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Hedge Fund Manager Registration Under the Dodd-Frank Act

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Hedge Fund Manager Registration Under the Dodd-Frank Act

WULF A. KAAL*

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I. INTRODUCTION

Registering hedge fund advisers is controversial because hedge funds evolved as unsupervised entities, free of most regulatory supervision. Hedge funds' ability to invest in global markets without supervision and significant disclosure obligations was important for successful hedge fund launches, helped generate higher returns, and attracted investors. Regulatory oversight could be an infringement on hedge fund managers' ability to generate absolute returns.[1] The hedge fund industry has traditionally opposed the registration of hedge fund managers and increased disclosure.[2]

1. *See* Dale A. Oesterle, *Regulating Hedge Funds*, 1 ENTREPRENEURIAL BUS. L.J. 1, 31 (2006) (arguing that direct regulation of hedge funds may also make the financial system less resilient by reducing the willingness of hedge funds to act as liquidity providers in times of crisis and that increased regulation may lead individual hedge funds to take on more risk or to invest less effort in managing risk); EISNERAMPER & HOFSTRA UNIV. FRANK G. ZARB SCH. OF BUS., DODD-FRANK BILL—A YEAR AND A HALF LATER: VIEWS FROM THE HEDGE FUND INDUSTRY 2–3 (2012), *available at* http://www.eisneramper.com/uploadedFiles/Resource_Center/Articles/Articles/Dodd_Frank.pdf [hereinafter EISNERAMPER SURVEY]; Press Release, Hofstra Univ., Dodd-Frank Drives Investor Acceptance of Hedge Fund Model, New Survey Reports (Apr. 12, 2012) (on file with author) ("[M]ost hedge funds surveyed expect their operational cost will rise due to increased costs of the regulations found in the Dodd-Frank bill."); *see also* Jón Daníelsson et al., *Highwaymen or Heroes: Should Hedge Funds Be Regulated—A Survey*, 1 J. FIN. STABILITY 522, 523 (2005) (expressing concern over the potential effects of regulation); Mohamed Gaber et al., *Funds of Hedge Funds: Ethics of This Black Box Strategy*, 9 PENSIONS 328, 328 (2004) ("As providers of absolute returns, hedge funds are less regulated by the Securities & Exchange Commission (SEC) than US mutual funds."); Michael R. King & Philipp Maier, *Hedge Funds and Financial Stability: Regulating Prime Brokers Will Mitigate Systemic Risks*, 6 J. FIN. STABILITY 283, 284, 293 (2009) (arguing against increased regulation of hedge funds); Houman B. Shadab, *The Challenge of Hedge Fund Regulation*, REGULATION, Spring 2007, at 36, 41 (2007).

2. *Hedge Fund Operations: Hearing Before the H. Comm. on Banking & Fin. Servs.*, 105th Cong. 26 (1998) (statement of Alan Greenspan, Chairman, Federal Reserve Board) (repeating Greenspan's support for continued loose regulation of the hedge fund industry); U.S. SEC. & EXCH. COMM'N, STAFF REPORT: IMPLICATIONS OF THE GROWTH OF HEDGE FUNDS 90 (2003) [hereinafter 2003 SEC HEDGE FUND REPORT], *available at* http://www.sec.gov/news/studies/hedgefunds0903.pdf ("Many of those opposing required registration expressed a strong preference for leaving the hedge fund industry 'unregulated.' They argued that the incidence of fraud among hedge fund advisers is low, and that hedge funds are adequately supervised by prime brokers, auditors and lenders. Some asserted that there would be no purpose in requiring registration, arguing that the types of clients investing in hedge funds are able to take steps to protect themselves without the assistance of the Commission." (footnotes omitted)); Stephen

With the success and the proliferation of the hedge fund industry, retail investors increasingly gained access to hedge funds,[3] and hedge fund fraud increased.[4] Several spectacular hedge fund failures[5] seemed

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Brown et al., *Mandatory Disclosure and Operational Risk: Evidence from Hedge Fund Registration*, 63 J. FIN. 2785, 2789 (2008) (stating that when the SEC tried to change registration rules in 2004, the changes were strongly opposed by hedge fund managers, "who argued that completing the 35-page form was unnecessarily costly and burdensome"); Carol J. Loomis, *Hard Times Come to the Hedge Funds*, FORTUNE, Jan. 1970, at 100, 100 (stating that the threat of SEC action was viewed as a deterrent to growth, and hedge fund managers in the 1960s and 1970s disliked the thought of SEC regulation, dreading the "prospect of an SEC move that would prevent them from earning their compensation in the traditional way").

3. *See generally* Wulf A. Kaal, *Hedge Fund Valuation: Retailization, Regulation, and Investor Suitability*, 28 REV. BANKING & FIN. L. 581 (2009).

4. *See* Dodd-Frank Wall Street Reform and Consumer Protection (Dodd-Frank) Act, Pub. L. No. 111-203, § 403, 124 Stat. 1376, 1571 (2010) (eliminating section 203(b)(3) of the Investment Advisers Act of 1940 (Advisers Act), the private adviser exemption); Rules Implementing Amendments to the Investment Advisers Act of 1940, 76 Fed. Reg. 42,950, 42,963–64, 42,982 (July 19, 2011) ("[W]e believe the public reporting requirements we are adopting will provide a level of transparency that will help us to identify practices that may harm investors, will aid investors in conducting their own due diligence, and will deter advisers' fraud and facilitate earlier discovery of potential misconduct. . . . [T]hese reports will create a publicly accessible foundation of basic information that could aid investors and prospective investors in conducting due diligence and could further help investors and other industry participants protect against fraud." (footnotes omitted)); Whittier, Investment Advisers Act Release No. 2637, 91 SEC Docket 1161, at 2 (Aug. 21, 2007) (settling an action against hedge fund manager for, among other things, misrepresenting to fund investors that a particular auditor audited certain hedge funds, when in fact it did not); Registration Under the Advisers Act of Certain Hedge Fund Advisers, 69 Fed. Reg. 72,054, 72,059 (Dec. 10, 2004) (requiring fund advisers to register under the Advisers Act so that the Commission could gather "basic information about hedge fund advisers and the hedge fund industry," "oversee hedge fund advisers," and "deter or detect fraud by unregistered hedge fund advisers"); 2003 SEC HEDGE FUND REPORT, *supra* note 2, at xi, 2, 72–75 (finding that the hedge fund industry as a whole lacks fraud protection and disclosure requirements and that the hedge fund industry allows for overleveraging and the retailization of hedge funds to investors); Majed R. Muhtaseb & Chun Chun "Sylvia" Yang, *Portraits of Five Hedge Fund Fraud Cases*, 15 J. FIN. CRIME 179 (2008) (identifying and extensively investigating fraud committed by hedge funds); Franklin R. Edwards, *New Proposals To Regulate Hedge Funds: SEC Rule 203(b)(3)-2*, at 2 (Columbia Univ. APEC Study Ctr., Discussion Paper No. 35, 2004), *available at* http://www7.gsb.columbia.edu/apec/sites/default/files/discussion/35EdwardsHedge.pdf (examining the Commission's new proposal to address its current concerns about hedge funds, rule 203(b)(3)-2, which would require the registration of most advisers to hedge funds with the SEC); Press Release, U.S. Sec. & Exch. Comm'n, SEC Adopts Dodd-Frank Act Amendments to Investment Advisers Act (June 22, 2011), http://www.sec.gov/news/press/2011/2011-133.htm ("These reporting requirements are designed to help identify practices that may harm investors, deter advisers' fraud, and facilitate earlier discovery of potential misconduct.").

to confirm that the failure of systematically important hedge funds could have the potential to create such uncertainty as to impede trading, and in a worst case scenario, could cause damage to the real economy.[6] The combination of these factors, among others, resulted in an unparalleled effort by regulators to increase the supervision of hedge funds.[7]

