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Private Equity + Hedge Funds

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Private Equity and Hedge Funds – What's Ahead for 2016?

Ever since the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), private equity and hedge fund managers have become increasingly subject to regulatory supervision by the Securities and Exchange Commission (SEC) as well as other agencies. With an eye on regulators' agendas for 2016, the following is a brief snapshot of some U.S. and offshore proposals and regulatory changes:

- The SEC recently published and is reviewing a report and recommendations concerning changes to the definition of "accredited investor." Recommendations in the report include, among others, revising the income and net worth thresholds for natural persons, revising the list-based approach for entities to qualify as accredited investors, and allowing individuals to demonstrate adequate sophistication in ways other than meeting financial thresholds.

- The SEC announced in its 2016 exam priorities (2016 Priorities) that it will maintain focus on private fund advisers' fees and expenses and will evaluate controls and disclosures concerning simultaneous management of performance-based and asset-based fee accounts. Of note is the continuing discord raised by various writers and bloggers concerning M&A transaction fees paid by portfolio companies to fund advisers and whether additional registration as broker-dealers should be required. Some relief was granted via a SEC no-action letter in 2014, however, the situation is far from being fully settled.

- On May 20, 2015, the SEC issued a rulemaking proposal regarding amendments to Form ADV that require different or additional information from what advisers have provided in the past. Key elements of the proposed amendments require providing significant information about an adviser's separately managed accounts and additional information about an adviser's businesses. The proposed amendments also provide an "umbrella registration" mechanism for private fund advisers and include certain clarifying amendments.

- On August 25, 2015, the U.S. Department of the Treasury's Financial Crimes Enforcement Network issued a rulemaking proposal to require registered investment advisers to comply with certain portions of the Currency and Foreign Transactions Reporting Act of 1970, commonly known as the Bank Secrecy Act. The proposed rule requires registered investment advisers to establish antimoney laundering programs and report suspicious activity. Additionally, the rule proposal incorporates investment advisers into the definition of "financial institution," requiring them to file Currency Transaction Reports.

- The Bipartisan Budget Act of 2015 repealed certain sections of the Internal Revenue Code

of 1986 applicable to partnerships and limited liability companies taxed as partnerships and replaced them with new rules. The new rules provide the potential for partnership-level (instead of investor level) tax adjustment and require funds to consider certain elections prior to January 1, 2018.

- Revisions to Cayman Islands law require that locally registered funds obtain self-certification forms containing tax-related information from new (after January 1, 2016) and preexisting investors. The exact timeline for obtaining the self-certifications will be based on date of subscription and account size.

- As of June 1, 2015, the British Virgin Islands began offering alternate fund structures aimed at emerging managers or those with smaller funds. The incubator fund is aimed at managers who do not necessarily have the benefit of seed investor capital but who wish to set up quickly and establish a track record with minimal setup costs, without having to comply with certain regulatory obligations. The incubator fund is permitted to operate for two years (with the possibility of an additional one-year extension) without appointing an auditor or typical fund functionaries (that is, administrator, custodian or third-party manager). The approved fund is aimed at managers who wish to establish a fund for a longer and unencumbered term, but on the basis of a more private investor offering, which may appeal to family offices or an investor base of close connections. Relevant thresholds include a maximum of 20 investors and a cap of $100 million in net assets. Like the incubator fund, an approved fund need not appoint an auditor, third-party manager, or custodian, but it is required to appoint an administrator.

This summary is not intended to be a comprehensive review of these proposals, each of which you may wish to discuss with counsel.

If you have any questions, please contact the author, Shant H. Chalian, or another member of Robinson+Cole's Corporate Law Group.

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