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Hedge Fund Regulation Bills Introduced

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On January 29, 2009, Senators Chuck Grassley (R-IA) and Carl Levin (D-MI) introduced legislation that, if passed, would give the Securities and Exchange Commission (the SEC) the authority to regulate private investment funds, including private equity funds and hedge funds, under the Hedge Fund Transparency Act of 2009 (the Senate Bill). Two days earlier on January 27, 2009, Representatives Michael Castle (D-DE) and Michael Capuano (D-MA) also introduced three bills affecting the private investment fund industry (collectively, the House Bills). Each of these pieces of legislation is in early form and may change, possibly significantly.

Senate Bill

Senate Bill Revises the Definition of "Investment Company"

Private investment funds commonly avoid registration under the Investment Company Act of 1940 (the '40 Act) by relying on section 3(c)(1) (private investment funds with 100 or fewer beneficial owners) or section 3(c)(7) (private investment funds available to only "qualified investors"). These provisions of the '40 Act currently operate as exceptions from the definition of "investment company." The Senate Bill would remove these exceptions from the definition of "investment company" and convert them to exemptions from certain parts of the '40 Act in section 6 (new sections 6(a)(6) and 6(a)(7)) that largely mirror the current sections 3(c)(1) and 3(c)(7).

Proposed Exemptions

Under the Senate Bill, a private investment fund with assets of less than $50 million could rely on the new exemptions from registration provided by the new sections 6(a)(6) or 6(a)(7) of the '40 Act without being subject to any new regulatory conditions proposed under the Senate Bill, except for the anti-money laundering requirements discussed below that would apply to all funds meeting the definition of "investment company" under the '40 Act.

Under the Senate Bill, a private investment fund with assets of $50 million or more could rely on the new section 6(a)(6) or 6(a)(7) exemptions under the '40 Act only if it:

Registers with the SEC;

Maintains books and records required by the SEC;

Cooperates with any request for information or examination by the SEC;

Electronically files an information form with the SEC at least annually that includes certain information about the company, including:

the name and address of each individual who is a beneficial owner and any company with an ownership interest;

an explanation of its ownership interest structure;

information on its affiliations with other financial institutions;

the name and address of its primary accountant and broker;

the minimum investment commitment of any investor;

its total number of investors; and

the value of its assets and any assets under management.

This form would be made available to the public in an electronic, searchable format at no cost.

Investment Adviser Registration

Although not directly addressed in the Senate Bill or the related press release, the construction of the provisions described above would seemingly have the effect of requiring registration for the advisers to private investment funds (often a general partner) that rely on the exemptions provided by new sections 6(a)(6) or 6(a)(7) and have in excess of $50 million in assets. Advisers to private investment funds generally avoid registration in reliance on an exception provided by section 203(b)(3) of the Investment Advisers Act of 1940 (the Advisers Act). This exception is not available to an investment adviser to an investment company registered under the '40 Act. Since the Senate Bill would require most private funds to register as investment companies under the '40 Act, many advisers to large private investment funds who have historically avoided registration as an investment adviser would probably be required to register.

Anti-Money Laundering Provisions

Under the Senate Bill, any investment company relying on the new sections 6(a)(6) or 6(a)(7) of the '40 Act (regardless of its asset size) would be required to establish an anti-money laundering program,

the requirements of which would be set forth in a rule made by the Secretary of the Treasury within 180 days of the enactment of the Senate Bill, and to report any suspicious transactions.

Senate Bill Timeframe
The SEC would be required to issue forms and guidance to implement the Senate Bill within 180 days of its enactment.

House Bills

The House Bills propose three new acts. One of the proposed acts, the Hedge Fund Adviser Registration Act of 2009, calls for the elimination of the "private adviser" exemption currently available under section 203(b)(3) of the Advisers Act by striking that section in its entirety.

The second of the proposed acts, the Pension Security Act of 2009, contains provisions that would amend section 103(b) of the Employee Retirement Income Security Act of 1974 to require disclosure of plan investments in hedge funds in the annual report of each defined benefit pension plan on a separate schedule identifying each hedge fund in which the plan invests at the end of the plan year covered by the annual report and the amount invested in each such fund. "Hedge fund" is defined under this proposed act to include an unregistered investment pool permitted under sections 3(c)(1) and 3(c)(7) of the '40 Act, and section 4(2) of the Securities Act of 1933 and Rule 506 of Regulation D promulgated thereunder.

The third of the proposed acts, the Hedge Fund Study Act, would require President Obama's Working Group on the Financial Markets to conduct a study of the hedge fund industry, including an analysis of:

1. the changing nature of hedge funds and what characteristics define a hedge fund;
2. the growth of hedge funds in financial markets;
3. the growth of pension funds investing in hedge funds;
4. whether hedge fund investors are able to protect themselves adequately from the risk associated with their investments;
5. whether hedge funds leverage is effectively constrained;
6. the potential risks hedge funds pose to financial markets or investors;
7. various international approaches to hedge fund regulation; and
8. the benefits of the hedge fund industry to the economy and the markets.

This proposed act would require the working group to complete its study within 180 days of the date of enactment when the group must submit its findings to the House of Representatives Committee on Financial Services and the Senate Committee on Banking, Housing, and Urban Affairs in a report that includes:

1. any proposed legislation relating to the appropriate disclosure requirements for hedge funds;
2. the type of information hedge funds should disclose to regulators and to the public;
3. any efforts the hedge fund industry or regulators of financial institutions should undertake to improve practices or provide examples of successful industry initiatives; and
4. any oversight responsibilities that members of the President's working group should have over the hedge fund industry, and the degree and scope of such oversight.

For More Information

Husch Blackwell Sanders LLP will follow this legislation closely and will continue to update you on its development. For more information, please contact your Husch Blackwell Sanders attorney.

Husch Blackwell Sanders LLP regularly publishes updates on industry trends and new developments in the law for our clients and friends. Please contact us if you would like to receive updates and newsletters, or request a printed copy.