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KIRKLANDPEN

Private Equity Newsletter

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Financial Services Reform for Private Fund Advisers—Where are We?

PENpoints

Several proposed elements of the Private Fund Investment Advisers Registration Act of 2009 could have a significant impact on private funds and their managers.

After initial progress in the U.S. House of Representatives, the momentum behind the Private Fund Investment Advisers Registration Act of 2009 (the "House Bill") appeared to have slowed, with the Senate path less defined. However, with health care legislation loosening its grip on Congressional resources, financial services reform appears to be regaining momentum. In addition, the Obama administration recently put forth a proposal to limit banks' ability to trade through proprietary accounts, hedge funds or private equity funds, and to push forward additional legislation covering financial institutions, private funds and their advisers.

SEC Registration of Private Fund Managers - House Bill

The House Bill was approved at the end of 2009. Although a companion bill must be passed by the U.S. Senate before the House Bill becomes law, several elements of the House Bill as proposed could have a significant impact on private funds and their managers.

As anticipated, the House Bill would eliminate the existing exemption from investment adviser registration for advisers with fewer than 15 clients. Without such an exemption, nearly every manager of private funds, including hedge funds, buyout funds and real estate funds, would be required to register with the Securities and Exchange Commission ("SEC") as an investment adviser if it meets the relatively low $30 million assets-under-management threshold.

However, the House Bill would create a new registration exemption for so-called "mid-sized" private fund advisers if (1) each of the adviser's private funds has assets under management of less than $150 million and (2) the adviser solely manages private funds—3(c)(1) or 3(c)(7) funds—and not an employee securities company or managed separate accounts. The SEC would be authorized (1) to establish recordkeeping and reporting obligations for mid-sized private fund advisers if the SEC determines it is in the public interest or necessary to protect investors, and (2) to provide for registration and examination procedures reflecting the level of systemic risk posed by private funds advised by such advisers.

The House Bill also contains a new exemption for "venture capital fund" advisers, a term to be defined by the SEC, and for advisers to small business investment companies. As with mid-sized private fund advisers, the House Bill would authorize the SEC to establish recordkeeping and reporting obligations for venture capital fund advisers if the SEC determines it is in the public interest or necessary to protect investors.

The House Bill also introduces a new exemption from registration for "foreign private fund advisers," defined as any investment adviser with (1) no place of business in the U.S.; (2) fewer than 15 clients and investors in the U.S. in its private funds; (3) assets under management of less than $25 million that are attributable to clients and investors in the U.S. in its private funds, and (4) no clients that are registered investment companies or business development companies.

Registered Investment Adviser Compliance

An SEC-registered investment adviser ("RIA") would be subject:

- as under current law, to recordkeeping and disclosure requirements, regular periodic compliance examinations and a prohibition on receipt of carried interest (or other performance-based compensation), except from a Section 3(c)(7) QP fund, a BDC, a non-U.S. person or a "qualified" LP in a Section 3(c)(1) fund (generally a person with $750,000 or more in assets managed by the RIA or

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a net worth of more than $1.5 million, although the House Bill would adjust such amounts for inflation beginning in 2010);[1]

- to new confidential reports for private funds advised by the RIA, including information regarding assets under management, use of leverage (including off-balance-sheet leverage), counterparty credit risk exposures, trading and investment positions, trading practices and other information that the SEC, in conjunction with the Federal Reserve, may deem necessary or appropriate to assess the private fund's systemic risk; and
- to new disclosure requirements prescribed by the SEC, under which the RIA would disclose to investors, prospective investors, counterparties and creditors of the RIA's private funds information that the SEC deems necessary or appropriate in the public interest and for the protection of investors or for the assessment of systemic risk; however, the House Bill would prohibit the SEC from requiring an RIA's private fund to disclose to counterparties and creditors any private information, including sensitive, non-public information regarding investment or trading strategies, analytical or research methodologies, trading data or computer hardware or software containing intellectual property.

Establishment of Financial Services Oversight Council

The House Bill would also establish a Financial Services Oversight Council (the "Council")[2] to monitor systemic risk, coordinate financial regulation and, in consultation with the Federal Reserve, determine whether the failure of a financial company could pose a threat to overall financial stability due to, among other things, its nature, scope, size, scale, concentration, leverage or "interconnectedness" to other firms.

