Registration of Private Investment Companies Proposed in Senate Bill

On January 29, 2009, a bill entitled the "Hedge Fund Transparency Act of 2009" (the "Bill") was introduced in the United States Senate. If passed, the Bill would require hedge funds, private equity funds and other alternative investment firms to register with the Securities and Exchange Commission (the "SEC"), as well as require compliance by such funds with a number of other regulatory requirements.[1]

The Investment Company Act of 1940 (the "Act") subjects all entities that fall within its definition of "investment company" to extensive regulation. Presently, domestic hedge funds, private equity funds and other alternative investment firms rely on either Section 3 (c)(1) or Section 3 (c)(7) of the Act for exemption from the definition of "investment company" and as a result, from virtually all of the Act's extensive regulations. These sections allow domestic hedge funds, private equity funds and other alternative investment firms to be exempt from the registration requirements of the Act so long as they do not make, or propose to make, a public offering of their securities and (i) in the case of Section 3(c)(1), limit the number of their security holders to not more than one hundred (calculated as required under the Act); or (ii) in the case of Section 3(c)(7), voluntarily limit their investors to "qualified purchasers," as such term is defined in the Act and the regulations thereunder.[2]

The Bill would relocate Sections 3(c)(1) and 3(c)(7) from the Section 3 definition of "investment company" to Section 6 of the Act -- a section in which a variety of conditional exemptions from the Act are collected, among other things -- and the relocated sections would be re-numbered as Section 6(a)(6) and Section 6(a)(7), respectively. The operative exemptive provisions of Sections 3(c)(1) and 3(c)(7) would not be altered as part of this move. However, under the terms of the Bill certain conditions would be placed on the ability of a fund to avail itself of either of these exemptions if the fund has assets under management of $50 million or more. Such a fund would be required to comply with the following:

(i) register with the SEC;

(ii) maintain such books and records as the SEC may require;

(iii) cooperate with any request for information or examination by the SEC; and

(iv) file an information form with the SEC.

The information form would have to be filed at such time and in such manner as the SEC would require. It would have to be filed electronically at least once every 12 months and include:

(i) the name and address of each person and company with ownership in the investment company or its holdings; as well as that of the primary accountant and broker used by the company;

(ii) an explanation of the structure of ownership interests in the investment company;

(iii) information on any affiliation that the investment company has with another financial institution;

(iv) a statement of any minimum investment commitment required of a limited partner, member or other investor;

(v) the total number of any limited partners, members or other investors; and

---

1 The Bill, S.344, is available at: http://grassley.senate.gov/private/upload/01292009-2.pdf.

2 Rule 3c-5 under the Act affords a narrow exception to these investor limitations for "knowledgeable employees," as defined in the Rule.

(vi) the current value of the assets of the investment company and any assets under management by the company.

In addition, a fund relying on either of these exemptive provisions would have to establish an anti-money laundering program, and report suspicious transactions. The Secretary of the Treasury, in consultation with the Chairman of the SEC and the Chairman of the Commodity Futures Trading Commission, would be required to issue a rule governing how the anti-money laundering provisions are to be effectuated. The substance of the rule would include requirements that funds use risk-based due diligence policies, procedures and controls that are reasonably designed to ascertain the identity of and evaluate any foreign person (including, where appropriate, the nominal and beneficial owner or beneficiary of a foreign corporation, partnership, trust, or other entity) that supplies or plans to supply funds to be invested with the advice or assistance of a fund relying on one of the exemptive provisions. In addition, the Bill would require that such funds be subject to section 5318(k)(2) of title 31 of the United States Code, which requires that not later than 120 hours after receiving a request by an appropriate Federal banking agency for information related to anti-money laundering compliance by a fund, a fund would be required to provide to the appropriate Federal banking agency, information and account documentation for any account opened, maintained, administered or managed in the United States by the covered fund. The anti-money laundering rule may also incorporate provisions of various other statutes and rules releases.

Within one hundred-eighty (180) days after the Bill is enacted, the SEC would be required to issue forms and guidance necessary to carry it out. Furthermore, the SEC would be granted authority to make a rule to carry out the Bill.

* * *

If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; John Schuster at 212.701.3323 or jschuster@cahill.com.