

Private Equity

E-ALERT

October 29, 2009

UPDATE ON PRIVATE FUND ADVISER REGISTRATION

KEY HOUSE COMMITTEE APPROVES LEGISLATION

On October 27, 2009, the House Financial Services Committee approved a bill that would require investment advisers to most private investment funds to register with the Securities and Exchange Commission. Although the bill - the Private Fund Investment Advisers Registration Act of 2009 (H.R. 3818) - generally tracks a proposal offered this summer by the Obama Administration, some noteworthy exemptions and other changes were added in the version approved by the committee.¹

Consistent with prior reform proposals, the legislation would greatly expand the SEC's regulatory coverage of private investment funds and their advisers. It would do so in two principal ways: (1) by eliminating almost entirely an existing exemption for investment advisers with fewer than 15 clients, and (2) by subjecting advisers to a new regulatory regime, which will include registration for many currently unregistered advisers to private funds.

Key elements of the bill are summarized below:

- Subject to the exemptions described below, an investment adviser to any fund with at least \$30 million in assets under management would be required to register with the SEC under the Investment Advisers Act of 1940.²
- There would be exemptions from registration for advisers to three kinds of funds: venture capital funds (to be defined by the SEC³), "private funds"⁴ with assets under management in the United States of less than \$150 million⁵, and licensed small business investment companies.⁶
- Private fund advisers that must register with the SEC would be required to comply with new recordkeeping, SEC reporting and disclosure requirements

¹ The description of the bill in this alert is based on a draft of the legislation and various amendments approved during the bill's markup by the House Financial Services Committee on October 27, 2009. The final legislative language had not been made available as of the date of this alert.

² Under current law, investment advisers with fewer than 15 clients generally are exempt from such registration. Because a typical "blind pool" fund is treated as a single client (regardless of how many investors invest through the fund), fund managers that manage 14 or fewer funds generally are exempt from registration under the Advisers Act.

³ Given the overlap between venture capital investment, on the one hand, and growth equity and other similar areas of private equity investment, on the other, the SEC faces some challenges in defining what constitutes a "venture capital fund".

⁴ "Private funds" are those that are exempt from registration as investment companies under either Section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940.

⁵ The obvious ambiguity in the category "assets under management in the United States" will presumably require further SEC clarification.

⁶ In addition, "foreign private fund advisers," would not be required to register under the Advisers Act. A "foreign private fund adviser" is an investment adviser that (i) has no place of business in the United States, (ii) during the preceding 12 months has had fewer than 15 clients in the United States and has assets under management attributable to U.S. clients of less than \$25 million and (iii) neither holds itself out generally to the public in the United States as an investment adviser, nor acts as an investment adviser to a registered investment company or a business development company.

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regarding such funds.⁷ Additionally, all records of a private fund maintained by a registered adviser would be subject to examination by the SEC.

- The bill specifies types of “systemic risk” records and reports that registered advisers to private funds would be required to maintain or file, including with respect to such matters as fund assets under management, the use of leverage (including off-balance sheet leverage), counterparty credit risk exposures, trading and investment positions, and trading practices. The bill also requires the SEC, in promulgating rules for registered advisers to “mid-sized private funds”⁸ to take into account the size, governance, and investment strategy of such funds and to adopt registration and examination procedures for advisers to such funds which reflect the level of systemic risk posed by such funds.
- Although they will not be required to register with the SEC, advisers to both venture capital funds and smaller private funds, as described above, would be required to maintain such records and file such annual and other reports as the SEC deems appropriate.
- The SEC would make available the information it receives regarding private funds to the Federal Reserve and other regulators with systemic risk responsibility to enable such regulators to assess the systemic risk of a private fund.
- The bill allows a one-year transition period before advisers will first be required to register with the SEC.

If you would like to discuss such legislation and our capabilities to assist you in the upcoming legislative process, please feel free to contact:

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⁷ The definition of “private funds” has no territorial limitation and is intended to capture offshore funds (including, without limitation, Cayman Islands, Bermuda, Guernsey and other non-US domiciled funds) managed by investment advisers registered with the SEC.

⁸ This term is not defined in the bill.