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5. Massive hedge fund failures include Amaranth Advisors, with the most significant loss of value, Bailey Coates, Cromwell Fund, Marin Capital, Aman Capital, Tiger Funds, and Long-Term Capital Management (LTCM), the most famous hedge fund collapse. *See* ROGER LOWENSTEIN, WHEN GENIUS FAILED: THE RISE AND FALL OF LONG-TERM CAPITAL MANAGEMENT (2000) (providing an in-depth look at LTCM's collapse); PRESIDENT'S WORKING GRP. ON FIN. MKTS., HEDGE FUNDS, LEVERAGE, AND THE LESSONS OF LONG-TERM CAPITAL MANAGEMENT 10–25 (1999), *available at* http://www.treasury.gov/resource-center/fin-mkts/Documents/hedgfund.pdf (discussing the LTCM incident and recommending a number of measures to constrain excessive leverage); U.S. GEN. ACCOUNTING OFFICE, LONG-TERM CAPITAL MANAGEMENT: REGULATORS NEED TO FOCUS GREATER ATTENTION ON SYSTEMIC RISK (1999) (reviewing LTCM's "near-collapse"); Franklin R. Edwards, *Hedge Funds and the Collapse of Long-Term Capital Management*, 13 J. ECON. PERSP. 189 (1999) (exploring the policy implications of LTCM's collapse); King & Maier, *supra* note 1, at 288 ("Prominent victims of funding illiquidity are LTCM, Amaranth Advisors, Bear Stearns and Lehman Brothers. In all cases, their asset positions had a positive mark-to-market value, but they were unable to meet margin calls."); René M. Stulz, *Hedge Funds: Past, Present, and Future*, 21 J. ECON. PERSP. 175, 188 (2007) ("[T]he Amaranth losses led to calls for regulation of hedge funds."); Linda Chatman Thomsen et al., *Hedge Funds: An Enforcement Perspective*, 39 RUTGERS L.J. 541, 545–47 (2008) (describing LTCM's "meltdown"); Joseph G. Haubrich, *Some Lessons on the Rescue of Long-Term Capital Management* (Fed. Reserve Bank of Cleveland, Policy Discussion Paper No. 19, 2007), *available at* http://ssrn.com/abstract=987558 (reviewing the restructuring and recapitalization of LTCM).

6. *Hedge Funds and Systemic Risk in the Financial Markets: Hearing Before the H. Comm. on Fin. Servs.*, 110th Cong. 4 (2007) (statement of Rep. Spencer Bauchus); *id.* at 8 (statement of E. Gerald Corrigan, Managing Director, Goldman Sachs & Company); Jón Daníelsson & Jean-Pierre Zigrand, *Regulating Hedge Funds*, 10 FIN. STABILITY REV. 29, 30 (2007) ("Hedge funds do . . . contribute to systemic risk whereby the failure of a systemically important hedge fund has the potential to create sufficient uncertainty in the markets for liquidity to dry up and for trading to cease with potentially costly consequences."); Tomas Garbaravicius & Frank Dierick, *Hedge Funds and Their Implications for Financial Stability* 27 (Eur. Cent. Bank Occasional Paper Series, Paper No. 34, 2005), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=752094 ("The near-collapse of LTCM . . . underscores how hedge fund activities can harm financial institutions and markets."); Jim Geene, Defining Hedge Funds: Regulations and Strategies in Mature and Emerging Markets 12 (June 15, 2010) (unpublished manuscript), *available at* http://ssrn.com/abstract=1641592 ("After the fall of LTCM, it became clear that unregulated hedge funds come with risks. LTCM caused financial problems to investors and the whole financial system was in danger."); Nicholas Chan et al., *Systemic Risk and Hedge Funds*, NAT'L BUREAU ECON. RES. (Mar. 2005), http://www.nber.org/papers/w11200 ("[S]ince the collapse of Long Term Capital Management in 1998, it has become clear that hedge funds are also involved in systemic risk exposures. The hedge-fund industry has a symbiotic relationship with the banking sector, and many banks now operate proprietary trading units that are organized much like hedge funds. As a result, the risk exposures of the hedge fund industry may have a material impact on the banking sector, resulting in new sources of systemic risks.").

7. *See* Geene, *supra* note 6, at 12; *see also* Loomis, *supra* note 2, at 100 (discussing previous efforts to regulate hedge funds); Ben S. Bernanke, Chairman, Fed.

Since the proliferation of the hedge fund industry in the 1980s, the SEC had repeatedly attempted to register hedge fund advisers.[8] The SEC made its last attempt in 2004 to require registration of hedge fund advisers,[9] but two years later the United States Court of Appeals for the District of Columbia vacated the registration rule, finding it "arbitrary" in *Goldstein v. SEC*.[10] Although the vast majority of hedge fund advisers had registered under the SEC's registration requirements, they immediately deregistered after the *Goldstein* decision.[11] The advisers' decision to deregister in 2006 seems to confirm the industry's opposition to registration and disclosure requirements.

The role of hedge funds in global financial markets was again highlighted in the global financial crisis of 2008–2009.[12] Some studies

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Reserve Bd., Speech at the Federal Reserve Bank of Atlanta's 2006 Financial Markets Conference: Hedge Funds and Systemic Risk (May 16, 2006), *available at* http://www.federalreserve.gov/newsevents/speech/Bernanke20060516a.htm ("Following the LTCM crisis and the publication of the Working Group's recommendations, the debate about hedge funds and the broader effects of their activities on financial markets abated for a time. That debate, however, has now resumed with vigor—spurred, no doubt, by the creation of many new funds, large reported inflows to funds, and a broadening investor base. Renewed discussion of hedge funds and of their benefits and risks has in turn led to calls for authorities to implement new policies, many of which will be topics of this conference. . . . Authorities' primary task is to guard against a return of the weak market discipline that left major market participants overly vulnerable to market shocks. Continued focus on counterparty risk management is likely the best course for addressing systemic concerns related to hedge funds.").

8. *See infra* Part II.

9. Registration Under the Advisers Act of Certain Hedge Fund Advisers, 69 Fed. Reg. 72,054 (Dec. 20, 2004) (to be codified at 17 C.F.R. pts. 275 & 279); *see also* Troy A. Paredes, *On the Decision To Regulate Hedge Funds: The SEC's Regulatory Philosophy, Style, and Mission*, 2006 U. ILL. L. REV. 975, 976; *infra* Part II.

10. Oesterle, *supra* note 1, at 41 (citing Goldstein v. SEC, 451 F.3d 873 (D.C. Cir. 2006)).

11. *See Is Deregistration as an Adviser with U.S. SEC an Option?: 1 February 2007 Deadline Approaches*, DECHERT (Jan. 2007), http://www.dechert.com/files/Publication/882b5c5a-7fc0-4d48-9553-90939b1607e0/Presentation/PublicationAttachment/444d917d-420b-4d0c-b037-91e8fe9d6780/FSissue2De-Registrationpdf.pdf ("[M]any hedge fund advisers that registered with the SEC have already deregistered, and others are now contemplating deregistration.").

12. Maria Strömqvist, *Hedge Funds and Financial Crises*, 1 ECON. REV. 87, 89–90 (2009), *available at* http://www.riksbank.se/upload/Dokument_riksbank/Kat_publicerat/PoV_sve/eng/stromqvist2009_1_eng.pdf ("The high degree of leverage entails risks for the counterparties of the hedge funds (for example the lenders) and the failure of a fund may therefore have contagion effects in the financial system."); Photis Lysandrou, *The Real Role of Hedge Funds in the Crisis*, FIN. TIMES (Apr. 1, 2012, 6:55 AM), http://www.ft.com/cms/s/0/e83f9c52-6910-11e1-9931-00144feabdc0.html#ixzz1zmj84oze (registration required) ("Had it not been for hedge funds' intermediary position between the investors

suggest that hedge funds may have a destabilizing effect on financial markets.[13] Others point out that hedge funds were not identifiable as the culprits for the financial crisis.[14] Despite the mixed evidence, regulators

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seeking yield on the one hand and the banks that created the high yielding securities on the other, the supply of these securities, known as collateralised debt obligations, would never have reached the proportions that were critical in precipitating the near collapse of the whole financial system.").

