KIRKLAND & ELLIS Alert

Venture Capital/Private Equity
Investment Management **May 2003**

Anti-Money Laundering, Privacy Safeguards and Proxy Voting Developments

This Alert is to inform you of the following recent developments and upcoming deadlines affecting private fund managers:

- Treasury has issued *proposed* regulations which, if adopted, would require any investment adviser, including a private fund general partner or manager, to (1) adopt a formal anti-money laundering program, and (2) make an initial and annual notice filing with Treasury unless the adviser is already registered with the Securities and Exchange Commission ("SEC").

- By May 23, 2003, any investment adviser not registered with the SEC must comply with Federal Trade Commission ("FTC") privacy safeguarding rules by (1) adopting written privacy safeguards to ensure the security, confidentiality and integrity of non-public individual investor or customer information, and (2) ensuring any service provider contract obligates the provider to safeguard any non-public individual investor or customer information.

- By August 6, 2003, any investment adviser registered with the SEC must adopt a formal proxy voting policy and disclose its policy to advisory clients.

Treasury Issues Proposed Anti-Money Laundering Regulations

On April 29, 2003, Treasury issued *proposed* regulations, which, if adopted, would require any investment adviser to adopt a formal anti-money laundering program and, in certain cases, make an initial and annual notice filing with Treasury's Financial Crimes Enforcement Network ("FinCEN"). Investment advisers covered under the proposed regulations include (1) SEC registered investment advisers, and (2) any investment adviser, including a private fund general partner or investment manager, with at least $30 million under management using the fewer-than-fifteen client exemption from SEC investment adviser registration. Any non-U.S. investment adviser (i.e., an investment adviser with its principal office and place of business outside the United States) would not be covered under the proposed regulations.

The proposed regulations reflect a change in policy from September 2002 when Treasury issued regulations that would have exempted most private funds (other than hedge funds) from anti-money laundering program requirements.

Under the proposed regulations, an investment adviser would be required to adopt a formal anti-money laundering program, such as our model AML Program previously distributed to clients, including:

- policies, procedures and internal controls designed to prevent the investment adviser from being used to assist money laundering or financing terrorist activities;

- independent testing of the program;

- compliance officer(s) to oversee the program; and

- ongoing training for employees.

Additionally, investment advisers would be required to file an initial one-page notice with FinCEN, which must be updated annually, that includes basic information such as the adviser's name and address, number of clients and assets under management. This notice filing would *not* be required for SEC registered investment advisers.

The proposed regulations delegate enforcement authority to the SEC for investment adviser anti-money laundering compliance.

May 23, 2003 Deadline Nears for Compliance with FTC Privacy Safeguards Program

As discussed in our May 2002 Alert, investment advisers that are *not* SEC registered must, under FTC privacy rules, adopt a formal safeguarding program to protect the privacy of non-public individual investor or customer information by May 23, 2003.[1] This safeguards program requirement is independent of the obligation to deliver privacy statement notices. Under the rules, a covered investment adviser must:

- designate compliance coordinators;
- assess privacy risks to non-public individual investor or customer information;
- implement safeguards to control identified risks and regularly test effectiveness of safeguards;
- use measures, such as contractual provisions, to ensure service providers with access to non-public individual investor or customer information maintain appropriate privacy safeguards for such information; and
- periodically evaluate and adjust the program.

In addition, service provider contracts currently in effect or entered into after May 23, 2003 must obligate the service provider to safeguard non-public individual investor or customer information.[2] Under FTC rules, a service provider is any person or entity that possesses or otherwise has access to individual investor or customer information through its services to an investment adviser.

SEC Registered Investment Advisers Must Adopt Formal Proxy Voting Policy

The SEC recently adopted new rules requiring formal proxy voting policies for SEC registered investment advisers with voting authority over client (e.g., private fund or separate account) portfolio securities. These new rules will require, by August 6, 2003, each SEC registered investment adviser to:

- adopt written proxy voting policies and procedures designed to ensure the adviser votes proxies in the best interests of its clients, including policies addressing material conflicts between the interests of the investment adviser and its clients;
- disclose to clients the adviser's proxy voting policy and provide a copy to clients upon request; and
- disclose how clients may obtain voting information from the adviser for the client's securities.

The rules also require SEC registered investment advisers to keep certain records relating to proxy voting policies, including the proxy voting policy, a record of all votes cast, and client communications related to proxy voting.

Questions

Should you have any questions about this Alert, please contact any of the K&E attorneys identified in this Alert or the K&E partner or associate with whom you maintain a client relationship. .

[1] SEC registered advisers have been subject to Regulation S-P since 2001 requiring less onerous "policies and procedures" to safeguard individual customer information.

[2] Under the transition rules, contracts entered into before June 24, 2002 need not comply with this requirement until May 24, 2004.

Fund Formation

Chicago

Bruce I. Ettelson, P.C.
(312/861-2326)
Jack S. Levin, P.C.
(312/861-2004)
Kevin R. Evanich, P.C.
(312/861-2076)
Edward T. Swan, P.C.
(312/861-2465)
Margaret A. Gibson, P.C.
(312/861-2223)

New York

Frederick Tanne
(212/446-4831)
Elizabeth P. Gottschalk
(212/446-4685)

London

Stuart L. Mills
(+44 (0)20 7816 8750)
James L. Learner, P.C.
(+44 (0)20 7816 8728)

Washington, D.C.

Michael T. Edsall
(202/879-5028)

San Francisco

Jeffrey C. Hammes, P.C.
(415/439-1450)

Investment Management

Chicago

Scott A. Moehrke
(312/861-2199)