



GlobalNote®

THE HEDGE FUND TRANSPARENCY ACT

To: Clients and Friends of Tannenbaum Helpern Syracuse & Hirschtritt LLP¹

Date: February 6, 2009

I. Introduction

On January 29, 2009, U.S. Senators Carl Levin (D-Michigan) and Charles Grassley (R-Iowa) introduced a bill in the U.S. Senate titled the “Hedge Fund Transparency Act.” Under the proposed Hedge Fund Transparency Act, private funds (including hedge funds and private equity funds (“Private Funds”)) satisfying the criteria currently set forth in Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act of 1940, as amended (the “Company Act”) would become investment companies under the Company Act, subject to the Security and Exchange Commission’s (“SEC”) regulatory authority. However, such Private Funds could still be (or remain) exempt from the Company Act’s general registration and filing requirements, in certain instances, pursuant to the proposed Hedge Fund Transparency Act’s newly added Section 6(a)(6) and Section 6(a)(7).² Specifically, Private Funds with assets, or assets under management, of less than \$50 million would automatically be exempt from the Company Act’s general registration and filing requirements. In contrast, however, Private Funds with assets, or assets under management, of not less than \$50 million would only be exempt under Section 6(a)(6) or Section 6(a)(7) if such Private Funds register with the SEC and follow certain other requirements as discussed in more detail herein.

II. Background

Today, Private Funds are generally excepted from being defined as investment companies under the Company Act pursuant to Section 3(c)(1) or Section 3(c)(7); as a result, Private Funds are exempt from the Company Act’s general registration and filing

¹ This **GlobalNote**® memorandum provides general information on the subject matter described, and it should not be relied on for legal advice on any matter, which may turn on specific facts. You should seek specific legal advice before acting with regard to the subjects discussed herein. For further information, please see the firm’s website: www.thshlaw.com.

² As discussed herein, the Company Act’s exemption criteria set forth in Sections 6(a)(6) and 6(a)(7) are analogous to the Company Act’s exclusionary criteria set forth in Sections 3(c)(1) and 3(c)(7).

requirements. Section 3(c)(1) provides an exception from the definition of investment company to issuers whose outstanding securities (other than short-term paper) are beneficially owned by not more than one hundred persons and who are not making and do not presently propose to make a public offering of their securities. Section 3(c)(7) provides an exception from the definition of investment company to issuers whose outstanding securities are owned exclusively by persons who, at the time of the acquisition of such securities, are “qualified purchasers,”³ and who are not making and do not at that time propose to make a public offering of such securities.

III. The Proposed Hedge Fund Transparency Act Would Sweep Many Private Firms Within the Purview of the Company Act

The proposed Hedge Fund Transparency Act literally strikes Section 3(c)(1) from the Company Act and then transplants much of its content into proposed Section 6(a)(6). Section 6(a)(6) provides an exemption from the Company Act’s general registration and filing requirements to issuers whose outstanding securities (other than short-term paper) are beneficially owned by not more than 100 persons, and who are not making and do not presently propose to make a public offering of their securities. The effect of such rewording is that Private Funds that are currently excepted from being defined as investment companies under the Company Act pursuant to Section 3(c)(1) would, instead, become investment companies under the Company Act subject to the SEC’s regulatory authority. However, Section 6(a)(6) and Section 6(g) would continue to allow Private Funds to remain exempt from the Company Act’s general registration and filing requirements (i) automatically, if they have assets, or assets under management, of less than \$50 million, or (ii) conditionally, if they have assets, or assets under management, of \$50 million or more (such Private Funds are referred to as “Large Private Funds”) and to the extent the additional conduct and disclosure requirements described herein are satisfied.

The proposed Hedge Fund Transparency Act also literally strikes Section 3(c)(7) from the Company Act and then transplants much of its content into proposed Section 6(a)(7). Section 6(a)(7) provides an exemption from the Company Act’s general registration and filing requirements to issuers whose outstanding securities are owned exclusively by persons who, at the time of the acquisition of such securities, are qualified purchasers, and who are not making and do not at that time propose to make a public offering of such securities. The effect of such rewording is that Private Funds that are currently excepted from being defined as investment companies under the Company Act pursuant to Section 3(c)(7) would, instead, become investment companies under the Company Act subject to the SEC’s regulatory authority. However, Section 6(a)(7) and Section 6(g) would continue to allow Private Funds to remain exempt from the Company Act’s general registration and filing requirements (i) automatically, if they are not Large Private Funds, or (ii) conditionally, if they are Large Private Funds and to the extent the additional conduct and disclosure requirements described herein are satisfied.

³ “Qualified Purchaser” is defined in Section 2(a)(51) under the Company Act.

