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COVINGTON & BURLING LLP

ADVISORY | Investment Management

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FINANCIAL SERVICES REGULATORY REFORM LEGISLATION

REGISTRATION OF ADVISERS TO PRIVATE INVESTMENT FUNDS

On December 11, 2009, the U.S. House of Representatives passed the Wall Street Reform and Consumer Protection Act of 2009 (H.R. 4173) – the House's version of financial services regulatory reform legislation.

On March 15, 2010, the Senate Banking Committee released its own draft of proposed financial services regulatory reform legislation.[1]

Both the House-passed legislation and the current Senate Committee draft would require investment advisers to many private investment funds to register with the Securities and Exchange Commission ("SEC"). Although the two versions of this legislation are consistent in many respects, several important differences remain. Below is a side-by-side comparison that summarizes the key elements of the House-passed legislation regarding private fund adviser registration, and the principal respects in which the current Senate draft differs from the House-passed legislation.

If you have any questions regarding the House-passed legislation or the current Senate Banking Committee draft, please free to contact the Covington attorneys listed at the end of this alert or any other members of Covington's Funds Group.

HOUSE BILL	SENATE BILL
■ **Elimination of exemption for advisers with fewer than 15 clients–** ➢ The current exemption from registration under the Investment Advisers Act for advisers with fewer than 15 clients would be eliminated.	■ Same
■ **New category of "private funds" defined–** ➢ Any fund that would be an "investment company" under the Investment Company Act *but for* the exemptions provided by Section 3(c)(1) (i.e., funds owned by 100 or fewer investors) or Section 3(c)(7) (i.e.,	■ Same

[1] In November 2009, the Senate Banking Committee released an initial draft of financial services regulatory reform legislation. However, following a Committee discussion of that initial draft, Chairman Dodd and the Committee staff substantially rewrote the draft. In doing so, Senator Dodd and the Committee staff consulted extensively with a number of other Democrat and Republican members of the Committee, but no agreement on the revised draft legislation was reached with any Republican members. This process resulted in the draft legislation that the Senate Banking Committee released on March 15, 2010.

funds owned solely by "qualified purchasers").	
■ **Requirements applicable to advisers to private funds–**	
➢ Advisers to private funds would be required to register under the Investment Advisers Act (subject to exceptions noted below).	■ Same
➢ Private fund advisers would be required to comply with various new recordkeeping, reporting, and disclosure rules, as described below.	■ Same
➢ For advisers to "mid-sized" private funds (which term is not defined), any registration and examination procedures adopted by the SEC for such funds must reflect the level of systemic risk posed by the funds.	■ Not included
■ **Dollar threshold that triggers registration under Advisers Act–**	
➢ Raised from $25 million (current statutory threshold) to $100 million of assets under management.	■ Same
■ **Exemptions from Advisers Act registration–**	
➢ Foreign private fund adviser - any adviser who: (i) has no place of business in U.S.; (ii) doesn't hold self out to public in U.S. as investment adviser or act as adviser to registered investment company; and (iii) during last 12 months, had (a) fewer than 15 clients and investors in U.S. in private funds advised by the adviser, and (b) assets under management attributable to clients and investors in U.S. in private funds advised by the adviser of less than $25 million.	■ Included, with slightly different wording that makes the exemption somewhat broader in the Senate bill.
➢ Advisers to SBIC's - advisers who solely advise: (i) small business investment companies; (ii) entities that have been notified by the SBA that they may proceed to qualify for a license as a SBIC; and (iii) applicants for a SBIC license that are related to another licensed SBIC.	■ Same
➢ Venture capital fund advisers - any adviser to a "venture capital fund" (with such term to be defined by SEC through rulemaking process). However, these advisers would	■ Included, but does not require any annual or other reporting by such advisers.

be subject to annual report and other reporting requirements to be specified by SEC. ➢ Private equity fund advisers - Not included.	■ Included - provides exemption from registration for advisers to private equity funds (with such term to be defined by SEC through rulemaking process). These advisers would be subject to recordkeeping and annual report and other reporting requirements to be specified by SEC, taking into account fund size, governance, investment strategy, risk, and other factors.
➢ Advisers to smaller private funds - any adviser acting solely as adviser to private funds with assets under management in the U.S. below $150 million.	■ Not included.
➢ New limitation on exemption for commodity trading advisers - under existing law, a commodity trading adviser registered with the Commodity Futures Trading Commission and whose business does not consist primarily of acting as an investment adviser is exempt from registration under the Advisers Act. However, the House bill makes this exemption unavailable if the adviser acts as an investment adviser to a private fund.	■ Not included - the Senate bill does not contain the limitation pertaining to commodity trading advisers acting as investment advisers to private funds.
■ **Recordkeeping and reporting requirements–** ➢ The SEC is authorized to establish recordkeeping and reporting requirements for registered advisers to private funds. ➢ These requirements are to cover information about the private funds relating to: -amount of assets under management -use of leverage (including off balance sheet) -counterparty credit risk exposures -trading and investment positions -trading practices -other information as determined by SEC	■ Generally the same, but the Senate bill provides that information in the various specific categories must be maintained by the adviser and will be subject to inspection by the SEC, as opposed to being required to be "reported" to the SEC (as the House bill provides). ■ Also, the Senate bill would expand the categories of information about the fund required to be maintained by advisers, to also include: ➢ valuation policies and practices ➢ types of assets held ➢ side arrangements/side letters giving some investors in fund "more favorable rights or entitlements" than others

■ ***Disclosures to other parties***– SEC authorized to establish rules requiring registered advisers to private funds to make disclosures to investors, prospective investors, counterparties and creditors, as necessary or appropriate in the public interest and for the protection of investors or the assessment of systemic risk.	■ Not included.
■ **Protection of confidential and proprietary information provided to SEC–**	
➢ Reports, records and other information provided to the SEC, the new Financial Services Oversight Council or any other governmental agency or any self-regulatory organization would be excluded from the scope of Freedom of Information Act (FOIA) requests.	■ Same
➢ "Proprietary information" of an investment adviser (including information regarding investment or trading strategies and analytical or research methodologies) ascertained by the SEC from any report filed with the SEC by a registered investment adviser would be subject to the same limitations on public disclosure as facts ascertained during an examination of the adviser as provided by Section 210(b) of the Advisers Act.	■ Same
■ **SEC rulemaking authority–**	
➢ The SEC's authority to issue rules under the Advisers Act would be clarified.	■ Not included.
➢ The SEC would be prohibited from defining the term "client" to include an investor in a private fund managed by a registered investment adviser, where such private fund has an advisory contract with such adviser.	■ Not included.
■ **Definition of "investment adviser" –**	
➢ No change from current law	■ New language excluding "family office" (to be defined by SEC through rulemaking process, consistent with the SEC's previous exemptive orders for family offices).

■ **Transition period–** ➢ Amendments effective one year after date of enactment	■ Same

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If you have any questions concerning the material discussed in this client advisory, please contact the following members of our firm:

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