

SEC Proposes Significant New Rules



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After being told by the D.C. Court of Appeals that the SEC had overstepped its bounds as regards hedge fund registration requirements, the SEC recently proposed new accredited investors rules that would impact private equity and hedge funds of all types and a new anti-fraud rule applicable to all types of pooled investment vehicles. These proposed rules may have a tremendous impact on how private equity and hedge funds are structured and managed.

Changes To Accredited Investors Rules

Proposed Rules 509 and 216 create a new category of accredited investors -- accredited natural persons. An "accredited natural person" would be defined by

reference to the existing net worth requirement (\$1 million individually or jointly with such person's spouse) and income thresholds (\$200,000 or \$300,000 jointly with such person's spouse) set forth in Regulation D, but would also impose a new requirement that such person own at least \$2.5 million in investments. As is the case with much of Regulation D and securities laws in general, the devil is in the details. For example, the definition of "Investments" will require careful consideration when reviewing investor subscription materials to determine whether the \$2.5 million threshold is met and if the investor is, in fact, accredited. As well, while an important exemption is provided for investments in "venture capital funds," the term is defined in a detailed and technical manner. The proposed changes to the accredited investor rules would clearly impact future fundraising efforts where it is common among funds to exclude individual investors who are not accredited. As important, certain existing fund investors who do not meet the new accredited natural person standard would not be eligible to make further investments in a fund subject to the proposed rules. This could leave funds in a position where they may not draw down capital commitments from pre-existing investors who do not qualify as accredited natural persons under the proposed rules!

New Anti-fraud Rule

The proposed anti-fraud rule is designed to resolve any uncertainty concerning the SEC's ability to take

action against fund advisers who defraud investors in pooled investment vehicles. The proposed rule subjects investment advisers of pooled investment vehicles to liability for: (a) making untrue statements of a material fact or omitting to state a material fact necessary in order to make the statements not misleading; and, (b) engaging in any other fraudulent, deceptive, or manipulative act. The proposed rule would apply to all investment advisers, regardless of whether they are (or are required to be) registered under the Investment Advisers Act, and would apply to a much broader set of communications with investors and prospective investors than current law. Thus, the proposed rule will require advisers to take extra caution and care with all communications to investors/prospective investors.

The proposed rules are available at: <http://www.sec.gov/rules/proposed/2006/33-8766.pdf>.

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