TUCKER ELLIS & WEST LLP
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CLIENT ALERT **JULY 2004**

SEC PROPOSES TO REQUIRE HEDGE FUND ADVISERS TO REGISTER UNDER INVESTMENT ADVISERS ACT

The Securities and Exchange Commission has voted to propose that advisers to hedge funds be required to register under the Investment Advisers Act of 1940. The vote follows a major recommendation of the Commission's staff in its hedge fund study of last year.

The linchpin of the proposal is that hedge fund advisers would no longer be allowed to count just the fund itself as a client. Instead, hedge fund advisers would be required to count each fund investor toward the maximum of 14 clients that an adviser may have in a 12-month period without registering. Key to the proposal would be the definition of hedge fund. The Commission proposes to use a definition for "private fund," which would be a fund that:

- would be an investment company but for the exceptions in Sections 3(c)(1) of the Investment Company Act of 1940 (privately offered funds with fewer than 100 owners) or 3(c)(7) of the Investment Company Act of 1940 (privately offered funds limited to "qualified purchasers");
- permits owners to redeem their ownership interests within two years of purchase; and
- is offered based on the investment advisory skills, ability or expertise of the investment adviser.

Currently, the proposed definition does not depend on the size of a fund's portfolio. The proposal does, however, contain special provisions for advisers located outside the United States, which are designed to limit the extraterritorial application of the Advisers Act to offshore advisers to offshore funds that have U.S. investors.

The Commission justifies its proposal on the basis that registration under the new rule would permit the Commission to:

- Collect and provide to the public basic information about hedge funds and hedge fund advisers, including the number of hedge funds operating in the United States, the amount of assets, and the identity of their advisers.
- Improve disclosures made to prospective and current hedge fund investors.
- Require all hedge fund advisers to adopt basic compliance controls to prevent violation of the federal securities laws.
- Examine hedge fund advisers to identify compliance problems early, limit the harm to investors, and deter questionable practices.
- Prevent individuals with criminal or other serious disciplinary records from managing hedge funds.

The comment period on the proposal will be open until September 15, 2004. Questions concerning the proposal may be directed to any to the following Tucker Ellis & West LLP attorneys:

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