13. *See, e.g.*, Tobias Adrian et al., *Hedge Fund Tail Risk*, *in* QUANTIFYING SYSTEMIC RISK 155, 155 (Joseph G. Haubrich & Andrew W. Lo eds., 2013) ("While hedge funds are liquidity providers in usual times, during times of market crisis, they can be forced to delever, potentially contributing to market volatility."); Photis Lysandrou, *The Primacy of Hedge Funds in the Subprime Crisis*, 34 J. POST KEYNESIAN ECON. 225, 227 (2012) ("Take away hedge funds and a general financial crisis could still have occurred in 2007–8, but it is only because of the hedge funds that the crisis that actually occurred initially took on the . . . form of a subprime crisis."); Garbaravicius & Dierick, *supra* note 6, at 27 ("The near-collapse of LTCM . . . underscores how hedge fund activities can harm financial institutions and markets. A sequence of negative events can start with losses on leveraged market positions. Liquidity shortages then come into play, which are further exacerbated by asset illiquidity in stressed markets. Thus, leveraged market risk can, if not supported by adequate liquidity reserves or borrowing capacity, force a fund to default on its obligations to prime brokers and other financial institutions. The spill-over effect on markets depends on the fund's size and the relative importance of its positions in certain markets."); John Kambhu et al., *Hedge Funds, Financial Intermediation, and Systemic Risk* 11–12 (Fed. Reserve Bank of N.Y., Staff Report No. 291, 2007), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1003210 ("If systemic risk is fundamentally about financial markets linkages to the real economy, then hedge funds create systemic risk to the extent that they can disrupt the ability of financial intermediaries or financial markets to efficiently provide credit. . . . [B]anks' direct exposure to hedge funds has been growing proportionately with the hedge fund industry itself."); Andrew W. Lo, Hedge Funds, Systemic Risk, and the Financial Crisis of 2007–2008: Written Testimony Prepared for the U.S. House of Representatives Committee on Oversight and Government Reform's November 13, 2008 Hearing on Hedge Funds 10 (Nov. 17, 2008) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1301217 ("[O]ver the past decade, these investors and funds have become central to the global financial system, providing loans, liquidity, insurance, risk-sharing, and other importan[t] services that used to be the exclusive domain of banks. But unlike banks—which are highly regulated entities (but less so, since the repeal of the Glass Steagall Act in 1999), with specific capital adequacy requirements and leverage and risk constraints—hedge funds and their investors are relatively unconstrained. . . . [Hedge funds] can also cause market dislocation in crowded markets with participants that are not fully aware of or prepared for the crowdedness of their investments.").

14. Andrew W. Lo, *Regulatory Reform in the Wake of the Financial Crisis of 2007-2008*, 1 J. FIN. ECON. POL'Y 4, 16 (2009) ("While the shadow banking system has no doubt contributed to systemic risk in the financial industry, hedge funds have played only a minor role in the current financial crisis, as evidenced by the lack of attention they have received in the government's recent bailout efforts."); Roberta Romano, *Against Financial Regulation Harmonization: A Comment* 3 (Yale Law & Econ., Research Paper No. 414, 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1697348 ("[T]here is an absence of evidence pointing to hedge funds as a contributing factor in the recent financial panic."); Houman B. Shadab, *Hedge Funds and the Financial Crisis* 1 (N.Y. Law Sch. Legal Studies, Research Paper No. 09/10 #31, 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1564847 ("[H]edge funds did not cause or meaningfully exacerbate the financial crisis and in fact have reduced its impact

and commentators demanded greater regulatory oversight of the global hedge fund industry to improve the stability of global financial markets.[15]

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) is the latest chapter in the debate on hedge fund adviser registration. Title IV of the Dodd-Frank Act is entitled the Private Fund Investment Advisers Registration Act of 2010 (PFIARA or Title IV).[16] The PFIARA authorizes the SEC to promulgate rules requiring registration and enhanced disclosure for private equity and hedge funds managers.[17] As part of the new rules, the SEC introduced controversial reporting obligations that require the disclosure of strategies and products used by the investment adviser and its funds, performance and changes in performance, financing information, risks metrics, counterparties and credit exposure, positions held by the investment adviser, percentage of assets traded using algorithms, and the percentage of equity and debt, among others.[18]

This Article presents the results of the first survey study with hedge fund advisers after the SEC's registration effective date. The population consists of 1267 private fund advisers who registered before the SEC's registration effective date for private funds, March 30, 2012. The Author's research team contacted the entire population via fax questionnaire, e-mail survey, and interviews. Respondents (n=94) answered questions in several categories designed to identify the effects of registration and disclosure requirements under the Dodd-Frank Act. The categories

and are helping the economy to recover."); Stephen Brown et al., *Hedge Funds After Dodd-Frank*, NYU STERN SCH. BUS. (July 19, 2010, 3:41 PM), http://w4.stern.nyu.edu/blogs/regulatingwallstreet/2010/07/hedge-funds-after-doddfrank.html (assessing hedge funds' noncontribution to systemic risk in general and during the recent crisis).

15. Robert J. Bianchi & Michael E. Drew, *Hedge Fund Regulation and Systemic Risk*, 19 GRIFFITH L. REV. 6, 16–25 (2010); Oesterle, *supra* note 1, at 13; Geene, *supra* note 6, at 2; Luis A. Aguilar, Comm'r, U.S. Sec. & Exch. Comm'n, Speech at the Hedgeworld Fund Services Conference: Hedge Fund Regulation on the Horizon—Don't Shoot the Messenger (June 18, 2009), *available at* http://www.sec.gov/news/speech/2009/spch061809laa.htm.

16. Dodd-Frank Act, Pub. L. No. 111-203, § 401, 124 Stat. 1376, 1570 (2010).

17. *Id.* §§ 402–408.

18. SEC. & EXCH. COMM'N, SEC 2048 (12-11), FORM PF, REPORTING FORM FOR INVESTMENT ADVISERS TO PRIVATE FUNDS AND CERTAIN COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS [hereinafter FORM PF], *available at* http://www.sec.gov/about/forms/formpf.pdf; SEC. & EXCH. COMM'N, SEC 1707 (09-11), FORM ADV, UNIFORM APPLICATION FOR INVESTMENT ADVISER REGISTRATION AND REPORT BY EXEMPT REPORTING ADVISERS [hereinafter FORM ADV], *available at* http://www.sec.gov/about/forms/formadv.pdf.

included, among others, compliance measures, strategic responses, long-term effect of reporting and disclosure rules on private funds, long-term effect of reporting and disclosure rules on the private fund industry, cost of compliance, effect of the regulatory regime on assets under management, and effect of the regulatory regime on profitability.

Part I of this Article introduces the issue of hedge fund registration and the tension between regulators and the hedge fund industry regarding the appropriate level of regulatory oversight. After a short introduction of historical attempts to register hedge fund managers, Part II describes the legal requirements in the Dodd-Frank Act pertaining to hedge fund managers. Over fifty years of low-level regulatory oversight for the hedge fund industry came to an end with the enactment of the Dodd-Frank Act. Part III outlines the methodological approach of the survey study. It introduces the survey instrument, data sources, sampling, coding, and coding constraints, and evaluates possible selection bias issues. Part IV discusses the results of the survey study with descriptive statistics, and Part V presents the substantive results of the study in summary graphs. Part VI summarizes the key findings and discusses implications for hedge fund policy. It also evaluates limitations of the survey study and possible implications for future research.

II. HEDGE FUND OVERSIGHT

Securities regulation in the United States has traditionally not emphasized hedge fund oversight. To restore public trust in capitalism after the 1929 depression, Roosevelt's New Deal included comprehensive securities regulations.[19] Although the New Deal securities regulation established the legal basis for modern securities regulation,[20] the drafters considered sophisticated investors investing their own funds capable of fending for themselves with no need for the protection of the securities laws.[21]

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19. MICHAEL E. PARRISH, SECURITIES REGULATION AND THE NEW DEAL 3 (1970).

