

Client Alert

T +41 (0) 58 450 20 00
F +41 (0) 58 450 20 01
www.shvc.com

New Legislation Will Require Certain Swiss Asset Managers to Be Regulated by the Securities and Exchange Commission

Congress looks set to repeal the current exemption relied upon by many Swiss asset managers to avoid registration with the U.S. Securities and Exchange Commission ("SEC") by maintaining a limited number of U.S. client relationships (fewer than 15 U.S. clients). Legislation moving through Congress in connection with the reform of the financial services industry will require non-U.S. based asset managers to register with the SEC if they manage \$25 million or more of assets for U.S. clients. As a result of this change, Swiss private banks, external asset managers, family offices and trust companies must review their client portfolios and decide whether to subject themselves to SEC regulation or exit U.S. client relationships in order to manage less than \$25 million of U.S. client assets.

On Thursday, May 20, 2010, the U.S. Senate approved the Restoring American Financial Stability Act of 2010 ("RAFSA") (S. 3217), legislation focused on increasing regulation in the financial sector following the economic crisis. Included within the RAFSA is the Private Fund

Investment Advisers Registration Act of 2010 ("the 2010 Bill"), which will change the exemption from SEC registration for non-U.S. based investment advisers. A companion bill previously passed by the House of Representatives includes almost identical language. It is very likely that the Act will pass. Swiss based investment advisers with U.S. clients should carefully review their client portfolios over the coming weeks.

Who Is an Investment Adviser?

Generally speaking, an investment adviser is any person who, for compensation, provides advice to others concerning the value or advisability of investing in or selling securities. Unless excluded or exempt from the Investment Advisers Act of 1940, as amended by the 2010 Bill or other changes (the "Advisers Act"), it is unlawful for an investment adviser to provide investment advisory services to U.S. clients without registering with the SEC.

Who is a U.S. Client?

For these purposes, a "U.S. client" means a U.S. resident, a U.S. entity

and certain trusts. Under the current interpretation of the Advisers Act, the term “client” includes only persons or entities that have a direct advisory relationship with the adviser. In the case of a private investment fund, the fund itself is considered to be the client of the adviser, but the underlying investors in the fund are not (the House Bill would change this result by including investors in funds to be counted in determining the application of the foreign private adviser exemption).

Both the House Bill and the 2010 Bill provide the SEC with statutory authority to define the term “client”, but it is prohibited from defining the term “client” to include an investor in a private fund managed by an investment adviser *if* the fund has entered into an advisory contract with the advisor.

Registration Exemption for Foreign Private Advisers

The 2010 Bill would exempt from registration “foreign private advisers,” defined as Investment Advisers that:

- have no place of business in the U.S.;
- have, in total, fewer than 15 clients who are domiciled in or residents of the U.S.;
- have aggregate assets under management attributable to clients in the U.S. and investors in the U.S. in private funds advised by the Investment Adviser of less than \$25 million, or such higher amount as the SEC may, by rule, deem appropriate; and
- do not generally hold themselves out to the public in the U.S. as

Investment Advisers, nor act as Investment Advisers to any investment company registered under the Investment Company Act of 1940, or a company that has elected to be a business development company and has not withdrawn its election.

As a result of the 2010 Bill, Swiss based independent asset managers will be required to register if they have (i) 15 U.S. clients; *or* (ii) \$25 million or more of assets under management attributable to U.S. investors.

The SEC could still potentially define the term “client” to include the underlying investors in a private investment fund as long as the definition did not include investors in private funds who have entered into an advisory relationship with the advisor.

The House Bill provides a much narrower exemption than the 2010 Bill passed by the Senate insofar as it would require Swiss based advisers to register under the Advisers Act if they have, during the preceding 12 months, (i) a combined total of 15 U.S. clients (counting both direct clients *and* also counting U.S. investors within a private fund advised by the Investment Adviser), *or* (ii) \$25 million of assets under management attributable to U.S. investors.

Exemption for Family Offices

The Senate Bill excludes family offices from the definition of “Investment Adviser” and requires that the SEC define the term “family office.” At this point, it is unclear how

the term family office would be defined.

The House Bill does not contain an exception from the definition of “Investment Adviser” for family offices.

Recordkeeping, Reporting and Examination Rules for Private Funds

The Senate Bill would require Investment Advisers to “private funds” who aren’t exempt from registration to file certain information including, for each private fund advised by the Investment Adviser, a description of:

- the amount of assets under management and use of leverage;
- counterparty credit risk exposure;
- trading and investment positions;
- valuation policies and practices of the fund;
- types of assets held;
- side arrangements or side letters;
- trading practices;
- such other information as the SEC, in consultation with the Council, determines is necessary and appropriate in the public interest and for the protection of investors or for the assessment of systemic risk, which may include the establishments for different

classes of fund advisers, based on the type or size of private fund advised.

The House Bill contains a similar list of information to be maintained by a private fund and subject to inspection by the SEC, but it is less inclusive. It does not require a description of the following information:

- valuation policies and practices of the fund;
- types of assets held;
- side arrangements or side letters.

The House Bill would require the SEC to consult with the Board of Governors of the Federal Reserve System to determine what information may be necessary or appropriate in the public interest and for the protection of investors or for the assessment of systemic risk.

Conclusion

The Senate Bill now must be reconciled with the House Bill. The effective date of this bill remains uncertain.

Assuming these changes are enacted, Swiss based asset managers will be forced either to register as Investment Advisers with the SEC or exit U.S. client relationships.

* * * * *