



Pending U.S. and E.U. Legislation Promises Broad Changes for Private Fund Managers

Posted by Andrew R. Brownstein, Wachtell, Lipton, Rosen & Katz, on Saturday May 29, 2010

Editor's Note: [Andrew R. Brownstein](#) is a partner in the Corporate Department at Wachtell, Lipton, Rosen & Katz. This post is based on a Wachtell Lipton firm memorandum by Mr. Brown, [Andrew J. Nussbaum](#), [Steven A. Cohen](#) and [Amanda N. Persaud](#).

Responding to the recent financial crisis, the U.S. and E.U. governments are taking steps to implement a broad extension of regulatory power to a wide range of private investment fund managers that previously operated globally subject to limited or no direct regulation.

Pending U.S. Legislation

The Restoring American Financial Stability Act, passed by the Senate, requires any investment adviser, other than an investment adviser to a "private equity fund" or "venture capital fund," that has at least \$100 million of assets under management, to register with the SEC and requires these advisers to maintain extensive records and reports. On its face, the bill would require investment advisers to hedge funds to register with the SEC, although the bill leaves it to the SEC to define "private equity funds" and "venture capital funds." Similar to the House bill, investment advisers who are required to register will be subject to significantly increased reporting and disclosure obligations for each private fund they advise, including as to the amount of assets under management, use of leverage, counterparty credit risk exposures, trading and investment positions, trading practices, valuation policies and practices, asset-types held and side letter arrangements, along with other information the SEC deems necessary. Even exempt advisers will be required to maintain certain detailed records and reports. The bill also provides a limited exemption for certain "foreign private advisers" that have no place of business in the U.S., manage less than \$25 million attributable to U.S. clients and have fewer than 15 U.S. clients.

The bill incorporates the so-called "Volcker Rule," which prohibits U.S. and foreign banks operating in the U.S. from "sponsoring" or "investing in" private equity or hedge funds. The bill leaves it to federal banking regulators to issue regulations, subject to guidance from a newly established Financial Stability Oversight Council, to determine the meaning of "investing in"

private equity or hedge funds (as well as the precise scope of the funds that are covered), which will define the scope of the Volcker Rule. The House bill does not contain a similar provision.

The bill also requires the SEC to enact changes to Regulation D, one of the more widely used registration exemptions for private investment funds, to deny the exemption to any person subject to specified federal or state disciplinary orders based on securities or related violations. The SEC will have discretion in defining the universe of covered persons and in identifying disqualifying conduct but regardless of the scope of the rules, this provision will significantly increase the compliance burdens on private investment funds.

Pending E.U. Legislation

The E.U. Directive on Alternative Investment Fund Managers, which moved from committee to full European Parliament consideration, would prevent non-E.U. fund managers from marketing their private investment funds to E.U. investors, unless they are located in countries with an equivalent regulatory framework to that established by the Directive. Fund managers would be required to have risk management policies, meet minimum capital requirements, abide by certain compensation policies and provide detailed information to both regulators and investors, with additional disclosures for highly leveraged funds. The current U.S. system would not meet the proposed E.U. requirements; thus, the Directive effectively would prohibit U.S.-based fund managers from raising capital in Europe without a local organization regulated by the E.U. It remains to be seen whether the Restoring American Financial Stability Act will spur the European Parliament to relax such requirements for U.S.- based private investment funds.

* * *

While the Senate bill must now be reconciled with the House bill adopted last year, and the E.U. Directive must continue to make its way through the European Parliament, it is clear that regulation is coming and that private investment fund managers who operate in these jurisdictions will need significantly expanded compliance programs to meet the requirements of a new regulatory environment.