20. *Id.* Roosevelt's New Deal established the Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a–77aa (1982 & Supp. IV 1987)); the Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a–78kk (1982 & Supp. IV 1987)); the Investment Company Act of 1940, Pub. L. No. 76-768, 54 Stat. 789 (codified as amended at 15 U.S.C. §§ 80a-1 to -64 (1982 & Supp. IV 1987)); and the Investment Advisers Act of 1940, Pub. L. No. 76-768, 54 Stat. 789 (codified as amended at 15 U.S.C. §§ 80b-1 to -21 (1982 & Supp. IV 1987)).

21. *See* JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE 41 (1982); James M. Landis, *The Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29, 37 (1959).

The drafters also considered the sale of securities to a limited group of experienced investors beyond the reach of the federal government.[22] Accordingly, hedge fund regulation in the United States was historically based mostly on compliance with accredited investor standards[23] in combination with exemptions for hedge fund advisers.[24] Before the enactment of the Dodd-Frank Act in 2010,[25] hedge funds were able to remain exempt from the securities laws as long as they limited the sale of their securities to a limited number of accredited investors, limited the

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22. *See* SEC v. Ralston Purina Co., 346 U.S. 119, 124–25 (1953); Landis, *supra* note 21, at 37. Companies selling securities to sophisticated investors, as defined by investor wealth, can be exempt from securities regulations if they comply with statutory requirements. *See, e.g.*, Rules Governing the Limited Offer and Sale of Securities Without Registration Under the Securities Act of 1933, 17 C.F.R. § 230.501 (2012). The Securities Act distinguishes between public and private offerings and provides exemptions for transactions not involving a public offering, 15 U.S.C. § 77d(2) (2006), and sales of securities other than those made by an issuer, underwriter, or dealer, Securities Act § 4(1).

23. *See Ralston Purina*, 346 U.S. at 125 (holding that investors who met the Regulation D criteria qualified to invest in hedge funds because they could "fend for themselves"); 17 C.F.R. § 230.501(a)(5)–(6) (defining the term "accredited investor" as a natural person whose individual net worth exceeded $1 million at the time of the purchase, or whose individual income exceeded $200,000 in each of the two most recent years and who had a reasonable expectation of reaching the same income level in the year of investment). After its attempt to require hedge fund registration and its subsequent defeat in *Goldstein*, the SEC, in August 2007, dramatically expanded fraud protection for investors. *See* Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles, 72 Fed. Reg. 44,756, 44,757 (Aug. 9, 2007) (to be codified at 17 C.F.R. pt. 275) ("The rule prohibits advisers from (i) making false or misleading statements to investors or prospective investors in hedge funds and other pooled investment vehicles they advise, or (ii) otherwise defrauding these investors. The rule clarifies that an adviser's duty to refrain from fraudulent conduct under the federal securities laws extends to the relationship with ultimate investors and that the Commission may bring enforcement actions under the Advisers Act against investment advisers who defraud investors or prospective investors in those pooled investment vehicles."); Prohibition of Fraud by Advisors to Certain Pooled Investment Vehicles; Accredited Investors in Certain Private Investment Vehicles, 72 Fed. Reg. 400, 404 (proposed Dec. 26, 2006) (to be codified as amended at 17 C.F.R. pts. 230 & 275) (reasoning that "natural persons may have indirect exposure to private pools" and "many individual investors today may be eligible to make investments in privately offered investment pools as accredited investors that previously may not have qualified as such for those investments").

24. *See* Advisers Act § 203(b) (providing broader registration requirement exemptions for hedge fund advisers than the Dodd-Frank Act).

25. *See infra* Part II.B.

resale of their securities, and did not advertise or otherwise hold themselves out to the public.[26]

The collapse of large hedge funds such as Long-Term Capital Management (LTCM) in 1998,[27] Amaranth in 2006,[28] and others[29] highlighted the potential systemic risks posed by the industry.[30] In 2008 and 2009, the hedge fund industry was blamed for taking excessive risks that contributed to the financial crisis.[31] The systemic risk of hedge

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26. *See* Wulf A. Kaal, *Hedge Fund Regulation via Basel III*, 44 VAND. J. TRANSNAT'L LAW 389, 412–16 (2011) (summarizing hedge fund regulation before the Dodd-Frank Act). Hedge funds, for the most part, limited the sale of their securities to accredited investors to remain exempt from registration and supervision. *See* 17 C.F.R. § 230.501(a)(5) (providing a safe harbor under § 4(2) of the Securities Act and defining an "accredited investor" as a person with a net worth of more than $1 million). The SEC proposed amending Regulation D, noting that inflation might have eroded the significance of a $1 million net worth as a proxy for investor sophistication. *See* Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles; Accredited Investors in Certain Private Investment Vehicles, 72 Fed. Reg. at 405 (proposing two steps for determining whether an investors would be accredited: (1) whether the individual meets the test in rule 501(a) or rule 215 and (2) whether the individual "owns at least $2.5 million in investments"). *But see* Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles, 72 Fed. Reg. at 44,756 n.2 (deferring consideration of proposed change to definition of "accredited investor").

27. *See* sources cited *supra* notes 5–6; *see also* Philippe Jorion, *Risk Management Lessons from Long-Term Capital Management*, 6 EUR. FIN. MGMT. 277 (2000) (drawing risk management lessons from LTCM); Paul N. Roth & Brian H. Fortune, *Hedge Fund Regulation in the Aftermath of Long-Term Capital Management*, *in* HEDGE FUNDS: LAW AND REGULATION 83 (Iain Cullen & Helen Parry eds., 2001) (describing the industry response to LTCM's collapse).

28. *See* sources cited *supra* notes 5–6; *see also* Ludwig B. Chincarini, *The Amaranth Debacle: A Failure of Risk Measures or a Failure of Risk Management?*, J. ALTERNATIVE INVESTMENT, Winter 2007, at 91 (analyzing "the causes and details of the collapse of Amaranth").

29. Other massive hedge fund failures included Bailey Coates, Bayou Management, Cromwell Fund, Philadelphia Alternative Asset Management, Marin Capital, Aman Capital Global, Tiger Funds, Eifuku Master Trust, Lyceum Capital, and Wood River Partners. *See* MARK JICKLING & ALISON A. RAAB, CONG. RESEARCH SERV., RL33746, HEDGE FUND FAILURES 5–9 (2006).

30. *See* sources cited *supra* notes 6, 13; *see also Regulation of Hedge Funds: Hearing Before the S. Comm. on Banking, Hous., & Urban Affairs*, 109th Cong. 31 (2006) (statement of Christopher Cox, Chairman, SEC) ("[H]ad the Federal Reserve Bank of New York not intervened to organize a $3.6 billion bailout by the fund's creditor banks, the bankruptcy of LTCM 'could have potentially impaired the economies of many nations, including our own.'"); Kaal, *supra* note 3, at 628 ("Regulators could be inclined to argue that market failure in financial instruments precipitated systemic risk.").

31. 155 CONG. REC. H14,441–42 (daily ed. Dec. 9, 2009) (statement of Rep. Sheila Jackson-Lee) ("[The Dodd-Frank Act will] provide[] more transparency and tougher regulation of hedge funds, private equity firms, and credit rating agencies, whose seal of approval gave way to excessively risky practices that led to a financial collapse."); Kaal, *supra* note 26, at 391 ("Hedge funds have been blamed for their part in the crisis and . . . for the problems affecting many aspects of financial markets." (footnotes omitted)); *America's Stockmarket Plunge: A Few Minutes of Mayhew*, ECONOMIST, May 15, 2010,

funds in combination with increasing hedge fund adviser fraud[32] and the retailization of the hedge fund industry[33] led to increasing demands for a heightened level of supervision for the hedge fund industry.[34] In 2004, the SEC changed the rules to, in effect, register hedge fund advisers.[35] The D.C. Circuit Court of Appeals overturned the registration requirement for hedge fund advisers in 2006.[36] The hedge fund registration and disclosure requirements in the Dodd-Frank Act increase oversight and appear to resolve the tension between the industry and the regulators.[37]

A. Attempts To Register Hedge Funds

Since the inception of the hedge fund industry,[38] the appropriate level of oversight has been a balancing act to satisfy the demands of the

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at 82, 82, *available at* http://www.economist.com/node/16113270 ("Another factor [in the debate] was the sudden retreat by the 'high frequency' firms whose algorithmic trading has come to dominate equity markets.").