IV. The Proposed Hedge Fund Transparency Act Imposes Additional Disclosure and Conduct Requirements Upon Large Private Funds Seeking Exemption From the Company Act's Registration and Filing Requirements Pursuant to Either Section 6(a)(6) or Section 6(a)(7)

Under the proposed Hedge Fund Transparency Act, Large Private Funds seeking exemption from the Company Act's registration and filing requirements pursuant to either Section 6(a)(6) or Section 6(a)(7) (which, effectively, embody the 3(c)(1) or 3(c)(7) criteria, respectively) would be required to:

- (i) register with the SEC;
- (ii) file an information form with the SEC electronically, not less frequently than once every 12 months (which shall be made available by the SEC to the public at no cost in an electronic and searchable format), containing:
 - a. the name and current address of:
 - i. each natural person who is a beneficial owner of the private fund;
 - ii. any company with an ownership interest in the Private Fund; and
 - iii. the primary accountant and primary broker used by the Private Fund;
 - b. an explanation of the structure of ownership interests in the Private Fund;
 - c. information on any affiliation that the Private Fund has with another financial institution;
 - d. a statement of any minimum investment commitment required of a limited partner, member, or other investor;
 - e. the total number of any limited partners, members, or other investors; and
 - f. the current value of
 - i. the assets of the Private Fund; and
 - ii. any assets under management by the Private Fund;
- (iii) maintain such books and records as the SEC may require; and

- (iv) cooperate with any request for information or examination by the SEC (items (i) through (iv) above are referred to as the “Hedge Fund Disclosure and Conduct Requirements”)

Accordingly, if the proposed Hedge Fund Transparency Act is enacted in its current form, Large Private Funds that are currently exempt from the Company Act’s general registration and filing requirements because they satisfy the criteria set forth in either Section 3(c)(1) or Section 3(c)(7) would be required to satisfy each of the Hedge Fund Disclosure and Conduct Requirements to remain exempt from the Company Act’s general registration and filing requirements.

The proposed Hedge Fund Transparency Act would require the SEC to issue forms and guidance necessary to carry out the proposed Hedge Fund Transparency Act not later than 180 days after the date of its enactment.

V. The Proposed Hedge Fund Transparency Act Would Also Impose Anti-Money Laundering Obligations On Private Funds That Rely on Sections 6(a)(6) or 6(a)(7)

The proposed Hedge Fund Transparency Act also would require Private Funds that would be exempt from the Company Act’s general registration and filing requirements pursuant to the proposed Sections 6(a)(6) or 6(a)(7) to establish an anti-money laundering program. Such Private Funds would then be required to undertake and/or comply with the following anti-money laundering procedures:

- (i) report suspicious transactions under subsections (g) and (h) of 31 U.S.C. 5318;⁴
- (ii) use risk-based due-diligence policies, procedures, and controls that are reasonably designed to ascertain the identity of and evaluate any foreign person (including, where appropriate, the nominal and beneficial owner or beneficiary of a foreign corporation, partnership, trust, or other foreign entity) that supplies or plans to supply funds to be invested with the advice or assistance of such Private Fund; and
- (iii) produce records requested by a federal regulator under 31 U.S.C. 5318(k)(2).⁵

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⁴ See Exhibit A.

⁵ See Exhibit B.

If you have any questions or wish to discuss issues or concerns relating to the proposed Hedge Fund Transparency Act, any of the Hedge Fund Disclosure and Conduct Requirements, or any other item mentioned herein, please do not hesitate to contact us.

EXHIBIT A

SUBSECTIONS (G) AND (H) OF 31 U.S.C. 5318

Subsections (g) and (h) of 31 U.S.C. 5318 provide the following terms and conditions in connection with reporting suspicious transactions and anti-money laundering programs to the U.S. Treasury:

(g) REPORTING OF SUSPICIOUS TRANSACTIONS.—

(1) IN GENERAL.--The Secretary [of the Treasury] may require any financial institution, and any director, officer, employee, or agent of any financial institution, to report any suspicious transaction relevant to a possible violation of law or regulation.

(2) NOTIFICATION PROHIBITED.--

(A) IN GENERAL.--If a financial institution or any director, officer, employee, or agent of any financial institution, voluntarily or pursuant to this section or any other authority, reports a suspicious transaction to a government agency—

(i) the financial institution, director, officer, employee, or agent may not notify any person involved in the transaction that the transaction has been reported; and

(ii) no officer or employee of the Federal Government or of any State, local, tribal, or territorial government within the United States, who has any knowledge that such report was made may disclose to any person involved in the transaction that the transaction has been reported, other than as necessary to fulfill the official duties of such officer or employee.