In addition to its power to mandate tougher regulations, the Council could require any financial company to (1) submit periodic and other reports and (2) adhere to stricter prudential standards, if the Council determines that the company could pose a threat to financial stability or the economy as a whole. Such stricter prudential standards could include risk-based capital requirements, leverage limits, liquidity requirements, concentration limits and short-term debt limits. The Council's power in such cases could extend to private fund managers and even to private funds themselves, but is more likely to apply to hedge fund managers, as it is less likely that even large private equity fund sponsors could pose systemic risk.

Obama Administration's Proposed Limitations on Investment of Bank Capital

On January 21, the Obama administration announced proposals designed to restrict the size and scope of financial institutions. This plan would limit the ability of banks and financial institutions to own, invest in or sponsor a hedge fund, private equity fund or proprietary trading operation. Although the announcement lacked detail, any limitation on bank ownership of or investment in private funds could result in significant changes to the management, operations and fundraising procedures of private funds. For example, such restrictions could reduce the resources, including seed capital and marquee-level commitments, available to private fund advisers, making the fundraising and other startup processes more difficult. Additionally, if enacted, the proposals could de-centralize investment within the industry by encouraging banks to spin off their private funds and proprietary trading desks. Further clarification of the Obama proposals is expected in connection with the Senate's financial services reform legislation, although early responses from the Senate indicate some opposition to the proposals in the name of achieving bipartisan support for financial services reform.

Effective Date

The Council would be formed immediately after the House Bill's enactment; however, the requirement that private funds' advisers register with the SEC would not become effective until one year after enactment.

The Senate seems ready to push forward with financial services reform, but with some uncertainty over the legislation's scope. The initial draft legislation, Senator Dodd's Restoring American Financial Stability Act of 2009, contains an exemption from investment adviser registration for private equity fund managers, but the Dodd bill was criticized by key senators and seems likely to be amended in many aspects. Initial statements by the President in his January 27 State of the Union address and in connection with the January 21 announcement indicate an intention to prioritize the enactment of financial institution regulatory reform legislation in a form similar to the House Bill.

Recent Proposals in E.U. Regulation

The E.U. Commission's proposed Alternative Investment Fund Managers Directive continues to be of concern to U.S. private fund managers who market private fund interests to E.U. investors, although recent developments are encouraging. Under the orig-

inal April 2009 proposal, U.S. private fund managers would have, in all likelihood, been unable to market their funds to investors in the European Union. After several rounds of reviews and counter-proposals, it now seems that existing national private placement regimes will be retained in some form. This would allow U.S.-based private fund managers to continue to market to institutional, but not retail, investors in the European Union, although some have suggested that those managers who do so should be subject to certain compliance obligations, such as transparency and disclosure requirements. The proposals remain in a state of flux, with further negotiations and discussions to take place over the coming months.

It originally appeared that the Directive would be finalized in July 2010, although this now appears somewhat optimistic. It is likely that there will be an implementation period of 18 to 24 months after the legislation is passed, such that new rules would not be effective before 2012.

1 Current Investment Advisers Act regulations are discussed in detail in a previous *Kirkland Brief*.

2 The Council would be composed of the secretary of the Treasury, the chair of the Board of Governors of the Federal Reserve System, the comptroller of the Currency, the director of the Office of Thrift Supervision, the chair of the SEC, the chair of the CFTC, the chair of the FDIC, the director of the Federal Housing Finance Agency and the chair of the National Credit Union Administration. A state insurance commissioner and a state banking supervisor would also serve in a nonvoting, advisory capacity.

If you have any questions about the matters addressed in this *KirklandPEN,* please contact the following Kirkland authors or your regular Kirkland contact.

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U.S. Department of Justice Fines Firms $900,000 for Illegal HSR "Gun Jumping"

PENpoints

The government brings gun-jumping cases to send a message that competitors must act like competitors until their deal closes, and that HSR waiting periods must be taken seriously.

Smithfield Foods and its subsidiary, Premium Standard Farms, recently agreed to pay fines of $900,000 to settle charges, brought by the U.S. Department of Justice, of illegal "gun-jumping" in connection with Smithfield's 2007 acquisition of Premium. Before the parties received Hart Scott Rodino antitrust clearance, Premium allegedly sought Smithfield's consent to enter into three contracts to purchase hogs from an independent producer, providing Smithfield with the contract terms, including price, quantity and duration. The DOJ claimed that Smithfield used the contract approval process to exercise operational control, and thereby acquire beneficial ownership, of Premium before obtaining HSR approval.