32. Registration Under the Advisers Act of Certain Hedge Fund Advisers, 69 Fed. Reg. 72,054, 72,078 (Dec. 10, 2004) (to be codified at 17 C.F.R. pts. 275 & 279) ("Registration allows us to conduct examinations of hedge fund advisers, and our examinations provide a strong deterrent to advisers' fraud, identify practices that may harm investors, and lead to earlier discovery of fraud that does occur.").

33. *Id.* at 72,058 ("Investors that have not been traditional hedge fund investors, including pension plans that have millions of beneficiaries, are thus today purchasing hedge funds. As a result of the participation by these entities in hedge funds, the assets of these entities are exposed to the risks of hedge fund investing. Losses resulting from hedge fund investing and hedge fund frauds may affect the entities' obligations to their beneficiaries or pursue other intended purposes."); *see also Hearing on the Nomination of William H. Donaldson, of New York, To Be a Member of the U.S. Securities and Exchange Commission Before the S. Comm. on Banking, Hous. & Urban Affairs*, 108th Cong. 1, 37 (2003) (statement of William H. Donaldson), *available at* http://www.gpo.gov/fdsys/pkg/CHRG-108shrg90929/pdf/CHRG-108shrg90929.pdf (describing the retailization of hedge funds as a "distressing move"); Kaal, *supra* note 3 (discussing the phenomenon of retailization). *But see* 2003 SEC HEDGE FUND REPORT, *supra* note 2, at 80 ("[T]he staff has not uncovered evidence of significant numbers of retail investors investing directly in hedge funds.").

34. *See, e.g.*, 2003 SEC HEDGE FUND REPORT, *supra* note 2, at 77, 80; Oesterle, *supra* note 1, at 1 ("Pressure is mounting to control hedge funds, managed pools of private money that use very sophisticated trading strategies in securities, currencies, and derivatives.").

35. *See supra* note 9 and accompanying text.

36. Goldstein v. SEC, 451 F.3d 873, 884 (D.C. Cir. 2006).

37. *See supra* notes 16–18 and accompanying text.

38. *See generally* Carol J. Loomis, *The Jones Nobody Keeps Up With*, FORTUNE, Apr. 1966, at 237 (describing the hedge fund model of Alfred Winslow Jones and introducing the concept to the investing community); Loomis, *supra* note 2 (discussing the history of hedge funds); Julie Rohrer, *The Red-Hot World of Julian Robertson*,

industry for lower levels of oversight against the need for investor protection. With the emergence of the Jones hedge fund model in late 1949,[39] the hedge fund industry evolved without significant regulatory oversight.[40] In 1968, the SEC's first official action against a hedge fund came in the investigation of Merrill Lynch, Pierce, Fenner & Smith for alleged misuse of inside information.[41] Because of hedge funds' alleged impact on the markets in the 1969 bear market, the SEC started to consider

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INSTITUTIONAL INVESTOR, May 1986, at 86 (reintroducing investors to the potential of hedge funds).

39. FRANCOIS-SERGE LHABITANT, HEDGE FUNDS: MYTHS AND LIMITS 7 (2002); Stulz, *supra* note 5, at 176; Peter Landau, *Alfred Winslow Jones: The Long and Short of the Founding Father*, INSTITUTIONAL INVESTOR, Aug. 1968, at 1; Lawrence C. Strauss, *The Legacy*, BARRON'S, May 31, 2004, at 2; Alan Rappeport, *A Short History of Hedge Funds*, CFO.COM (Mar. 27, 2007), http://www.cfo.com/article.cfm/8914091/c_8913455; *see also* Ted Caldwell, *"Jones Model Funds": LMC's Recommended Classification Name*, LOOKOUT MOUNTAIN HEDGE FUND REV., 4th Quarter 1995, at 1, *available at* http://www.jones model.info/pdf/jones_model_named_Q4_95.pdf (describing the Jones Model); Alfred Winslow Jones, *Fashions in Forecasting*, FORTUNE, Mar. 1949, at 88 (providing Jones's thoughts on the new methods of market analysis); Loomis, *supra* note 38 (describing Jones's hedge fund model); *Measuring Market Risk*, A.W. JONES, http://www.awjones.com/measuringmarketrisk.html (last visited Apr. 7, 2013) (giving an excerpt from the 1961 Basic Report to the Limited Partners of the firm, describing in detail the measurement and management of market risk).

40. *See* sources cited *supra* note 2; *see also* Franklin R. Edwards & Stav Gaon, *Hedge Funds: What Do We Know?*, J. APPLIED CORP. FIN., Fall 2003, at 58, 58 ("While hedge funds have been around since at least the 1940s, . . . [g]overnment regulators . . . have become increasingly interested in hedge funds, especially since the much-publicized collapse of Long Term Capital Management (LTCM) in August 1998."); William Fung & David A. Hsieh, *A Primer on Hedge Funds*, 6 J. EMPIRICAL FIN. 309, 309 (1999) ("For over half a century of its existence, the hedge fund industry has stayed opaque to the general investing public."); Stulz, *supra* note 5, at 175 ("Hedge funds are mostly unregulated."); Rory B. O'Halloran, Comment, *An Overview and Analysis of Recent Interest in Increased Hedge Fund Regulation*, 79 TUL. L. REV. 461, 462 (2004) ("Hedge funds, though historically very secretive and lightly regulated, have recently been cast into the spotlight once again by the media, the United States Securities and Exchange Commission (SEC), and the New York State Attorney General.").

41. Merrill Lynch, Pierce, Fenner & Smith, Inc., SEC Admin. Proc. File No. 3-1680, [1967–1969 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,596 (Aug. 26, 1968); *In re* Merrill Lynch, Pierce, Fenner & Smith, Inc., 43 S.E.C. 933, 937 (1968) (settling with Merrill Lynch and establishing the "Chinese Wall"); *see also* Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 231 (2d Cir. 1974) (allowing private suit against Merrill Lynch and its clients by stock purchasers to proceed); *In re* Investors Mgmt. Co., 44 S.E.C. 633 (1971), *available at* http://www.sec.gov/alj/aljdec/1971/34-9267.pdf (reviewing censures against investors who sold stock based on Merrill Lynch's inside information); Loomis, *supra* note 2, at 139 (describing SEC's investigation and its ramifications); *Merrill Lynch Firm, Others Cited in SEC Action*, SEC NEWS DIG., Aug. 27, 1968, at 1, 1, *available at* http://www.sec.gov/news/digest/1968/dig082768.pdf ("The SEC has ordered administrative proceedings under the Securities Exchange Act of 1934 involving the New York broker-dealer firm of Merrill Lynch, Pierce, Fenner & Smith, Inc., fourteen of its officers and salesmen and fifteen institutional investors.").

ways to bring hedge funds under its regulatory authority.[42] Initially, the SEC opined that hedge funds are "dealers" in securities and could require registration under the Securities Exchange Act.[43] However, the SEC continued to provide guidance mostly in the form of no-action letters to help investment advisers determine the counting of clients to stay exempt from securities regulation.[44] Courts also provided very limited and sometimes contradictory guidance.[45]

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42. U.S. SEC. & EXCH. COMM'N, 35TH ANNUAL REPORT 18 (1969), *available at* http://www.sec.gov/about/annual_report/1969.pdf; Loomis, *supra* note 2, at 100.

