

Floor Amendments to House Legislation Clarify Small Fund Adviser Exception and Increase Protection of Proprietary Information

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Amendments to the Wall Street Reform and Consumer Protection Act of 2009, which were made during recent consideration and debate on the floor of the U.S. House of Representatives (the House), clarify the proposed exemption from registration with the Securities and Exchange Commission (SEC) available to advisers to small private funds.

Background

On December 11, 2009 the House passed the Wall Street Reform and Consumer Protection Act of 2009, which included the Private Fund Investment Advisers Registration Act of 2009 (the Proposal).¹ Under the Proposal, investment advisers of private funds must register with the SEC unless they qualify for an exemption. The Proposal broadly defines “private fund” as any issuer that would be an investment company under the Investment Company Act of 1940, as amended, but for the exclusions from the definition of “investment company” under Sections 3(c)(1) or 3(c)(7) contained therein.

Clarification of Exemption for Advisers to Small Private Funds

Currently, Section 203(b)(3) of the Investment Advisers Act of 1940, as amended (Adviser Act), exempts from registration advisers with fewer than 15 clients during the prior 12-month period, subject to certain other requirements. The version of the Proposal introduced to the House eliminated this 15-client exemption, but provided an exemption from registration under the Advisers Act for advisers to private funds, so long as each private fund advised by such adviser has less than \$150 million in U.S. assets under management.

¹ See The Wall Street Reform and Consumer Protection Act of 2009, H.R. 4173, 11th Cong. (1st Sess.), Title V, Subtitle A, §§ 5001–5011 (as passed by House of Representatives, Dec. 11, 2009), available at http://financialservices.house.gov/Key_Issues/Financial_Regulatory_Reform/FinancialRegulatoryReform/111_hr_finsrv_4173_full.pdf (Note: the publicly available version of The Wall Street Reform and Consumer Protection Act of 2009 does not reflect amendments made by the House during floor debate and consideration). Morgan Lewis’s prior Alerts on this and similar proposed legislation can be viewed at http://www.morganlewis.com/pubs/IMFYI_USTreasuryLegislation_17jul09.pdf and http://www.morganlewis.com/pubs/IM-PIFLF_HouseLegislationToRequireAdvisersToRegisterWithSEC_7jan10.pdf.

The terms of the exception included in the first version of the Proposal were somewhat surprising, as the Proposal did not indicate any limit on the number of such small private funds or the number of investors in any such fund that an adviser may provide advisory services to and still qualify for the exemption. Thus, by way of example, an adviser to 100 small private funds with aggregate assets under management of \$1 billion would have been exempt from registration requirements under the Advisers Act, according to the terms of the Proposal as introduced to the House, so long as each fund was no larger than \$150 million.

Several amendments were made to the Proposal during consideration and debate on the floor of the House,² including a clarification of the exemption from registration requirements for advisers to small private funds. As amended and passed by the House, the Proposal would add Section 203(m) to the Advisers Act, which would exempt an adviser to private funds from registration requirements so long as such adviser “acts solely as an adviser to private funds and has assets under management in the United States of less than \$150,000,000.”

Thus, as amended, an adviser must have, in the aggregate, less than \$150 million in U.S. assets under management and have only private fund clients in order to qualify for the exemption. Although the Proposal, as amended on the floor of the House, would seem to allow an adviser that is solely an adviser to private funds to qualify for the exemption, regardless of the amount of foreign assets it manages, such foreign assets would still be required to be in the form of “private funds.” Furthermore, advisers qualifying for the amended exemption from registration would still be subject to reporting requirements set forth elsewhere in the Proposal.

Protection of Proprietary Information

Other floor amendments to the Proposal enhance protection for any privilege attached to, and proprietary information contained within, the records and reports of private funds and their advisers provided to the SEC. Section 204(b)(8) of the Advisers Act, under the Proposal, clarifies that private fund advisers and private funds that provide records and reports to the SEC in accordance with other provisions of the Proposal shall not be compelled to waive or be deemed to have waived privileges otherwise attached to data or information contained in such records and reports.

Furthermore, Section 204(b)(9) of the Advisers Act, as amended by the Proposal, clarifies that reports and records received from private fund advisers shall be subject to the same public disclosure limitations as information obtained during an SEC examination, and that private funds shall not be compelled to disclose proprietary information to counterparties or creditors, including investing or trading strategies, analytical or research methodologies, trading data, and computer hardware or software containing intellectual property.

These amendments reflect an attempt to balance the perceived need for increased regulatory oversight with the preservation of private funds’ and private fund advisers’ legal and business interests.

² See 155 CONG. REC. H14,660, H14,666 (daily ed. Dec. 10, 2009) (Amendment No. 1, offered by Rep. Barney Frank of Massachusetts); 155 CONG. REC. H14,736 (daily ed. Dec. 10, 2009) (Amendment No. 25, offered by Rep. Stephanie Sandlin of S. Dakota as part of en banc amendments presented by Rep. Barney Frank of Massachusetts); see also 155 CONG. REC. DAILY DIGEST D1443 (Dec. 10, 2009) (summarizing Chamber Action regarding Wall Street Reform and Consumer Protection Act of 2009); 155 CONG. REC. DAILY DIGEST D1451 (Dec. 11, 2009) (same).

Further Questions

Morgan Lewis will continue to monitor the ongoing legislative process surrounding the registration of private fund advisers. If you have any questions concerning the information discussed in this LawFlash, please contact any of the following Morgan Lewis attorneys:

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