Gun-jumping rules are not limited to direct competitors: they can be triggered by improper coordination before HSR clearance even in deals raising no antitrust concerns. Although the *Smithfield* case involved direct competitors in agri-business—a high-priority focus of the DOJ Antitrust Division—the government brings gun-jumping cases to send a message that competitors must act like competitors until their deal closes, and that HSR waiting periods must be taken seriously.

Gun-jumping violations can carry a stiff penalty. Each merging party can be fined $16,000 per day for an HSR Act violation occurring after February 10, 2009 ($11,000 per day for pre-February 10, 2009 violations). The meter starts when the buyer exercises beneficial ownership, which can occur before the companies file their HSR notifications, and continues until the HSR waiting period expires.

To learn more about the *Smithfield* case, and practical suggestions for avoiding gun-jumping, see our recent *Kirkland Alert.*

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The 2010 Private Equity and Venture Capital Conference at Northwestern University's Kellogg School of Management
Chicago, Illinois
February 10, 2010

The 2010 Kellogg School of Management's Private Equity and Venture Capital conference will provide a forum for discussing the opportunities and challenges that are currently reshaping the private equity and venture capital industries. Kirkland partner Sanford Perl will participate in a panel discussion on "Evolving Strategies for Capital Appreciation."

Kirkland & Ellis International LLP's Private Fund Manager U.S. Investment Adviser Registration Seminar
London, United Kingdom
February 11, 2010

This Kirkland seminar will discuss proposed U.S. legislation that is likely to require European (and other non-U.S.) fund managers to register with the U.S. Securities and Exchange Commission beginning in 2011. Join Kirkland partners Scott Moehrke, Lisa Cawley and Richard Watkins as they discuss what SEC registration and supervision entails. This event will be held in Kirkland's London office.

The 16th Annual Harvard Business School 2010 Venture Capital and Private Equity Conference
Boston, Massachusetts
February 13, 2010

The 16th Annual Harvard Business School 2010 Venture Capital & Private Equity Conference aims to address issues and trends relevant to venture capitalists, private equity investors, entrepreneurs and those who support the venture capital and private equity communities. Kirkland partners Kirk Radke and Andrew Wright are scheduled to moderate the "Investing in the New World" and "Fundraising Corner" panels, respectively.

Beecken Petty O'Keefe & Company Private Equity Conference
Chicago, Illinois
February 19, 2010

This event, hosted by the University of Chicago's Booth School of Business, is designed to give students and friends of the school an opportunity to hear from professionals and alumni in the private equity industry. Kirkland partner Bruce Gelman will moderate a panel on "Infrastructure Investing."

GoldenNetworking.com's Distressed Investing Leaders Forum 2010
New York, New York
February 26, 2010

At GoldenNetworking.com's Distressed Investing Leaders Forum, panelists will evaluate the current distressed investing landscape, review recent regulatory developments promoting the role of private investors in the disposal of financial assets from the FDIC, and discuss opportunities and pitfalls in distressed financial assets. Kirkland partner Edwin del Hierro will speak on "Opportunities and Pitfalls in Distressed Financial Assets" and partner Jonathan Henes will present on "Extraordinary Opportunities Investors Cannot Afford to Pass," at this event, which will be held in Kirkland's New York office.

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Private Equity Practice at Kirkland & Ellis

Kirkland & Ellis LLP's nearly 400 private equity attorneys handle leveraged buyouts, growth equity transactions, recapitalizations, going-private transactions and the formation of private equity, venture capital and hedge funds on behalf of more than 200 private equity firms around the world.

Kirkland has been widely recognized for its preeminent private equity practice. In 2009, Kirkland received the awards for Best Law Firm (Private Equity Deals) and Best Law Firm (Fund Formation) in North America from *Private Equity International*. Mergermarket has ranked Kirkland first by volume for Global and North American Buyouts in its "Global M&A Round-Up for Year End 2008," and Pitchbook named Kirkland as one of the most active law firms representing private equity firms in its "Private Equity Breakdown" for 2009.

In 2009, for the second year in a row, *The Lawyer* magazine recently recognized Kirkland as one of the "The Transatlantic Elite," noting that the firm is "leading the transatlantic market for the provision of top-end transactional services ... on the basis of a stellar client base, regular roles on top deals, market-leading finances and the cream of the legal market talent." In addition, Kirkland's London office was named the 2008 "Banking Team of the Year" at the Dow Jones *Private Equity News* Awards for Excellence in Advisory Services.

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