



# Private Equity Alert

## Developments in private equity law

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### House passes Private Fund Investment Advisers Registration Act

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On December 11, 2009, the U.S. House of Representatives passed H.R. 4173, the Wall Street Reform and Consumer Protection Act of 2009. The legislation is an omnibus bill that would, among other things, (i) establish a federal Consumer Financial Protection Agency; (ii) overhaul the regulation of financial derivatives and security-based swap markets; (iii) require private fund investment advisers to register with the SEC, maintain records, and provide reports on systemic risk data; and (iv) regulate the compensation of officers of banks and financial institutions.

Incorporated as Title V of the Act is the Private Fund Investment Advisers Registration Act of 2009, which would eliminate the existing exemption from the requirement to register as an investment adviser under the Investment Advisers Act of 1940 relied upon by general partners and investment managers of hedge funds and private equity partnerships. Section 203(b) of the Investment Advisers Act currently exempts from the registration requirement advisers who do not hold themselves out generally to the public as investment advisers and who, during any 12-month period, have fewer than 15 clients. It has long been the established rule that, in counting the clients of the fund manager of a private pool, the fund itself—and not each individual investor in the fund—is the client. The Act, as passed by the House of Representatives, would amend Section 203(b) to eliminate the 15-client rule for “an investment adviser who acts as an investment adviser to any private fund,” thereby requiring an investment manager or general partner of even a single private fund (subject to certain thresholds set forth in the legislation) to register as an investment adviser. In defining the private funds whose investment advisers will be required to register, the bill excludes (i) managers with less than \$150 million in assets under management and (ii) all investment advisers to venture capital funds (the definition of which will be determined by the SEC) or licensed small-business investment companies.

The Act would further require any registered investment adviser to private funds to maintain such records and file with the SEC such reports as the SEC determines are necessary or appropriate for the assessment of systemic risk. At a minimum, such records and reports must include:

- the amount of assets under management;
- the use of leverage (including off-balance-sheet leverage);

- counter-party credit risk exposures;
- trading and investment positions; and
- trading practices.

The Act directs the SEC to take into account the characteristics of private funds, including size, scope, business models, investment strategies, and compensation schemes in prescribing regulations, and specifically directs the SEC, in establishing registration and examination procedures with respect to investment advisers to mid-sized private funds, to determine whether they pose systemic risk, and to provide regulations that reflect the level of systemic risk posed by such funds.

Investment advisers to funds with less than \$150 million under management will, although exempted from the requirement to register under the Investment Advisers Act, nevertheless be required to maintain such records and provide to the SEC such reports as the SEC determines necessary or appropriate for the protection of investors.

The requirement that managers of private funds register as investment advisers will become effective one year after the date on which the becomes law.

The legislation now passes to the Senate, which has been generally less focused than the House on the issue of regulation of the financial markets or on hedge fund transparency and the regulation of investment managers of hedge funds and private equity funds. We will continue to follow this legislation and to advise our clients on significant developments.

For more information on this issue or any private equity matter, please contact your regular Nixon Peabody attorney or:

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