

# ClientAlert

February 9, 2009

## Proposed Legislation Seeks to Regulate Hedge Funds and Private Funds

On January 29, 2009, Senators Charles Grassley (Iowa) and Carl Levin (Michigan) proposed The Hedge Fund Transparency Act (the "Transparency Act"). If passed in its current form, the Transparency Act would subject many hedge funds and private investment funds (collectively, "Private Funds") to U.S. Securities and Exchange Commission (the "SEC") regulation and oversight. In particular, the Transparency Act would require certain Private Funds to (a) register with the SEC, (b) file with the SEC an annual public information statement, (c) maintain books and records as required by the SEC, (d) cooperate with SEC examination requests and (e) establish certain anti-money laundering programs and policies.

### The Transparency Act Applies to an Array of Private Funds

Currently, most Private Funds are excluded from the onerous registration and ongoing regulatory requirements that the Investment Company Act imposes on mutual funds and other "investment companies." Private Funds typically fall within one of the following exemptions: (i) Section 3(c)(1) of the Investment Company Act, which excludes from the definition of an "investment company" any issuer with no more than 100 beneficial owners, and (ii) Section 3(c)(7) of the Investment Company Act, which excludes from the definition of an "investment company" any issuer owned exclusively by "qualified purchasers" (generally, individuals owning at least \$5 million, and entities owning at least \$25 million, in investments).

The Transparency Act would delete the Section 3(c)(1) and 3(c)(7) exclusions from the definition of

"investment company," and in their place add new Sections 6(a)(6) and 6(a)(7). It appears that these changes are intended to clarify that Private Funds would be "investment companies" under the Investment Company Act that are exempt from the full registration requirements only if they comply with the new Sections 6(a)(6) and 6(a)(7).

The Transparency Act does not specifically address the impact of its requirements on Private Funds organized outside of the U.S. The SEC would have to issue further guidance in this respect, although we would expect that non-U.S. Private Funds conducting U.S. offerings would be subject to the same or similar obligations.

### Compliance under the New Regulations

Proposed new Sections 6(a)(6) and 6(a)(7) would require Private Funds with \$50 million or more in assets or assets under management to meet the following conditions:

- The Private Fund must register with the SEC;
- The Private Fund must file an annual public information form (an "Information Form") prescribed by the SEC;
- The Private Fund must maintain such books and records as the SEC may require; and
- The Private Fund must cooperate with any request for information or examination by the SEC.

If the Transparency Act is passed, the SEC would be required within 180 days to issue such rules, forms and guidance as they determine are necessary to carry out the new legislation.

### Proposed Annual Disclosure Requirements

The Information Form would be filed electronically at such time as the SEC may require, but at least every 12 months, and would be publicly available in an electronic searchable format. It would include at least the following information:

- The name and address of (i) each natural person who is a beneficial owner of the Private Fund, (ii) any company with an ownership interest in the Private Fund and (iii) the Private Fund's primary accountant and primary broker;
- An explanation of the structure of ownership interests in the Private Fund;
- Information on any affiliation that the Private Fund has with another financial institution;
- A statement of any minimum investment commitment required of investors;
- The total number of investors; and
- The current value of the Private Fund's assets and assets under management.

### New Anti-Money Laundering Obligations

In addition to the requirements above, the Transparency Act would impose certain anti-money laundering obligations on Private Funds relying on the new Section 6 exemptions, without regard to whether they hold assets of \$50 million or more. Private Funds would be required to establish anti-money laundering ("AML") programs, and policies and procedures that are reasonably designed to identify non-U.S. investors

(and their beneficial owners), and would also be subject to suspicious activity reporting requirements. If the Transparency Act is passed, the U.S Treasury Department, in consultation with the SEC and CFTC, would be required within 180 days to establish such rules, policies and procedures necessary to carry out these AML requirements. Otherwise, the AML requirements in the bill as written would take effect within one year of the bill's enactment.

### Future Developments

The Transparency Act is an initial proposal introduced for regulating Private Funds and (potentially) their advisers, and may change over time as it becomes debated and/or integrated with other proposals of similar focus. For instance, press reports indicate that President Obama's administration, state regulators and a Congressional panel are likewise preparing proposals of their own. We cannot predict when or if the Transparency Act or any similar proposal would come into effect. However, given the current economic climate and the general momentum to modernize current financial regulations, increase market transparency and reduce systemic risk, some form of enhanced regulation appears likely. We will continue to monitor the progress of the Transparency Act, as well as other regulatory initiatives that will impact private funds and their advisors.

**Our client alerts are for general informational purposes and should not be regarded as legal advice. If you are interested in reading the actual text of the Transparency Act, it can be viewed at <http://grassley.senate.gov/private/upload/01292009-2.pdf>. If you would like additional information or have any questions, please contact:**

Scott W. Naidech  
+1 (212) 408-5440  
[snaidech@chadbourne.com](mailto:snaidech@chadbourne.com)

Morton E. Grosz  
+1 (212) 408-5592  
[mgrosz@chadbourne.com](mailto:mgrosz@chadbourne.com)

Talbert I. Navia  
+1 (212) 408-5316  
[tnavia@chadbourne.com](mailto:tnavia@chadbourne.com)

Elizabeth S. Grimaldi  
+1 (212) 408-5134  
[egrimaldi@chadbourne.com](mailto:egrimaldi@chadbourne.com)

Peter K. Ingerman  
+1 (212) 408-5422  
[pingerman@chadbourne.com](mailto:pingerman@chadbourne.com)