 would generally eliminate the Advisers Act exemption that currently enables advisers with fewer than 15 clients to avoid registering under that Act. This 15 client exemption would, however, be preserved for certain foreign private fund advisers whose assets under management attributable to U.S. clients are relatively modest.

Although H.R. 3818 has been motivated largely by a desire to enhance regulation with respect to hedge funds, the repeal of the 15 client exemption will have ramifications far beyond such funds. As discussed further below, the effect of this repeal would be somewhat ameliorated for some advisers to venture capital funds or small business investment companies. Nevertheless, repeal of the 15 client exemption would require numerous other persons who provide investment advisory services to a limited number of other types of companies or clients (including private equity companies) to register as investment advisers. There has been incomplete public discussion of all the many and varied types of entities that currently rely on the 15 client exemption. It is therefore likely that that the ramifications of the exemption's

repeal would be far greater than are commonly appreciated.

The repeal of the 15 client exemption is interrelated with the proposed legislation for a Consumer Financial Protection Agency ("CFPA") that is also wending its way through Congress.^[2] As currently proposed, the CFPA would generally have jurisdiction over investment advisory services rendered to consumers, subject to certain exceptions. The exceptions from CFPA regulation include, among others, investment advisory services provided by an investment adviser registered under the Advisers Act. In some cases, therefore, even though repeal of the 15 client exclusion may require an adviser to register under the Advisers Act, such registration may enable the adviser to avoid CFPA regulation that otherwise would apply.

Partial Repeal of Exemptions for Intrastate Advisers and Commodity Trading Advisers

Certain investment advisers currently are exempted from registration with the SEC under the Advisers Act if they conduct business solely within a single state or if they are registered with the CFTC as a commodity trading adviser.

H.R. 3818 would eliminate these exemptions for any "private fund." A "private fund," for purposes of this legislation, is defined as a company that would be subject to the Investment Company Act of 1940, but for the exemptions for private investment companies provided in Sections 3(c)(1) or 3(c)(7) of that Act.

New Exemptions From Investment Adviser Registration

To partially ameliorate the impact of the above-discussed repeals of registration exemptions, H.R. 3818 would add new exemptions from Advisers Act registration for the following categories of persons:

- Any investment adviser to private funds, "if each such private fund has assets under management in the United States of less than \$150 million." It is unclear, however, exactly what types of activities with respect to any assets would need to be conducted offshore in order to avoid those assets being deemed to be "under management in the United States." The SEC presumably would address this question, inasmuch as H.R. 3818 would require the SEC to adopt regulations implementing this exclusion.
- Any investment adviser who solely advises small business investment companies licensed under the Small Business Investment Company Act of 1958.
- Any investment adviser to a "venture capital fund," as defined by the SEC in its implementation of this exemption. Private equity funds would not be covered by this exemption, unless they were to fall within the SEC's definition of venture capital fund.

Providing Additional Information to Regulators

H.R. 3818 also would specifically require registered investment advisers to maintain such records and file such reports regarding private funds as are deemed necessary or appropriate by the SEC for the protection of investors or

for the assessment of systemic risks. Accordingly, there would be practically no limit on the information about private funds that the SEC could require a registered investment adviser to provide. Indeed, the legislation specifically would make it mandatory that each registered adviser at least maintain the following information about each private fund: the amount of its assets; its use of leverage; counterparty risk exposure; trading and investment positions; and trading practices.

Even some private fund investment advisers who are exempted from Advisers Act registration would be required to provide information to the SEC. For example, H.R. 3818 would require that, as to advisers who rely on the "under \$150 million" or venture capital fund exclusions discussed above, the SEC prescribe such record keeping and reporting requirements as the SEC determines necessary or appropriate in the public interest or for the protection of investors.

Considerations Applicable to "Mid-Size" Private Funds

H.R. 3818 would require that the SEC take steps to ensure that the Advisers Act registration and examination procedures that it implements for advisers to "mid-size private funds" reflect the level of systemic risk posed by such funds. In that regard, the legislation directs the SEC to consider the "size, governance, and investment strategy of such funds to determine whether they pose systemic risk." The legislation does not specifically define "mid-size private fund," however, and, in other respects as well, it is not clear what effect the SEC would give (or is intended to give) to this provision.

Potential Additional Disclosure to Investors, Counterparties and Creditors

H.R. 3818 would empower the SEC to require that SEC-registered advisers to private funds provide investors, prospective investors, counterparties, and creditors with such reports, records and other documents concerning such funds 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. This is a remarkably broad provision, in that it seems to authorize the SEC to impose disclosure obligations with respect to private funds that might even exceed the disclosure obligations of fully-registered mutual funds.

Clarification of SEC Rulemaking Authority Under Advisers Act

H.R. 3818 would clarify the SEC's rulemaking authority under the Advisers Act, including its authority to classify persons and matters (and regulate different classes differently), and to ascribe different meanings to terms used in different sections of the Act. In particular, the legislation specifies that the SEC may ascribe different meanings to the term "client," except that no definition of "client" may include any investor in a private fund managed by an investment adviser pursuant to an investment advisory contract. This would mean, generally, that a private fund (and not the fund's investors) would be considered to be the investment adviser's client.

Status of Legislation

As suggested above, H.R. 3818 has significant momentum in the House of

Representatives. The principal legislation in the Senate that addresses the subject of hedge funds (and other private investment companies) is S. 1276, which is very similar to the draft Treasury Department legislation^[3] that ultimately evolved into H.R. 3818.^[4]

Also pending in the Senate is S. 344 (the "Hedge Fund Transparency Act"). Although many of the ultimate consequences of S. 344 would not be dissimilar those of H.R. 3818, the two pieces of legislation achieve their results in somewhat different ways and differ in many of their details.^[5]

Both S. 1276 and S. 344 are pending in the Senate Committee on Banking, Housing and Urban Affairs.

For additional information:

Jorden Burt has formed a special Task Force to monitor this legislation and other proposals relating to reform of financial services regulation. To obtain additional information about particular proposals that might have an impact on the insurance or reinsurance industries, you may contact Roland Goss (rcg@jordenusa.com or (202) 965-8148). To obtain additional information about particular proposals that might have an impact on the investment adviser and fund industries you may contact Tom Lauerman (tcl@jordenusa.com or (202) 965-8156). Or you may contact any of Jorden Burt's other regulatory attorneys.

[1] H.R. 3818 also is quite similar to draft legislation that was released by the Treasury Department on July 15, 2009 as part of the Obama administration's proposed regulatory reforms.

[2] We published a recent Client Alert that discusses the CFPA proposal, which can be found [here](#).

[3] See footnote 1, *supra*.

[4] S. 1276 was introduced by Senator Jack Reed on June 16, 2009 and can be found [here](#).

[5] S. 344 was introduced by Senator Charles Grassley on January 29, 2009 and can be found [here](#).

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