

## Update on Financial Services Reform for Private Fund Managers

### PENpoints

*Financial services reform legislation proposed by Senator Dodd and approved by the Senate Banking Committee includes a potentially broadened exemption from federal investment adviser registration for private equity and venture capital fund managers.*

As widely reported in the financial press, the Senate Banking Committee recently approved financial services reform legislation proposed by Senator Dodd (the “Dodd Bill”), containing a number of significant differences from the House bill approved at the end of 2009 (the “House Bill”),<sup>1</sup> including a potentially broadened exemption from federal investment adviser registration for private equity and venture capital fund managers.

The Dodd Bill would eliminate the existing Investment Advisers Act exemption from registration for advisers with fewer than 15 clients. Without an exemption based on a limited number of clients, most managers of certain types of private funds (e.g., hedge funds) with \$100 million or more of assets under management (“AUM”) would be required to register with the Securities and Exchange Commission (“SEC”) as an investment adviser within a one-year transition period. However, the Dodd Bill would:

- Exempt from federal investment adviser registration a manager of “private equity funds” and “venture capital funds” (terms to be defined by the SEC within six months after the Dodd Bill’s passage, apparently without regard to the number of such funds advised by a manager).
- Exempt from federal investment adviser registration a “foreign private adviser” with: (1) no place of business in the United States; (2) fewer than 15 clients domiciled or resident in the United States; (3) AUM attributable to clients and investors in the United States less than \$25 million (or more if specified by the SEC); and (4) no client that is a registered investment company or business development company.
- Create new recordkeeping and confidential reporting obligations for private funds, such as hedge funds, advised by registered advisers, including: assets under management and use of leverage;

counterparty credit risk exposures; trading and investment positions; valuation policies and practices; types of assets held; side letter arrangements; trading practices; and other information that the SEC, in conjunction with a new Financial Stability Oversight Council, may deem necessary or appropriate to assess the private fund’s systemic risk. Private equity funds not advised by a registered adviser would be subject to reporting requirements as determined by the SEC within six months of the Dodd Bill’s passage.

- Raise the current AUM threshold of \$25 million for federal investment adviser registration to \$100 million. U.S. advisers with less than \$100 million AUM would be regulated by the states.
- Require the SEC to update (when the legislation becomes effective and every five years) for inflation longstanding “accredited investor” income and net worth standards for individual investors.
- Change Regulation D’s uniform state filing procedures for private offerings, potentially subjecting private funds to substantially greater state information and filing obligations.
- Require the GAO to complete a feasibility study within one year to determine whether a self-regulatory organization (“SRO”) should be created to oversee and regulate private funds, including private equity and venture capital funds.<sup>2</sup>

The Dodd Bill also includes the so-called “Volcker Rule,” previously announced by the Obama administration, which would restrict insured deposito-

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ry institutions, bank holding companies and their subsidiaries from engaging in proprietary trading, (i.e., trading for their own account), owning, sponsoring or investing in private funds, or entering into certain transactions or relationships (e.g., custodial or brokerage relationships) with private funds advised by such banks.

The scope of the final legislation remains uncertain. As with the House Bill, the Dodd Bill may change significantly during the amendment process, with approximately 400 amendments currently under consideration. Moreover, even if private equity and venture capital fund advisers are ultimately exempted from investment adviser registration, there could be renewed calls at the state level for registration of such advisers. In addition, ongoing uncertainty as to how narrowly the SEC would define terms such as “private equity fund” or “venture capital fund” leaves open the possibility that even advisers that might classify themselves as private equity or venture capital may not qualify for the new exemptions.

### **E.U. Alternative Investment Fund Managers (AIFM) Directive**

Numerous revised versions of the AIFM directive have been proposed over the last few weeks in an attempt to reach E.U. inter-governmental agreement. It was thought that E.U. finance ministers would vote on revised legislation at a recent meeting; however, the vote has been postponed until June, indicating significant political disagreement.

Depositary and valuation requirements are still sources of disagreement, but the agenda’s key issue is the treat-

ment of funds managed by non-E.U. fund managers, and by U.S. fund managers in particular. The most recent proposal would have allowed non-E.U. fund managers to continue marketing to institutional investors within the European Union under the private placement regime in each country, but on the condition that such firms comply with the directive’s new transparency and disclosure rules in the same way as an E.U.-based fund manager. These new requirements would include:

- producing a directive-compliant annual report for each fund with E.U. investors (primarily financial information and compensation disclosures);
- providing directive-compliant information to investors, which would require additional disclosures in PPMs;
- providing certain required information to the national regulator in each jurisdiction in which the fund is marketed; and
- providing disclosure and reporting requirements in relation to majority-owned European portfolio companies.

