Title:
Hedge Fund Advisers Will Continue to Register Despite Court Decision to Strike Down SEC Rule

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Summary:
Small, independent hedge funds were given a boost on Friday by a favorable court decision that struck down a controversial rule requiring hedge funds to register with the Securities and Exchange Commission. Notwithstanding the decision, many fund advisers are expected to continue to register voluntarily in order to attract and retain institutional investors.

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Article Body:

Small, independent hedge funds were given a boost on Friday by a favorable court decision that struck down a controversial rule requiring hedge funds to register with the Securities and Exchange Commission. Notwithstanding the decision, many fund advisers are expected to continue to register voluntarily in order to attract and retain institutional investors.

In 2004, the SEC amended one of the key exemptions fund advisers relied on to avoid registration with the SEC as an investment adviser. Previously, fund managers with fewer than 15 clients were not required to register as an investment adviser. Under the old rule, each fund the adviser managed was considered a "client", regardless of the number of individual investors in the fund. In most cases, managers that advised fewer than 15 funds could avoid registration as an investment adviser.

Under the 2004 rule amendment, the SEC changed the definition of a "client" of an investment adviser to mean the individual investors in the funds it managed. Thus, with few exceptions, the 2004 rule amendment forced fund advisers managing investment funds with 15 or more investors (and more than $30 million in assets) to register as an investment adviser. Since the adoption of the 2004 rule amendment, 1,260 new fund advisers have registered with the SEC. Last week's appeals court decision strikes down the 2004 rule amendment, which will relieve many smaller funds from the burden and expense of investment adviser registration, compliance and random SEC inspections.

This is a big development in U.S. hedge fund regulation, and a sign of a potential backlash against the SEC’s attempt to expand its regulatory reach in this area. However, no one expects the SEC to close the door completely on hedge fund regulation. And while some advisers may elect to de-register to avoid the cost of compliance, many funds are expected to take a "wait-and-see" approach in anticipation the SEC's potential enactment of new rules in reaction to the court's decision.

Notwithstanding the court decision, many institutional investors appreciate the transparency that registration affords investors, and will continue to require registration as part of their investment criteria. In the fund business, and especially for small, independent funds, institutional investors are the Holy Grail. Accordingly, many advisers will continue to voluntarily register despite the burden of compliance.

While registration is a modest burden for advisers, there are ways for independent advisers to maintain their registration status without having compliance issues overwhelm their operations. In my practice, we help advisers devise cost effective strategies to register and meet their ongoing compliance requirements. We have found that the advisers who work with us are able devote minimal time to the annoyance of compliance and more time on what’s really important: raising and managing capital.