(B) DISCLOSURES IN CERTAIN EMPLOYMENT REFERENCES.--

(i) RULE OF CONSTRUCTION.--Notwithstanding the application of subparagraph (A) in any other context, subparagraph (A) shall not be construed as prohibiting any financial institution, or any director, officer, employee, or agent of such institution, from including information that was included in a report to which subparagraph (A) applies--

(I) in a written employment reference that is provided in accordance with section 18(w) of the Federal Deposit Insurance Act in response to a request from another financial institution; or

(II) in a written termination notice or employment reference that is provided in accordance with the rules of a self-regulatory organization registered with the Securities and Exchange Commission or the Commodity Futures Trading

Commission, except that such written reference or notice may not disclose that such information was also included in any such report, or that such report was made.

(ii) INFORMATION NOT REQUIRED.--Clause (i) shall not be construed, by itself, to create any affirmative duty to include any information described in clause (i) in any employment reference or termination notice referred to in clause (i).

(3) LIABILITY FOR DISCLOSURES.--

(A) IN GENERAL.--Any financial institution that makes a voluntary disclosure of any possible violation of law or regulation to a government agency or makes a disclosure pursuant to this subsection or any other authority, and any director, officer, employee, or agent of such institution who makes, or requires another to make any such disclosure, shall not be liable to any person under any law or regulation of the United States, any constitution, law, or regulation of any State or political subdivision of any State, or under any contract or other legally enforceable agreement (including any arbitration agreement), for such disclosure or for any failure to provide notice of such disclosure to the person who is the subject of such disclosure or any other person identified in the disclosure.

(B) RULE OF CONSTRUCTION.--Subparagraph (A) shall not be construed as creating--

(i) any inference that the term "person", as used in such subparagraph, may be construed more broadly than its ordinary usage so as to include any government or agency of government; or

(ii) any immunity against, or otherwise affecting, any civil or criminal action brought by any government or agency of government to enforce any constitution, law, or regulation of such government or agency.

(4) SINGLE DESIGNEE FOR REPORTING SUSPICIOUS TRANSACTIONS.—

(A) IN GENERAL.--In requiring reports under paragraph (1) of suspicious transactions, the Secretary of the Treasury shall designate, to the extent practicable and appropriate, a single officer or agency of the United States to whom such reports shall be made.

(B) DUTY OF DESIGNEE.--The officer or agency of the United States designated by the Secretary of the Treasury pursuant to subparagraph (A) shall refer any report of a suspicious transaction to any appropriate law enforcement, or supervisory agency, or United States intelligence agency for use in the conduct of intelligence or counterintelligence activities, including analysis, to protect against international terrorism.

(C) Coordination with other reporting requirements.--Subparagraph (A) shall not be construed as precluding any supervisory agency for any financial institution from requiring the financial institution to submit any information or report to the agency or another agency pursuant to any other applicable provision of law.

(h) ANTI-MONEY LAUNDERING PROGRAMS.--

(1) IN GENERAL.--In order to guard against money laundering through financial institutions, anti-money laundering programs, including at a minimum

- (A) the development of internal policies, procedures, and controls,
- (B) the designation of a compliance officer,
- (C) an ongoing employee training program, and
- (D) an independent audit function to test programs.

(2) REGULATIONS.--The Secretary of the Treasury, after consultation with the appropriate Federal functional regulator (as defined in section 509 of the Gramm-Leach-Bliley Act), may prescribe minimum standards for programs established under paragraph (1), and may exempt from the application of those standards any financial institution that is not subject to the provisions of the rules contained in part 103 of title 31, of the Code of Federal Regulations, or any successor rule thereto, for so long as such financial institution is not subject to the provisions of such rules.

(3) CONCENTRATION ACCOUNTS.--The Secretary may prescribe regulations under this subsection that govern maintenance of concentration accounts by financial institutions, in order to ensure that such accounts are not used to prevent association of the identity of an individual customer with the movement of funds of which the customer is the direct or beneficial owner, which regulations shall, at a minimum—

(A) prohibit financial institutions from allowing clients to direct transactions that move their funds into, out of, or through the concentration accounts of the financial institution;

(B) prohibit financial institutions and their employees from informing customers of the existence of, or the means of identifying, the concentration accounts of the institution; and

(C) require each financial institution to establish written procedures governing the documentation of all transactions involving a concentration account, which procedures shall ensure that, any time a transaction involving a concentration account commingles funds belonging to 1 or more customers, the identity of, and specific amount belonging to, each customer is documented.

EXHIBIT B

SUBSECTION (K)(2) OF 31 U.S.C. 5318

(k) Bank Records Related to Anti-Money laundering Programs.--

(2) 120-HOUR RULE.--Not later than 120 hours after receiving a request by an appropriate Federal banking agency for information related to anti-money laundering compliance by a covered financial institution or a customer of such institution, a covered financial institution shall provide to the appropriate Federal banking agency, or make available at a location specified by the representative of the appropriate Federal banking agency, information and account documentation for any account opened, maintained, administered or managed in the United States by the covered financial institution.