However, it is now clear that E.U. finance ministers have not reached agreement on this proposal and further changes are likely. In the meantime, the European Parliament continues to debate the directive, so the next key development is expected to be the publication of the Parliamentary Committee’s final report, expected in April. It is still anticipated that there will be a two-year implementation period after the directive is agreed at the E.U. level, so any new rules are highly unlikely to come into force before mid-2012.

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1 Discussed in a previous *Kirkland PEN*.

2 The SRO model is used for broker-dealers, with the Financial Industry Regulatory Authority (“FINRA”) providing day-to-day oversight and regulation.

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## PENbriefs

## Poison Pill Plumbing

The market has seen a recent uptick in the implementation of shareholder rights plans, or “poison pills,” including increased prevalence of so-called NOL pills designed to protect a company’s tax attributes that may be limited if there are certain ownership changes. While much has been written about the pros and cons of poison pills, it is important for boards and their advisers also to pay attention to the mechanical details of a pill, many of which will determine whether the outcome will match the board’s expectations. To learn more, please see our recent [M&A Update](#).

## EPA Provides Initial Roadmap for Greenhouse Gas Regulation Under the Clean Air Act

In a February 2010 letter to several Senators, the Environmental Protection Agency set forth its timeline for the implementation of regulations for greenhouse gas emissions, using the EPA’s existing authority under the Clean Air Act. While the February letter lacked specific details, it does provide a clear roadmap for the EPA’s plan and the timing for such regulations. To learn more, please see our recent [Kirkland Alert](#).

## PENnotes

**The University of Chicago’s 5th Annual Booth Distressed Investing and Restructuring Conference**  
Chicago, Illinois  
April 16, 2010

The 5th Annual Chicago Booth Distressed Investing and Restructuring Conference, presented by the University of Chicago’s Booth School of Business, will provide a broad overview of the state of the distressed investing and restructuring industry to professionals from around the country. Kirkland partner Jack S. Levin, P.C., will speak at this event and moderate a panel. Partners James H.M. Sprayregen, P.C., and Nicole L. Greenblatt will also participate as panelists.

**The 30th Annual Ray Garrett Jr. Corporate and Securities Law Institute**  
Chicago, Illinois  
April 29 - 30, 2010

The 30th Annual Ray Garrett Jr. Corporate and Securities Law Institute will take place from April 29 - April 30, 2010, in Chicago. More than 400 law firm and in-house attorneys will come together for a discussion of current issues including the capital markets today, financing and the return of the equity market, regulatory reform and the M&A market. Kirkland partner R. Scott Falk, P.C., will chair a session on “The Thawing of the M&A Market.”

**Kirkland & Ellis LLP’s Hedge Fund Networking Event: Market and Regulatory Trends Update**  
New York, New York  
May 11, 2010

Join Kirkland & Ellis, Houlihan Smith & Company and Rothstein Kass for a brief update on hedge fund market and regulatory trends in Kirkland’s New York office. Panel discussions will cover topics including proposed U.S. and E.U. regulation of hedge fund managers, pending tax legislation affecting hedge funds, current SEC examination and enforcement trends and accounting and valuation developments. Presenters will include Kirkland partners Scott A. Moehrke, P.C., Nabil Sabki, Robert H. Sutton, Charles J. Clark and Kevin W. Treesh.

**Infoline’s Private Equity Regulation & Compliance Conference**  
London, UK  
May 25, 2010

This Infoline conference will provide a practical update on regulatory and compliance developments for private equity firms. Kirkland partners Lisa Cawley and Stephanie Biggs will speak on “An Overview of U.S. Changes in Regulation Impacting Private Equity Firms.”

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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. Kirkland received the 2009 and 2008 awards for Best Law Firm (Private Equity Deals) and received the 2008 award for Best Law Firm (Fund Formation) in North America from *Private Equity International*. Mergermarket has ranked Kirkland first by volume for North American Buyouts and Exits in its "North American Private Equity in Review for 2009," and Pitchbook named Kirkland as one of the most active law firms representing private equity firms in its "Private Equity Breakdown" in 2009.

*The Lawyer* magazine recognized Kirkland as one of the "The Transatlantic Elite" in 2008 and 2009, 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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