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Open Issues in the Hedge Fund Transparency Act

Contributed by: Addison Braendel and Seth Chertok, Baker & McKenzie LLP

Introduction

On January 29, 2009, Senators Chuck Grassley and Carl Levin introduced the *Hedge Fund Transparency Act* (Bill), a revised version of proposed legislation S.1402 from 2007 that was never considered by Congress. The Bill would amend the Investment Company Act of 1940 (Investment Company Act) by, among other things, deleting the Section 3(c)(1) and Section 3(c)(7) exclusions typically relied on by private investment funds and creating new Section 6(a)(6) and Section 6(a)(7) exemptions. The Bill was discussed in the February 9, 2009 issue of *Bloomberg Law Reports® — Securities Law*. For many private investment funds, including, without limitation, private hedge funds, private equity funds, private alternative class funds and private real estate funds, enactment of the Bill would mean:[1]

- registering with the Securities and Exchange Commission (SEC);
- filing electronically an annual information statement;
- broader disclosure requirements, including, without limitation, disclosure of fund investors; and
- increased anti-money laundering obligations.

Below, we note three unresolved technical issues relating to the future of the Bill.

How Would the Section 12(d)(1) Anti-Stacking Rules Apply to Large Exempt Funds?

Currently, the anti-stacking rules in Section 12(d)(1) of the Investment Company Act (Anti-Stacking Rules) significantly restrict registered investment companies' ownership of unregistered investment companies, and vice versa. For example, subparagraphs (A)(i) and (B)(i) of Section 12(d)(1) impose 3 percent ownership limits on such investments. While these subparagraphs apply to Section 3(c)(1) and 3(c)(7) exempt funds, the Anti-Stacking Rules do not restrict such funds from owning other unregistered investment companies in a fund of fund structure.

As drafted, the Bill does not address how the Anti-Stacking Rules would apply to large funds relying on the new Section 6(a)(6) or Section 6(a)(7) exemptions. Funds with assets or assets under management over $50 million (Large Exempt Funds) would be required to register with the SEC and their status as registered investment companies could trigger full application of the Anti-Stacking Rules. If this occurred, Large Exempt Funds would be significantly limited in their ability to own unregistered investment companies and engage in fund of fund activities. We believe such an outcome would be unwarranted and Congress should clarify the issue.

Would Subparagraphs (A)(i) and (B)(i) of Section 12(d)(1) Apply to Section 6(a)(6) Exempt Funds?

Under the Bill as drafted, Section 6(a)(7) provides that subparagraphs (A)(i) and (B)(i) of Section 12(d)(1) apply to Section 6(a)(7) exempt funds, as is currently the case for Section 3(c)(7) exempt funds. However, Section 6(a)(6) fails to state that subparagraphs (A)(i) and (B)(i) of Section 12(d)(1) also apply to Section 6(a)(6) exempt funds, as is currently the case for Section 3(c)(1) exempt funds. We expect that Congress will clarify that subparagraphs (A)(i) and (B)(i) of Section

12(d)(1) similarly apply to Section 6(a)(6). We see no reason why Section 12(d)(1) should potentially apply to Section 6(a)(7) exempt funds, but not Section 6(a)(6) exempt funds.

Would Foreign Exempt Funds be Permitted to Register with the SEC?

Currently, through SEC guidance in no-action letters, foreign funds rely on Section 3(c)(1) or Section 3(c)(7) for registration exemptions under the Investment Company Act. Under the current drafting of the Bill, non-U.S. funds relying on Section 3(c)(1) or Section 3(c)(7), as the case may be, would have to rely on Section 6(a)(6) or Section 6(a)(7) which, as noted above, may subject such funds to registration.

Although Section 8(a) of the Investment Company Act currently limits Investment Company Act registration to U.S. funds, the Bill's registration requirements ostensibly apply to all funds, whether U.S. or non-U.S. It is not clear how Congress intends Section 8(a) to interact with the Bill. Assuming registration of non-U.S. funds is anticipated, this right of non-U.S. funds to register should be confirmed in the legislative record, or through modifications to Section 8.

Addison Braendel is a principal at Baker & McKenzie LLP. Mr. Braendel holds a B.A. from Temple University, summa cum laude, and a J.D. from the University of Chicago. Mr. Braendel's practice focuses on domestic and international private equity fund formation and alternative asset classes fund formation, including real estate and infrastructure assets.

Seth Chertok is an associate at Baker & McKenzie LLP. Mr. Chertok holds a B.A. from the University of Chicago, with honors, and a J.D. from the University of Pennsylvania, where the faculty awarded him the Lefever Prize for the best paper in law and economics. Mr. Chertok's practice focuses on domestic and international private equity, hedge funds and alternative asset class funds (including real estate and infrastructure assets) fund review, fund formation and fund compliance.

[1] While anti-money laundering obligations will apply to all private investment funds, registration, filing an annual information statement and broader disclosure requirements will apply only to private investment funds with assets or assets under management greater than $50 million.