43. Hugh F. Owens, Comm'r, U.S. Sec. & Exch. Comm'n, Address at the North American Securities Administrators Association: A Regulator Looks at Some Unregulated Investment Companies—The Exotic Funds 3–4 (Oct. 21, 1969), *available at* http://www.sec.gov/news/speech/1969/102169owens.pdf (suggesting that the SEC's staff might view the typical hedge fund as a dealer within the meaning of section 3(a)(5) of the Securities Exchange Act); *see also* Robert C. Hacker & Ronald D. Rotunda, *SEC Registration of Private Investment Partnerships After* Abrahamson v. Fleschner, 78 COLUM. L. REV. 1471, 1474 (1978) ("A typical hedge fund partnership could conceivably be regarded as a 'dealer,' because it regularly buys and sells securities for its own account. Similarly, the manager of a hedge fund partnership could be viewed as a 'broker,' because he regularly effects securities transactions for the account of the partnership."); Loomis, *supra* note 2, at 140 (describing SEC staff attempts to define hedge funds as dealers).

44. To remain exempt from securities regulation, investment advisers were required to determine which clients qualified as a client for purposes of the securities laws. *See* Ruth Levine, SEC No-Action Letter, 1976 SEC No-Act. LEXIS 2719, at *2–3 (Dec. 15, 1976); David Shilling, SEC No-Action Letter, 1976 SEC No-Act. LEXIS 865, at *1–4 (Apr. 3, 1976); B.J. Smith, SEC No-Action Letter, 1975 SEC No-Act. LEXIS 2642, at *1–2 (Dec. 25, 1975); S.S. Programs, Ltd., SEC No-Action Letter, 1974 SEC No-Act. LEXIS 599, at *6–7 (Oct. 17, 1974); Wofsey, Rosen, Kweskin & Kuriansky, SEC No-Action Letter, 1974 SEC No-Act. LEXIS 2154, at *3 (Apr. 25, 1974); Hawkeye Bancorporation, SEC No-Action Letter, 1971 SEC No-Act. LEXIS 883, at *2 (June 11, 1971). International financial institutions with operations in the United States also structured their operations to meet U.S. regulatory requirements relying on SEC no-action letters under which a U.S. subsidiary and a non-U.S. parent are separate entities for the purpose of the registration requirements under U.S. securities law. *See, e.g.*, Royal Bank of Can. et al., SEC No-Action Letter, 1998 SEC No-Act. LEXIS 620, at *8–10 (June 3, 1998); ABN AMRO Bank N.V. et al., SEC No-Action Letter, 1997 SEC No-Act. LEXIS 754, at *10–11 (July 1, 1997); Murray Johnstone Holdings Ltd. et al., SEC No-Action Letter, 1994 SEC No-Act. LEXIS 734, at *4–5 (Oct. 7, 1994); Kleinwort Benson Inv. Mgmt. Ltd. et al., SEC No-Action Letter, 1993 SEC No-Act. LEXIS 1181 (Dec. 15, 1993); Mercury Asset Mgmt. PLC, SEC No-Action Letter, 1993 SEC No-Act. LEXIS 652, at *3–7 (Apr. 6, 1993); Uniao de Bancos de Brasileiros S.A., SEC No-Action Letter, 1992 SEC No-Act. LEXIS 817, at *5–10 (July 28, 1992); *see also* Janie Casello Bouges, *Why the SEC's First Attempt at Hedge Fund Adviser Registration Failed*, J. ALTERNATIVE INVESTMENTS, Winter 2006, at 89, 92 ("Confusion existed before the adoption of the 'safe harbor' when the SEC staff issued numerous no-action letters that required an investment adviser to look through and count each individual advisee or member as a separate client."); Donna M. Nagy, *Judicial Reliance on Regulatory*

Finally, in 1985, the SEC adopted the investment adviser registration safe harbor rule under the Investment Advisers Act of 1940 (Advisers Act).[46] For purposes of an exemption from registration under the Advisers Act, the safe harbor allowed a limited partnership, rather than each of its limited partners, to be counted as a "client" of a general partner acting as investment adviser to the partnership.[47] Justifying the rule, the SEC reasoned that if an investment adviser manages an investment pool on the basis of the investment objectives of its participants as a group, the entire pool should be viewed as the adviser's client rather than each participant.[48] The rule was aimed at providing investment advisers with greater certainty in determining when they may rely on the safe harbor.[49]

The SEC broadened the scope of the rule in 1997 by including other entities used by investment advisers to pool client assets.[50] While the

Interpretations in SEC No-Action Letters: Current Problems and a Proposed Framework, 83 CORNELL L. REV. 921, 966–67 (1998) (contending that mere reliance on SEC no-action letters led to significant legal uncertainty for the hedge fund industry and that the investing public's reliance on SEC no-action letters creates problems for courts).

45. *See, e.g.*, Abrahamson v. Fleschner, 568 F.2d 862, 869–71 (2d Cir. 1977) (stating that general partners of limited partnerships investing in securities were investment advisers but leaving unanswered the question of whether the partnership or each of the partners should be counted as clients), *overruled on other grounds by* Transamerica Mortg. Advisors, Inc. v. Lewis, 444 U.S. 11, 24 (1979) (stating that the Advisers Act confers a limited private remedy to void an investment contract but does not confer any other private causes of action, legal or equitable); *see also* Hacker & Rotunda, *supra* note 43, at 1484 (describing the *Abrahamson* court's failure to address the registration issue).

46. 17 C.F.R. § 275.203(b)(3)-1 (1986); *see also* Advisers Act, Pub. L. No. 76-768, 54 Stat. 789 (1940) (codified as amended at 15 U.S.C. §§ 80b-1 to -21 (1982 & Supp. IV 1987)); Definition of "Client" of an Investment Adviser for Certain Purposes Relating to Limited Partnerships, 50 Fed. Reg. 29,206, 29,206 (July 18, 1985) (to be codified at 17 C.F.R. pt. 275) (defining a single client for purposes of § 203(b)(3)-1 as a limited partnership to which investment advice is provided based on the objectives of the limited partnership rather than the individual objectives of the limited partners, thereby resolving the question of whether advisers to unregistered investment pools were required to look through the pools to count each investor as a client or could count each pool as a single client).

47. 17 C.F.R. § 275.203(b)(3)-1(b)(1) ("A limited partnership shall be counted as a client of any general partner or other person acting as investment adviser to the partnership . . . .").

48. Definition of "Client" of Investment Adviser for Certain Purposes Relating to Limited Partnerships, 50 Fed. Reg. 8740, 8741 (proposed Mar. 5, 1985).

49. Definition of "Client" of an Investment Adviser for Certain Purposes Relating to Limited Partnerships, 50 Fed. Reg. at 29,206; Bouges, *supra* note 44, at 92; Roberta S. Karmel, *Regulation by Exemption: The Changing Definition of an Accredited Investor*, 39 RUTGERS L. REV. 681, 695 n.90 (2008).

50. Rules Implementing Amendments to the Investment Advisers Act of 1940, 62 Fed. Reg. 28,112, 28,124 (May 22, 1997) (to be codified at 17 C.F.R. pts. 275 & 279) (allowing an investment adviser to count a legal organization as a single client under rule 203(b)(3)-1(a)(2)(i), provided the investment advice is based on the objectives of the legal organization instead of the individual investment objectives of any owner(s) of the

1985 rule permitted advisers to count each partnership, trust, or corporation as a single client, the 1997 rule expanded the rule to cover other legal entities.[51] Specifically, investment advisers were allowed to count a legal organization as a single client provided the investment advice was based on the objectives of the legal organization rather than the individual investment objectives of any owners of the legal organization.[52] This safe harbor allowed investment advisers to manage large amounts of securities indirectly for several hundreds of investors in several hedge funds.[53]

After the fall of LTCM in 1998 and its bailout orchestrated by the New York Federal Reserve Bank,[54] it became increasingly apparent that hedge funds could pose risks that may affect international markets. Concerns over excessive leverage by hedge funds and a lack of transparency led to increasing demands for new regulation.[55] Central banks, regulatory agencies, and international "regulatory" committees conducted studies to determine if hedge funds posed a risk to the global financial system.[56] Many of these studies concluded that there was a

legal entity). Before the SEC adopted this rule, it was largely unclear whether advisers to unregistered investment pools were required to count each pool as a single client or whether they had to look through the pools to count each investor as a client. Registration Under the Advisers Act of Certain Hedge Fund Advisers, 69 Fed. Reg. 45,172, 45,181 (proposed July 28, 2004).

