

**MEMO# 20133**

June 26, 2006

## **Court of Appeals Vacates Hedge Fund Adviser Registration Rule**

©2006 Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice. [20133] June 26, 2006 TO: BOARD OF GOVERNORS No. 20-06 CLOSED-END INVESTMENT COMPANY MEMBERS No. 26-06 INVESTMENT ADVISER MEMBERS No. 18-06 SEC RULES MEMBERS No. 57-06 SMALL FUNDS MEMBERS No. 46-06 RE: COURT OF APPEALS VACATES HEDGE FUND ADVISER REGISTRATION RULE On June 23, 2006, the United States Court of Appeals for the D.C. Circuit vacated the recently issued SEC rule that required most advisers to hedge funds to register as investment advisers.<sup>1</sup> The court found that the Commission's definition of what constitutes a client for purposes of the Investment Advisers Act of 1940 was arbitrary. The Advisers Act exempts from registration advisers that had fewer than 15 clients during the preceding 12 months and do not hold themselves out to the public as investment advisers. Prior to the adoption of the new rule, the SEC interpreted the term "client" to refer to private funds – usually limited partnerships – advised by an adviser. Most hedge fund managers advise fewer than fifteen funds, and were therefore exempt from registration. Under the new rule, the SEC defined "client" to include the shareholders, limited partners, members and beneficiaries of private funds. Under this definition, most hedge fund advisers were no longer exempt from registration, and were required to register with the SEC by February 1, 2006. The court found that this interpretation "falls outside the bounds of reasonableness," noting that "it is counterintuitive to characterize the investors in a hedge fund as the 'clients' of the adviser." As a result of the decision vacating the rule, many hedge fund advisers are no longer required to register or remain registered with the SEC. Mara Shreck Assistant Counsel 1 See *Goldstein v. SEC*, No. 04-1434 (D.C. Cir. June 23, 2006). A copy of the opinion is available at <http://pacer.cadc.uscourts.gov/docs/common/opinions/200606/04-1434a.pdf>.