Proposed Legislation Would Require Registration and Public Disclosure Regarding Private Investment Fund

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Executive Summary

On January 29, 2009, Senators Charles E. Grassley and Carl Levin introduced "The Hedge Fund Transparency Act", which, if enacted, would significantly increase the federal government's oversight of hedge funds and other private funds (including, private equity and venture capital funds) with at least $50 million of assets under management by requiring these funds to register with the SEC, comply with certain reporting and public disclosure requirements and establish anti-money laundering programs. The proposed Grassley-Levin bill is a revised version of a previous bill introduced by Senator Grassley two years ago, but which Congress did not act upon. However, the Grassley-Levin bill differs from the previous bill introduced by Senator Grassley in two significant ways:

(i) instead of amending the Investment Advisers Act to require managers to register as investment advisers, the proposed bill would amend the Investment Company Act to require the private funds themselves to register and comply with certain reporting and public disclosure requirements, including periodic disclosure of the identity of the funds' investors; and

(ii) it would require private funds to establish anti-money laundering programs and report suspicious transactions under federal anti-money laundering statutes.

Proposed Amendments to the Investment Company Act: Registration, Reporting and Public Disclosure Requirements

Most hedge funds, private equity funds and other private investment funds generally rely on the exceptions to the definition of "investment company" set forth in Section 3(c)(1) or 3(c)(7) of the Investment Company Act[1] to avoid registration under that

[1] Section 3(c)(1) excludes from the definition of "investment company" any entity whose outstanding securities are beneficially owned by not more than one hundred persons and are not offered publicly.

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Act. The Grassley-Levin bill would delete these exceptions from the definition of "investment company" and instead make them exemptions under new Sections 6(a)(6) and 6(a)(7), thereby making it clear that private investment funds are "investment companies" within the regulatory reach of the Investment Company Act. However, unlike public mutual funds and other investment companies that are required to register under Section 8 of the Investment Company Act, private investment funds would be exempt from the normal registration requirements and related substantive provisions of the statute, provided that they comply with the following conditions:[2]

- Registering with the SEC;
- Filing an information form ("Information Form") with the SEC;
- Maintaining books and records as the SEC may require; and
- Cooperating with any requests for information or examination by the SEC.

The Information Form will need to be filed electronically at least annually (and more frequently if the SEC so requires) and will need to be made publicly available in searchable form. The Information Form will need to include:

- The name and current address of (i) each natural person who is a beneficial owner of the investment company;[3] (ii) any company with an ownership interest in the investment company; and (iii) the primary accountant and primary broker used by the investment company;

Section 3(c)(7) excludes any entity whose outstanding securities are owned exclusively by "qualified purchasers" and are not offered publicly.

2 The proposed bill does not explicitly distinguish between the registration requirement for public investment companies under Section 8 and the registration requirement for hedge funds and other private funds under the new Sections 6(a)(6) and 6(a)(7) exemptions. Presumably, by being "registered" under the new Section 6(a)(6) or 6(a)(7), exempted private investment funds would not be subject to the other substantive requirements of the Investment Company Act applicable to public investment companies "registered" under Section 8 of the Investment Company Act that relate to, among other elements of fund operations and structure, composition of fund boards, capital structure and affiliate transactions.

3 It is unclear under the proposed bill whether a fund would be required to disclose the identity of the individuals who are the ultimate beneficial owners of its direct limited partners or shareholders.

- An explanation of the structure of ownership interests in the investment company;
- Information on any affiliation that the investment company has with another financial institution;
- A statement of any minimum investment commitment required of a limited partner, member, or other investor;
- The total number of any limited partners, members, or other investors; and
- The current value of (i) the assets of the investment company and (ii) any assets under management by the investment company.

Except for a handful of private investment funds with assets, or assets under management, of less than $50 million, all private funds will need to comply with these conditions in order to maintain their exemption from the normal registration and other substantive requirements of the Investment Company Act. However, the proposed bill is not clear on whether these new requirements, if enacted, would be applicable to existing private funds on a retroactive basis, and/or whether such funds would have a transition period to comply with the new requirements (including registration with the SEC). In addition, the bill does not expressly address whether (and to what extent) the new requirements will apply to funds organized outside the U.S. It is also not clear whether the proposed bill (including the private funds' obligation to register with the SEC), if enacted, would affect the availability of the exemption from registration under Section 203(b)(3) of the Investment Advisers Act, which exempts investment managers with fewer than 15 clients (none of which are registered under the Investment Company Act) from registration under that Act. Presumably, these and other implementation issues raised by the proposed bill, if enacted in its current form, would need to be addressed by the SEC, which is charged with issuing such forms and guidance as are necessary to implement the provisions of the bill within 180 days of its enactment.

Anti-Money Laundering Provisions

Under the proposed bill, private funds that seek to rely on the new Sections 6(a)(6) and 6(a)(7) exemptions would also be required to establish anti-money laundering programs and report suspicious transactions in accordance with federal anti-money laundering statutes (namely, subsections (g) and (h) of section 5318 of title 31 of the United States Code). In addition, private funds that rely on the new Section 6(a)(6) or 6(a)(7) exemptions will need to comply with the same requirements as other financial institutions

for producing records and other information related to anti-money laundering compliance requested by a federal bank regulator no later than 120 hours after receiving a request.

The Grassley-Levin bill has been referred to the Senate Banking Committee for consideration. It is too soon to predict at this point whether (and in what form) the proposed bill would be enacted. We will continue to monitor the progress of the Grassley-Levin bill and any other proposed legislation affecting private funds.

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Questions concerning The Hedge Fund Transparency Act discussed herein, and requests for copies of the proposed bill, may be directed to the individuals named on the attached schedule.

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