

Client Alert

A report
for clients
and friends
of the Firm February 2009

New Senate Proposal To Regulate Hedge Funds and Private Equity Funds

Senators Carl Levin and Charles Grassley introduced a bill on January 29, 2009, that would require all hedge and private equity funds with at least \$50,000,000 of assets under management to register with the Securities and Exchange Commission (the "SEC") and establish anti-money laundering programs.

Hedge funds and other private investment funds (such as venture capital funds, private equity funds and "funds of funds") rely on exceptions to the definition of "investment company" to avoid registration under the Investment Company Act of 1940. These private investment funds generally rely on Sections 3(c)(1) and 3(c)(7) in order to avoid registration. Section 3(c)(1) generally provides for an exemption from registration of any fund whose outstanding interests are beneficially owned by not more than 100 persons. Section 3(c)(7) provides an exemption for any fund whose outstanding interests are owned exclusively by "qualified purchasers" (generally defined to be persons owning at least \$5 million in investable assets or entities with \$25 million in investable assets, in each case measured at the time of investment in the fund).

The bill deletes Sections 3(c)(1) and 3(c)(7) and re-categorizes the exemptions in Sections 3(c)(1) and 3(c)(7) as exemptions in new Sections 6(a)(6) and 6(a)(7). The bill then adds additional requirements on the new exemptions for certain large investment funds (assets under management of not less than \$50,000,000). Those requirements include:

- Registering with the SEC as an investment company;
- Filing at least every 12 months an "information form" with the SEC;
- Cooperating with requests for information by the SEC; and
- Maintaining books and records as the SEC may require.

The publicly available information form would include:

- The name and current address of: each beneficial owner of the fund, any company with an ownership interest in the fund, and the primary accountant and primary broker used by the fund;
- An explanation of the structure of ownership interests in the fund;
- Information on any affiliation the fund has with another financial institution;
- A statement of any minimum investment commitment required of a limited partner, member, or other investor;
- The total number of any limited partners, members, or other investors; and
- The current value of the assets of the fund.

The bill further (i) requires investment companies otherwise exempt pursuant to Sections 6(a)(6) or 6(a)(7) to establish anti-money laundering programs; (ii) requires the SEC to issue forms and guidance to carry out the Act within 180 days after enactment; and (iii) authorizes the SEC to make rules to carry out the Act.

As currently drafted, the bill leaves important questions unanswered, including whether an adviser to a fund needs to register under the Investment Advisers Act and whether a fund of funds will be subject to the limitations in the Investment Company Act on investing in other investment companies (currently, a registered investment company is generally precluded from investing more than 10% of its

assets in other investment companies). In addition, despite the name of the bill, there is no attempt to distinguish hedge funds from other private investment funds, as was the case with prior SEC regulations. This bill has been referred to the Senate Banking Committee. It is impossible to predict if this bill or any similar bill will be enacted. We will monitor the bill as it progresses.

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Proskauer's Private Investment Funds Group comprises more than 100 lawyers and advises clients worldwide on all of the legal and business issues important to private equity and hedge funds and their managers, including structuring investment vehicles of all types, portfolio company investments, institutional investor representation and secondary purchases and sales.

For more information, please contact:

New York

Christopher M. Wells
212.969.3600 – cwells@proskauer.com

Ira G. Bogner
212.969.3947 – ibogner@proskauer.com

Timothy M. Clark
212.969.3960 – tclark@proskauer.com

Stephen A. Devaney
212.969.3262 – sdevaney@proskauer.com

Bruce L. Lieb
212.969.3320 – blieb@proskauer.com

Amanda H. Nussbaum
212.969.3642 – anussbaum@proskauer.com

Charles H. Parsons
212.969.3254 – cparsons@proskauer.com

Marc A. Persily
212.969.3403 – mpersily@proskauer.com

London

Matthew D.J. Hudson
44.20.7016.3601 – mhudson@proskauer.com

Mary B. Kuusisto
44.20.7016.3611 – mkuusisto@proskauer.com

William Yonge
44.20.7016.3680 – wyonge@proskauer.com

Paris

Olivier Dumas
33.1.53.05.69.17 – odumas@proskauer.com

Daniel Schmidt
33.1.53.05.68.30 – dschmidt@proskauer.com

Boston

Robin A. Painter
617.526.9790 – rpainter@proskauer.com

David W. Tegeler
617.526.9795 – dtegeler@proskauer.com

Laurier W. Beaupre
617.526.9759 – lbeaupre@proskauer.com

Howard J. Beber
617.526.9754 – hbeber@proskauer.com

Daniel P. Finkelman
617.526.9755 – dfinkelman@proskauer.com

Sean J. Hill
617.526.9805 – shill@proskauer.com

David T. Jones
617.526.9751 – djones@proskauer.com

Scott S. Jones
617.526.9772 – sjones@proskauer.com

Arnold P. May
617.526.9757 – amay@proskauer.com

Stephen T. Mears
617.526.9775 – smears@proskauer.com

Malcolm B. Nicholls III
617.526.9787 – mnicholls@proskauer.com

Jamie E. Poindexter
617.526.9773 – jpoindexter@proskauer.com

Hong Kong

Joseph Cha
852.3410.8033 – jcha@proskauer.com

Ying Li
852.3410.8088 – yli@proskauer.com

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