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A legal update from Dechert's Financial Services Group

## The U.S. SEC Adopts Rules to Require Hedge Fund Advisers to Register

Yesterday, the U.S. Securities and Exchange Commission (SEC) adopted new rules that will require many hedge fund managers, both inside and outside the United States, to register as investment advisers with the SEC. This Alert highlights the position of non-U.S. investment managers based in Europe ("European Investment Managers"), although the same rules will apply to all non-U.S. investment managers.

Under current law, a European Investment Manager is required to register with the SEC if it has had 15 or more U.S. clients in the preceding 12-month period. The new rules will require European Investment Managers to "look through" any "private fund" and include as "U.S. clients" underlying U.S. investors in the "private fund". This look through provision will have a significant impact on European hedge fund managers as well as managers of certain other open-ended funds.

Based upon information currently available, under the new rules, a "private fund" will include any fund (U.S. or non-U.S.) that is sold in a private placement in the United States and offers redemption rights within two years from the date of purchase. The definition of "private fund" excludes non-U.S. funds regulated as public investment companies in a non-U.S. jurisdiction and offering securities publicly outside the United States (e.g., an English OEIC or a Luxembourg Part I SICAV).

Although compliance with the new rules will require many European Investment Managers to register with the SEC, European Investment Managers to non-U.S. private funds will not be required to comply with most of the substantive provisions of the U.S. Investment Advisers Act of 1940 (Advisers Act). Once registered, European Investment Managers will, however, be required to:

- comply with certain of the Advisers Act's recordkeeping requirements;
- promptly provide records to the SEC upon request; and
- make their personnel available for questioning by the SEC.

SEC-registered European Investment Managers who advise "private funds" or individual advisory clients located in the U.S. will be required to comply with all of the substantive provisions of the Advisers Act with respect to such funds and advisory clients. Such compliance is likely to place a more onerous burden on hedge fund managers with a Delaware fund amongst their clients.

While the text of the final rules has not yet been released, the SEC staff did indicate during the SEC meeting yesterday approving the rules that:

- In determining whether an investor is a "U.S. client", the investor's place of residence *at the time of investment* controls. The place of residence of a corporation generally is its place of incorporation, and the place of residence of a trust is the place of residence of its trustee;
  - A task force is being appointed to tailor the SEC staff inspection program to hedge fund managers; and
  - The new rules will have transition provisions to facilitate the registration of investment managers and advisers, including prospective counting from the compliance date for determining whether the investment manager has had 15 clients in the preceding 12 months.
- submit to periodic SEC inspections;

European Investment Managers caught by the new rules will need to register by 1 February 2006. Once the SEC has released the new rules to the public, we will distribute a more detailed Client Memorandum.

We are also holding a seminar on 30 November 2004 to discuss the implications of the new rule for European Investment Managers. Please mark your calendars – a formal invitation will follow shortly. We will also continue to hold our periodic SEC Registration/Compliance Workshops, focusing on issues related to these new rules, in advance of the 1 February 2006 deadline.

Dechert London, Europe's largest Anglo-U.S. hedge fund advisory practice, has been obtaining SEC registrations and advising on European and U.S. compliance for European Investment Managers since 1998. We are well placed to help you on this extension of the 15-client rule and to provide a one-stop-shop service for you on European and U.S. requirements.

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## Practice group contacts

If you have questions regarding the information in this legal update, please contact the Dechert lawyer with whom you regularly work, or any of the lawyers listed. Visit the financial services practice area at [www.dechert.com](http://www.dechert.com)

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