On July 20, 2004, the SEC proposed a new rule and rule amendments that, if adopted, would require most investment advisers that manage more than $25,000,000 and manage “private funds” to register as investment advisers with the SEC.1 Proposed Rule.

Under Advisers Act section 203(b)(3), an investment adviser generally is not required to register if it (1) has had fewer than fifteen clients during the preceding twelve months and (2) does not hold itself out generally to the public as an investment adviser. Advisers Act Rule 203(b)(3)-1 currently permits an investment adviser to count each hedge fund it manages as a single “client” for these purposes. If adopted, the proposed rule would modify the current rule to require an investment adviser to count as a client each investor of any “private fund” it manages. The adviser would also be required to look through a private fund to the owners of any other private fund or any investment company registered under the Investment Company Act of 1940 (a so-called “mutual fund”) that has invested in the private fund that the adviser manages.

Any investment adviser that manages more than $25,000,0002 and has more than 14 clients, counting each separate account client and each investor in a “private fund,” would be required to register with the SEC as an investment adviser, whether that adviser currently is unregistered or registered as an investment adviser with a state securities authority or as a commodity trading adviser of commodity pool operators with the Commodity Futures Trading Commission. Investment advisers with less than $25,000,000 of assets under management remain subject to regulation of investment advisers under state law.

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