

Financial Regulatory Reform Proposal: Hedge Funds, Private Equity Funds, Venture Capital Firms May Be Required to Register with SEC

June 29, 2009

On June 17, the Obama administration released its recommendations to reform the financial regulatory system: *Financial Regulatory Reform—A New Foundation: Rebuilding Financial Supervision and Regulation*. The recommendations provide a blueprint for the administration’s sweeping reform of the federal regulation and supervision of the financial system.

One of the primary components of this reform is to “implement heightened consolidated supervision and regulation of large, interconnected financial firms.” Of particular relevance to hedge funds, private equity funds, and venture capital firms is the proposal that “all advisers to hedge funds (and other private pools of capital, including private equity funds and venture capital funds) whose assets under management exceed some modest threshold amount should be required to register with the SEC under the Investment Advisers Act.” Although the administration’s proposal does not quantify what is meant by “a modest threshold,” its language is similar to that of a bill introduced in the Senate on June 16, 2009, by Senator Jack Reed, chairman of the Senate Banking Committee’s Subcommittee on Securities, Insurance, and Investment, which proposes a \$30 million threshold for SEC registration, with smaller funds being subject to state regulation.

The administration’s rationale for the need for SEC registration is twofold. In the first instance, the proposal cites the government’s need for “reliable, comprehensive data with which to assess” the market activity of private investment funds that may place undue strain on financial markets. Additionally, the administration states that “it has also become clear that there is a compelling investor protection rationale to fill the gaps in the regulation of investment advisors and the funds that they manage.” It is unclear at this point if there will be a call for general partners of private investment funds to register as broker-dealers as well.

The administration proposes that “the advisors should be required to report information on the funds they manage that is sufficient to assess whether any fund poses a threat to financial stability.” In addition to requiring SEC registration by advisors, the proposal also calls for the funds themselves to be subject to “recordkeeping requirements; requirements with respect to disclosure to investors, creditors, and counterparties; and regulatory reporting requirements.” Under the administration’s plan, funds would also be required to report on a confidential basis to the SEC “the amount of assets under management, borrowings, off-balance-sheet exposures, and other information necessary to assess whether the fund or fund family is so large, highly leveraged, or interconnected that it poses a threat to financial stability.”

The SEC, in turn, would be required to report this information to the Federal Reserve, which would “determine whether any of the funds or family of funds meets the Tier 1 FHC criteria,” and thereby be “supervised and regulated as Tier 1 FHCs.

Although the administration’s initial recommendations on these issues will become more specific over time, it is clear that the administration is seeking to impose a new regulatory regime upon private investment funds that may prove costly, while increasing the potential liability of the managers and advisors of these funds, and imposing a new administrative burden on the managers of these funds. If, indeed, the “modest threshold” for regulation is in line with the current Senate proposal of \$30 million, the operations of many funds may be altered significantly. As the administration’s policy in this area comes into sharper focus, it will be important for fund managers, sponsors, and advisors to comment on proposed regulation in a timely manner.

Morgan Lewis will be following the administration’s policy statements regarding its proposals on regulation of hedge funds and other private pools of capital and the proposed regulations. We will also continue to report on any proposed legislation reflecting the administration’s proposal, so as to keep our clients informed on these issues as they develop.

The recommendations are available online at http://www.financialstability.gov/docs/regs/FinalReport_web.pdf.

For further information about the information contained in this LawFlash, please contact any of the following Morgan Lewis attorneys:

Philadelphia

Michael N. Peterson 215.963.5026 mpeterson@morganlewis.com

New York

Jedd H. Wider 212.309.6605 jwider@morganlewis.com

Washington, D.C.

Kathleen W. Collins 202.739.5642 kcollins@morganlewis.com
Steven W. Stone 202.739.5453 sstone@morganlewis.com

About Morgan, Lewis & Bockius LLP

Morgan Lewis is an international law firm with more than 1,400 lawyers in 22 offices located in Beijing, Boston, Brussels, Chicago, Dallas, Frankfurt, Harrisburg, Houston, Irvine, London, Los Angeles, Miami, Minneapolis, New York, Palo Alto, Paris, Philadelphia, Pittsburgh, Princeton, San Francisco, Tokyo, and Washington, D.C. For more information about Morgan Lewis, please visit www.morganlewis.com.

This LawFlash is provided as a general informational service to clients and friends of Morgan, Lewis & Bockius LLP. It should not be construed as, and does not constitute, legal advice on any specific matter, nor does this message create an attorney-client relationship. These materials may be considered Attorney Advertising in some states. Please note that the prior results discussed in the material do not guarantee similar outcomes.

© 2009 Morgan, Lewis & Bockius LLP. All Rights Reserved.

