

Senate Passes The Restoring American Financial Stability Act

May 21, 2010

THE FOLEY ADVISER - MAY 21, 2010

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On May 20, 2010, the U.S. Senate (the "Senate") voted 59-39 to approve the [Restoring American Financial Stability Act of 2010](#) (the "Senate Bill"). The Senate Bill would require most advisers to private funds (including advisers to hedge funds but not advisers to "venture capital funds" and "private equity funds" as defined by the SEC) to register as investment advisers with the Securities and Exchange Commission (the "SEC" or the "Commission") under the Investment Advisers Act of 1940, as amended. The Senate Bill would also impose various recordkeeping and disclosure requirements on private fund managers.

Registration of Investment Advisers to Private Funds

The Senate Bill, as approved, sets a lower AUM threshold at which registration is required for investment advisers to hedge funds than the corresponding registration proposal set out in the Wall Street Reform and Consumer Protection Act of 2009 passed by the U.S. House of Representatives on December 11, 2009 (the "House Bill"). The Senate Bill sets the threshold at \$100 million in managed assets, rather than the \$150 million threshold in the House Bill.

The Senate Bill defines a private fund as any fund that relies on a 3(c)(1) or 3(c)(7) exemption under the Investment Company Act of 1940. The Senate Bill eliminates the private adviser exemption which enables investment advisers with fewer than 15 clients to avoid registration with the SEC. However, the Senate Bill does provide an exemption for foreign private fund advisers. A foreign private fund adviser is defined as an adviser that (i) has no place of business in the United States, (ii) has, in total, fewer than 15 clients who are domiciled in or residents of the United States, (iii) has aggregate assets under management attributable to clients in the United States and investors from the United States which are invested in private funds advised by the adviser of less than \$25,000,000 or such higher amount as the SEC may deem appropriate, and (iv) does not hold itself out generally to the public in the United States as an investment adviser. It is not clear how the term "client" will be interpreted for purposes of this exemption.

In addition, as noted the Senate Bill provides an exemption for advisers to venture capital funds from registration. Advisers to private equity funds are also exempt from registration, however, private equity advisers are required to maintain records relating to fund size, governance, investment strategy, risk and other factors as determined by the SEC. The terms "private equity fund" and "venture capital fund" are to be defined by the SEC.

Reports and Records

The Senate Bill requires certain records and reports to be maintained by an adviser to a hedge fund, which will be subject to inspection by the SEC. These records and reports include:

- (i) AUM and use of leverage;
- (ii) counterparty credit risk exposure;
- (iii) trading and investment positions;
- (iv) valuation policies and practices of the fund;
- (v) types of assets held;
- (vi) side arrangements or side letters;
- (vii) trading practices; and
- (viii) such other information that the Commission determines is necessary.

This information will be shared with the Financial Stability Oversight Council for systemic risk. The public disclosure of proprietary information will be subject to limitations.

Rulemaking Authority

The Senate Bill also grants the SEC rulemaking authority to make, issue, amend and rescind rules, including rules and regulations defining technical, trade and other terms, except that the Commission may not define "client" to include an investor in a private fund managed by an investment adviser, if such private fund has entered into an advisory contract with such adviser.

Accredited Investor Standard

The Senate Bill revises the accredited investor standard for a natural person by eliminating the \$200,000 (or \$300,000 for a couple) income test. In addition, the individual net worth of a natural person, or joint net worth with the spouse of that person, at the time of investment should be \$1,000,000, excluding the value of the primary residence of such natural person, to qualify as an accredited investor. This is a material change from the current accredited investor standard which includes the primary residence in the net worth calculation. In addition, the Commission at least every 4 years will review whether the accredited investor standard should be adjusted.

The Senate Bill will now proceed to conference committee to merge with the House Bill. Compromises are expected but the provisions affecting investment advisers to private funds are not expected to be materially revised. Foley Hoag will monitor the progress of the Senate Bill and provide regular updates.

Investment advisers or Managers with questions about either of these proposals should contact [Peter Rosenblum](#) or [Jeffrey Collins](#) in Foley Hoag's [Investment Management Group](#) at 617 832 1000.