51. Rules Implementing Amendments to the Investment Advisers Act of 1940, 62 Fed. Reg. at 28,124; Definition of "Client" of an Investment Adviser for Certain Purposes Relating to Limited Partnership, 50 Fed. Reg. at 29,206.

52. Rules Implementing Amendments to the Investment Advisers Act of 1940, 62 Fed. Reg. at 28,124.

53. *See* Definition of "Client" of an Investment Adviser for Certain Purposes Relating to Limited Partnership, 50 Fed. Reg. at 29,206 (defining "client" of an investment adviser for purposes of the Advisers Act).

54. *See* Edwards, *supra* note 5, at 200–04 (discussing the policy implications of the LTCM rescue by the Federal Reserve); *see also* sources cited *supra* note 5.

55. Willa E. Gibson, *Is Hedge Fund Regulation Necessary?*, 73 TEMP. L. REV. 681, 681–82 (2000); Oesterle, *supra* note 1, at 31; Robert C. Pozen, Opinion, *Hedge Funds Today: To Regulate or Not?*, WALL ST. J., June 20, 2005, at A14.

56. *See, e.g.*, BASEL COMM. ON BANKING SUPERVISION, BANKS' INTERACTIONS WITH HIGHLY LEVERAGED INSTITUTIONS (1999), *available at* http://www.bis.org/publ/bcbs45.pdf; BASEL COMM. ON BANKING SUPERVISION & TECHNICAL COMM. OF THE INT'L ORGS. OF SEC. COMMS., RECOMMENDATIONS FOR PUBLIC DISCLOSURE OF TRADING AND DERIVATIVES ACTIVITIES OF BANKS AND SECURITIES FIRMS (1999), *available at* http://www.bis.org/publ/bcbs48.pdf; COMM. ON THE GLOBAL FIN. SYS., A REVIEW OF FINANCIAL MARKET EVENTS IN AUTUMN 1998 (1999), *available at* http://www.bis.org/publ/cgfs12.pdf; COUNTERPARTY RISK MGMT. POLICY GRP., IMPROVING COUNTERPARTY RISK MANAGEMENT PRACTICES (1999), *available at* http://archives.financialservices.house.gov/banking/62499crm.pdf; FIN. STABILITY FORUM, REPORT OF THE WORKING GROUP ON

need for greater disclosure by hedge funds to increase transparency and enhance market discipline.[57]

Eventually, in December 2004, the SEC, using its rulemaking authority under the Advisers Act,[58] issued a final rule requiring hedge fund advisers to register under the Advisers Act.[59] The rule was controversial and strongly opposed by hedge fund advisers.[60] Without the private adviser

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HIGHLY LEVERAGED INSTITUTIONS (2000), *available at* http://www.financialstabilityboard.org/publications/r_0004a.pdf; INT'L SWAPS & DERIVATIVES ASS'N, ISDA 1999 COLLATERAL REVIEW (1999), *available at* http://www.isda.org/press/pdf/colrev99.pdf; MULTIDISCIPLINARY WORKING GRP. ON ENHANCED DISCLOSURE, FINAL REPORT (2001), *available at* http://www.bis.org/publ/joint01.pdf; PRESIDENT'S WORKING GRP. ON FIN. MKTS., *supra* note 5; TECHNICAL COMM., INT'L ORG. OF SEC. COMM'NS, ELEMENTS OF INTERNATIONAL REGULATORY STANDARDS ON FUNDS OF HEDGE FUNDS RELATED ISSUES BASED ON BEST MARKET PRACTICES: FINAL REPORT (2009), *available at* http://www.iosco.org/library/pubdocs/pdf/IOSCOPD305.pdf; TECHNICAL COMM., INT'L ORG. OF SEC. COMM'NS, HEDGE FUNDS OVERSIGHT: FINAL REPORT (2009), *available at* http://www.iosco.org/library/pubdocs/pdf/IOSCOPD293.pdf; 2003 SEC HEDGE FUND REPORT, *supra* note 2; Transcript of SEC Hedge Fund Roundtable Part 1 (File No. 05-007-03), U.S. SEC. & EXCH. COMM'N (May 14, 2003), http://www.sec.gov/spotlight/hedgefunds/hedge1trans.txt; Transcript of SEC Hedge Fund Roundtable Part 2 (File No. 05-007-03), SECS & EXCH. COMM'N (May 15, 2003), http://www.sec.gov/spotlight/hedge funds/hedge2trans.txt.

57. Edwards & Gaon, *supra* note 40, at 58; *see, e.g.*, FIN. STABILITY FORUM, *supra* note 56, at 3.

58. 15 U.S.C. § 80b-11(a) (2006) ("The Commission [may adopt] . . . rules . . . necessary or appropriate to the exercise of the functions and powers conferred upon the Commission elsewhere in this subchapter . . . [and] may classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters"); 15 U.S.C. § 80b-2(a)(17) (2006) ("The Commission may by rules and regulations classify, for the purposes of any portion or portions of this subchapter, persons, including employees controlled by an investment adviser.").

59. Registration Under the Advisers Act of Certain Hedge Fund Advisers, 69 Fed. Reg. 72,054 (Dec. 10, 2004) (to be codified at 17 C.F.R. pts. 275 & 279) (adopting a new rule and rule amendments that require advisers of certain private investment pools to register with the SEC pursuant to the Advisers Act).

60. MANAGED FUNDS ASS'N, THE SEC FUNDS ASSOCIATION PROPOSAL: THE PUBLIC COMMENTARY—A SUMMARY (2004), *available at* http://www.sec.gov/rules/proposed/s73004/mfa101804.pdf ("The SEC received 156 letters as of October 13th, 124 of which were either for or against the proposal. The overwhelming number of the 124 comment letters that took a position *opposed* the SEC Proposal . . . 91 letters submitted were AGAINST the proposal (73%)." (footnote omitted)); Deborah Solomon, *SEC Pushing Proposal To Regulate Hedge Funds*, WALL ST. J., July 1, 2004, at C4 ("Opinions within the hedge-fund community are mixed. About 40% of hedge-fund advisers are already voluntarily registering with the agency, and some hedge funds have said they welcome regulation to help make their business more sound. But others see it as an unnecessary intrusion that could lead to further, more invasive regulation down the road. Some of the strongest dissent is coming from within the SEC, where Commissioners Cynthia Glassman and Paul Atkins have both expressed concern about hedge-fund regulation."); Adam C. Cooper, Chairman, Managed Funds Ass'n, Statement Before the Greenwich Roundtable 1, 4 (Aug. 19, 2004), *available at* https://www.managedfunds.org/downloads/Greenwich_Roundtable_Cooper.pdf ("[I]t remains MFA's position that the imposition of the proposed regulatory regime on hedge fund managers will not work to benefit investors or the global financial markets, and that other, more efficacious means may be employed to achieve the ends desired. . . . MFA believes that the success and growth of the industry

exemption, investment advisers were subject to SEC inspections and bookkeeping and record-keeping requirements.[61] Without the private adviser exemption, hedge funds were also faced with disclosure requirements[62] and code of ethics requirements[63] resulting in significantly higher legal fees. The industry "argued that completing the 35-page [Form ADV] was unnecessarily costly and burdensome."[64] Registration also allowed the SEC "to screen hedge fund advisers for prior convictions or other professional misconduct."[65]

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testify to the fact that the current regulatory regime works well. Under the existing regime, hedge fund managers are subject to a wide variety of direct and indirect regulation, whether registered or not. . . . This regime reflects a long-standing recognition by Congress and U.S. regulators that government resources should be devoted to protecting investors that require protection, rather than those that can look out for themselves."); Letter from Richard M. Whiting, Exec. Dir. & Gen. Counsel, Fin. Servs. Roundtable, to Jonathan G. Katz, Sec'y, U.S. Sec. & Exch. Comm'n 1 (Sept. 15, 2004), *available at* http://www.sec.gov/rules/proposed/s73004/rmwhiting091504.pdf ("[T]here are other, less intrusive methods to achieve the goals identified by the Commission."); *Comments on Proposed Rule: Registration Under the Advisers Act of Certain Hedge Fund Advisers*, U.S. SEC. & EXCH. COMM'N, http://www.sec.gov/rules/proposed/s73004.shtml (last modified Mar. 21, 2005); Transcript of SEC Hedge Fund Roundtable Part 1 (File No. 05-007-03), *supra* note 56; Transcript of SEC Hedge Fund Roundtable Part 2 (File No. 05-007-03), *supra* note 56.

