THE LONG VIEW

MARC ELOVITZ
offers an overview of the key pieces of US regulation set to impact private fund managers in 2012

"IT IS CRITICAL THAT MANAGERS UNDERSTAND HOW THE SEC COUNTS ASSETS FOR DETERMINING REGISTRATION THRESHOLDS AND EXEMPTIONS"

Private fund managers are asking the question: what's next in terms of US regulation? Predicting the future of hedge fund regulation is always a high-risk assignment. What we do know is that the new paradigm of increased regulatory demands, disclosures and scrutiny in the US is here to stay.

The deadline is fast approaching for fund managers to comply with the SEC's new registration rules. The old exemption for advisers with fewer than 15 clients is gone. All managers with US offices, or who manage US assets, need to evaluate their SEC registration status. Registered advisers will face new reporting requirements in the US including significant disclosures about private funds.

Those managing more than $150m from a US office will need to file ADV Parts 1 and 2 by 14 February to be registered by the 30 March deadline. Those that manage private funds with less than that may be able to take advantage of the private fund adviser exemption and file as Exempt Reporting Advisers (ERAs). While exempt from registration, ERAs still must file portions of ADV Part 1, and are subject to anti-fraud provisions and SEC examinations.

On 18 January, the SEC provided important guidance on registration. It confirmed that general partners and similar special purpose vehicles (SPV) of funds are not required to register separately from the affiliated registered adviser. The SEC also confirmed that related advisers may, in certain circumstances, file a single ADV that would cover each adviser.

This is key for global firms. As long as the filing adviser is based in the US, it may include international affiliates (UK, Hong Kong etc) or other affiliates (formed to manage different funds or for different compensation, liability or tax purposes). This works where the affiliates (relying advisers) are controlled by, or under common control with, the US filing adviser – and meet the conditions in the no-action letter. The SEC's relief applies only where the filing adviser has its principal office and place of business in the US, but we anticipate further guidance on non-US advisers in 2012.

It is critical that managers understand how the SEC counts assets for determining registration thresholds and exemptions. As part of its Dodd-Frank rulemaking, the SEC established 'Regulatory Assets Under Management' which is a gross number, not net, and includes leverage. The measure also includes proprietary capital (advisory firm and its principals).

Also, the Commodity Futures Trading Commission (CFTC) has proposed requiring many fund managers to register as commodity pool operators. We expect the final CFTC rule to carve out certain funds with de minimis futures trading. But calculating the futures percentage is becoming more difficult because of definitional changes for swaps and other derivatives.

Managers with at least $150m in private fund regulatory AuM will also need to file Form PF. This form creates significant operational challenges, and because it is a government filing, accuracy and consistency is critical. Many large hedge fund advisers will need to report detailed fund data, including instrument exposures, derivatives, portfolio liquidity, collateral, risk metrics and side pockets. This will take a significant amount of time and resources from legal, compliance, operations, finance, risk, IT and accounting. Firms need to start building PF functionality into their proprietary systems. The largest hedge fund advisers ($5bn) will make their first quarterly filing by the end of August 2012.

What about other regulation in 2012? The regulators are working through a tangle of rules related to derivatives and clearing – and the Volcker Rule. The SEC also has short-sale disclosures on its list of initiatives and broader equity market structure reforms. We might finally see final AML rules for investment advisers.

There is no doubt that US regulation of private fund managers is a growth play for 2012. ■

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