UNITED STATES: REGISTRATION OF INVESTMENT ADVISERS FOR NON-U.S. HEDGE FUNDS

AN EURO-AMERICAN LAWYERS GROUP BRIEFING ARTICLE
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Effective February 1, 2006, new rules will go into effect requiring non-U.S. hedge fund advisers to register as investment advisers with the Securities and Exchange Commission (the "***SEC***").

Under the new registration regime, non-U.S. hedge fund advisers that are advisers to "private funds" and have 15 or more U.S. clients during the preceding 12 months[1] will be required to register with the SEC under the Investment Advisers Act of 1940, as amended (the "***Advisers Act***").

A "private fund" is a fund which: (a) is not required to register under the Investment Company Act of 1940, as amended, and is relying on one of two exemptions commonly used by hedge funds, Section 3(c)(1) or Section 3(c)(7); (b) permits investors to redeem their interests within two years of purchase; and (c) is offered on the basis of the investment skills and expertise of the adviser. The two-year redemption test was intended to exempt private equity funds, venture capital funds and similar funds having a medium to long-term investment horizon.

A. Determining Whether or Not an Adviser Needs to Register under the Advisers Act

Look-through Rules. The new rules fundamentally change the method by which "clients" are counted. Currently, each fund (as well as any separately managed accounts) advised by an adviser is considered a single client. Under the new rules, advisers will be required to "look-through" a private fund and count each person who invests in the private fund as a "client."

Advisers in non-U.S. jurisdictions will be required to "look-through" the funds they manage, regardless of whether those funds are located in a non-U.S. jurisdiction. For purposes of counting clients, non-U.S. advisers only have to count U.S. residents that were invested in its funds or were otherwise advisory clients starting February 1, 2006. A non-U.S. adviser to any hedge fund that in the course of the preceding 12 months (as measured with the initial month

[1] The 12-month look-back period will not apply to any period prior to February 2006.

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being no earlier than February 2006), has more than fourteen investors that are U.S. residents must generally register under the Advisers Act.

Determining Residency. Deciding who is U.S. resident is determined on the basis of: (i) in the case of individuals, their residence, (ii) in the case of corporations and other business entities, their principal office and place of business, and (iii) in the case of discretionary or non-discretionary accounts managed by another investment adviser, the location of the person for whose benefit the account is held.[2] For determining residency, the determination will be made at the time of investment or transfer of investment by a client; subsequent relocations will not change such status.

In addition, family and friends of advisers who invest in funds advised by such advisers would not be counted as "clients."

Advisers to non-U.S. Publicly Offered Funds. Most significantly for non-U.S. funds, although the SEC decided not to give a blanket exemption to non-U.S. advisers regulated elsewhere, the new rules provide an exemption from the definition of "private fund" for those funds regulated in a non-U.S. country that are making public offerings in that country. To qualify for the exemption, a fund must: (i) have its principal place and place of business outside of the U.S., and (ii) be conducting a public offering of its securities in a non-U.S. country under whose laws the fund is regulated as a public investment company. Thus, such a fund would be counted as a single non-U.S. client.

Advisers to Offshore Privately Offered Funds. Non-U.S. advisers to non-U.S. funds would have to look through "private funds" only for determining the number of clients (counting only U.S. residents). As described in greater detail in the paragraphs below relating to implications for registered non-U.S. advisers, the new rules would otherwise allow such registered non-U.S. advisers to treat a non-U.S. private fund (and not its U.S. investors) as its client for most purposes under the Advisers Act.

B. Implications of Registering as an Investment Adviser

Compliance Generally. An investment adviser registered under the Advisers Act would generally be required, among other requirements, to (A) develop comprehensive compliance

[2] Practitioners should take note that this determination of U.S. resident is different from the definition of "U.S. Person" under Regulation S promulgated by the SEC under Securities Act of 1933, as amended.

procedures (e.g. code of ethics, certain distribution deadlines for audited financial statements, certain rules regarding advertising and solicitation), (B) designate a chief compliance office to oversee the adviser's compliance program, (C) maintain certain records and documentation relating to (i) its performance track record for a period of five years and (ii) securities transactions by certain personnel with access to nonpublic information, and (D) adopt certain custodial requirements and proxy voting and disclosure policies.

In order to register, an investment adviser must complete a Form ADV to be publicly filed with the Commission, which sets forth detailed disclosure of private fund activities as well as information about an adviser's business, owners and affiliates, and conflicts of interest and disciplinary history. Registered investment advisers are also subject to regular on-site inspections by the SEC staff.

C. Implications of Registering as an Investment Adviser for Non-U.S. Investment Advisers

The consequences for non-U.S. investment advisers who are required to register with the SEC under the Advisers Act, are as follows:

Dealings with U.S. Residents. A non-U.S. registered adviser would need to comply with all of the requirements of the Advisers Act with respect to its U.S. clients (i.e., those who are U.S. residents themselves rather than being deemed U.S. clients solely for counting purposes).

Dealings with Non-U.S. Clients. With respect to non-U.S. advisers, the SEC's jurisdictional scope and ability to regulate non-U.S. persons is limited. Accordingly, the substantive provisions of the Advisers Act would generally not apply to a non-U.S. adviser's dealings with its offshore fund. However, a registered non-U.S. adviser would be: (A) required to adopt certain recordkeeping practices, (B) subject to periodic SEC examination, and (C) subject to the anti-fraud rules under the Advisers Act. The Advisers Act rules relating to compliance policies, custody and proxy voting would not apply to a registered non-U.S. adviser, provided it has no U.S. clients other than for counting purposes. However, while a registered non-U.S. adviser without U.S clients (other than for counting purposes) would not be required to adopt a code of ethics under Rule 204A-1, it would still: (i) have a fiduciary duty to provide all clients with full and fair disclosure of conflicts of interest, and (ii) need to retain the personal securities transaction reports for certain persons with access to nonpublic information required under the Rule.

In addition, a registered investment adviser would be subject to the anti-fraud rules of the Advisers Act with respect to all dealings with U.S. and non-U.S. clients.

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