

October 4, 2005

February 1, 2006 Deadline for Hedge Fund Manager Registration Quickly Approaching

By February 1, 2006, most hedge fund managers will be required to be registered with the Securities and Exchange Commission (SEC) as a registered investment adviser (RIA) under revised Rule 203(b)(3)-2 of the Investment Advisers Act of 1940 (the Advisers Act). Also by that date, these new RIAs:

- must have in place a written compliance program designed to prevent violations of the Advisers Act and its rules;
- must have designated a chief compliance officer to operate the program; and
- must have the program fully functioning.

The Registration Process – Form ADV

To register, an RIA completes and files Part I of Form ADV. Filings are made electronically through the Investment Advisers Registration Depository (IARD) on its website, www.iard.com. The website explains how to set up an account to pay the filing fees and complete and submit the Form ADV. The website also contains Form ADV Part II, which may be used to satisfy the rule requiring the RIA to disclose material information about its services to its clients. Part II is not filed with the IARD but must be filled out, periodically updated and kept in the RIA's files.

Under current rules, the SEC must either grant registration or institute proceedings to determine whether to deny registration within 45 days after the adviser files a complete Form ADV. The filing period may be tolled if the SEC examiner concludes that the form is incomplete or if he or she has questions about any responses on the form.

The SEC is encouraging prospective advisers to file their Form ADV Part I by the end of October 2005 to accommodate its review and comment process. The SEC anticipates a large number of filings at year end and cannot assure that a filing received in November or later will have been processed by the February 1 deadline.

The Compliance Program

The Advisers Act's rules require that each investment adviser have designed and implemented a compliance program by February 1, 2006. The first steps in this process are to draft a compliance manual and a code of ethics, reasonably designed to prevent violations by the RIA and its employees of the Advisers Act and its rules, and to designate a Chief Compliance Officer to develop and enforce appropriate policies and procedures for the RIA.

The Compliance Manual: Although the rules do not specify the subjects that must be addressed in the compliance manual, an SEC release has enumerated those that, at a minimum, should be covered:

- portfolio management processes;
- trading practices;
- proprietary trading of the RIA and personal trading activities of supervised persons;
- the accuracy of disclosures made to investors, clients and regulators;
- safeguarding of client assets from conversion or inappropriate use by advisory personnel;
- the accurate creation and maintenance of required records;
- marketing activities, including the use of solicitors;
- processes to value client holdings and assess fees;
- privacy policies and procedures; and
- business continuity plans.

The Code of Ethics: The code of ethics must, among other things, address (i) restrictions on personal securities trading by the adviser's staff, (ii) compliance with the federal securities laws such as the ban against front running and (iii) the consequences of violating the code of ethics.

Tailoring the Compliance Manual and the Code of Ethics to the RIA's Operations: The SEC expects a compliance program to vary from RIA to RIA based upon many factors, including the types of services provided, the size of the adviser's work force and the kinds of clients the RIA accepts. While many model manuals and codes are now available, these are best used as a starting point for developing personalized documents, preferably in consultation with an attorney.

Educating the RIA's Personnel about its Compliance Program: By February 1, 2006, each RIA must have in place a properly functioning compliance program. A successful program will depend on educating the RIA's staff on how the program works and what is expected of them. Each RIA must decide how best to convey this information. For some, it may suffice to have their staff read the documents. Others may need to institute formal training classes. Special attention must be paid to familiarizing staff with the changing requirements of federal and state securities laws, the federal Privacy Act and the federal laws designed to prevent money laundering.

The SEC Audit. The SEC typically audits a new RIA within 6 to 18 months after registration is granted. These audits focus considerable attention on the RIA's compliance program, the Code of Ethics and other required policies, and the RIA's required records.

We would be pleased to respond to any questions you have about the RIA registration requirements, help you identify areas of your compliance program that need strengthening or provide training for your staff. Please contact the Seyfarth Shaw corporate attorney with whom you normally work or any member of the Investment Management Practice Group listed under the Corporate Practice area on our website at www.seyfarth.com.