61. 17 C.F.R. § 275.204-2 (2012) (stating that investment advisers "shall make and keep true, accurate and current the following books and records relating to its investment advisory business").

62. *Id.* § 275.204-3 (requiring registered investment advisers to "deliver a brochure and one or more brochure supplements to each client or prospective client that contains all information required by Part 2 of Form ADV").

63. *Id.* § 275.204A-1 (requiring registered investment advisers to "establish, maintain and enforce a written code of ethics," subject to some minimum requirements included in the rule).

64. Brown et al., *supra* note 2, at 2789; *see also* Paul S. Atkins, *Protecting Investors Through Hedge Fund Advisor Registration: Long On Costs, Short On Returns*, 25 ANN. REV. BANKING & FIN. L. 537, 541 (2006) ("Now that the rule has been adopted, its proponents can no longer overlook its flaws, which many of us foresaw. The application of the registration requirement to hedge fund advisors, for example, has highlighted information gaps in the existing Form ADV. Form ADV is unlikely to provide any new information to investors who have performed even the most minimal level of due diligence about an advisor. Nor does Form ADV provide information that is particularly helpful for the Commission's purpose in keeping abreast of hedge fund activities."); Gregory Zuckerman, *Hedge Funds Brace for Regulation*, WALL ST. J., June 8, 2005, at C1; Andrew Harris, *SEC Hedge Fund Registration Rule Struck Down by Court*, BLOOMBERG (June 23, 2006, 12:51 PM), http://www.bloomberg.com/apps/news?pid=email_us&refer=home&sid=axTbfV3PhcPg ("Plaintiff Phillip Goldstein, manager of Pleasantville, New York-based Opportunity Partners LP, argued that the SEC lacked the authority to regulate hedge funds and failed to take into account compliance costs as high as $500,000."); sources cited *supra* note 60.

65. Oesterle, *supra* note 1, at 9.

The rule was issued by a rare three-to-two vote of SEC Commissioners.[66] The SEC justified its rulemaking with reference to the growth of the hedge fund industry in combination with the retailization of the hedge fund sector, increased hedge fund risk, and financial loss to investors caused by instances of fraud by hedge fund advisers.[67] The SEC cited among the benefits of this rule more information about hedge fund advisers, the deterrence of fraud, the curtailment of losses, and improved compliance controls.[68] The SEC argued these positive aspects of its rulemaking would benefit mutual fund investors, other investors and markets, regulatory policy, and hedge fund advisers.[69]

The registration requirement precipitated significant opposition by the hedge fund industry.[70] Eventually, in July 2006, the D.C. Circuit in *Goldstein v. SEC* vacated the hedge fund rule as an instance of arbitrary rulemaking by the SEC.[71] Where the term *client* had not otherwise been

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66. *See* Registration Under the Advisers Act of Certain Hedge Fund Advisers, 69 Fed. Reg. 72,054, 72,089–97 (Dec. 10, 2004) (indicating that Commissioners Cynthia A. Glassman and Paul S. Atkins opposed releasing the final rule). Glassman and Atkins pointed to the 2003 SEC staff report, which found that retailization was not an issue and argued that the inflow of funds was so rapid that hedge fund advisers had more to invest than they could handle and were in no need to solicit retail investors. *Id.*; *see also* 2003 SEC HEDGE FUND REPORT, *supra* note 2, at 80 ("[T]he staff has not uncovered evidence of significant numbers of retail investors investing directly in hedge funds.").

67. *See* Registration Under the Advisers Act of Certain Hedge Fund Advisers, 69 Fed. Reg. at 72,057–59 (justifying the need for SEC action requiring hedge funds to register pursuant to the Advisers Act and noting several reasons for broader exposure to hedge funds in the investing public, including by investors who were previously too risk averse); 2003 SEC HEDGE FUND REPORT, *supra* note 2, at 81 (considering the decrease in minimum investment requirements and the corresponding increase in risks to small investors and stating that "[the SEC] ha[d] observed that the minimum qualifications required to invest in some hedge funds has decreased as newer entrants into the alternative investments market compete for investors").

68. *See* Registration Under the Advisers Act of Certain Hedge Fund Advisers, 69 Fed. Reg. at 72,078 (listing benefits that include a strong deterrent to advisers' fraud, identification of practices that may harm investors, earlier discovery of existing fraud, the ability to screen individuals seeking to advise hedge funds, and to deny entry to those with a history of disciplinary problems).

69. *Id.* at 72,078–80.

70. *See* sources cited *supra* note 60; *see also* Editorial, *Hedge Funds and the S.E.C.*, N.Y. TIMES, Oct. 27, 2004, at A20; *Hedge-Fund Proposal Troubles Greenspan*, WALL ST. J., Aug. 26, 2004, at A6; *Hedge Funds: Too Stern a Hand*, ECONOMIST, July 17, 2004, at 13; *Regulating Hedge Funds: Thorns in the Foliage*, ECONOMIST, Apr. 1, 2006, at 61; Deborah Solomon, *SEC Wants Hedge Funds in Open*, WALL ST. J., Apr. 9, 2004, at C1; Editorial, *The SEC's Expanding Empire*, WALL ST. J., July 13, 2004, at A14; Zuckerman, *supra* note 64.

71. Goldstein v. SEC, 451 F.3d 873, 884 ("[T]he *Hedge Fund Rule* only exacerbates whatever problems one might perceive in Congress's method for determining who to regulate. The Commission's rule creates a situation in which funds with one hundred or fewer investors are exempt from the more demanding Investment Company Act, but those with fifteen or more investors trigger registration under the Advisers Act. This is an arbitrary rule.").

defined in the Advisers Act, the SEC had no authority to determine the meaning of the term.[72] Most hedge fund advisers who had registered under the registration rule deregistered. After the *Goldstein* decision, the SEC proposed an increase for the accredited investor standards under Regulation D[73] and dramatically expanded antifraud protection for investors.[74]

B. Dodd-Frank Act Private Fund Rules

As a consequence of the global financial crisis, regulatory oversight of the global hedge fund industry became again a focus for regulators and legislatures.[75] In an attempt to close regulatory gaps and end the speculative trading practices that contributed to the 2008 financial market crisis,[76] Congress enacted the PFIARA in Title IV of the Dodd-Frank Act.[77] The Act amends the Advisers Act by establishing rules and regulations for the registration of private funds with the SEC.[78] By expanding the reporting requirements of private advisers to the SEC, Title IV is intended to provide greater protections for investors.[79]

72. *Id.* at 880–81.
73. *See* 17 C.F.R. § 230.501(a)(5) (2007).
74. *See* Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles; Accredited Investors in Certain Private Investment Vehicles, 72 Fed. Reg. 400 (proposed Jan. 4, 2007) (to be codified at 17 C.F.R. pts. 230 & 275) (proposing a new rule to allow the SEC to bring enforcement actions against investment advisers who defraud investors or prospective investors of hedge funds).
75. Dodd-Frank Act, Pub L. No. 111-203, §§ 401–416, 124 Stat. 1376, 1570–79 (2010) (incorporating the PFIARA in Title IV); *Proposal for a Directive of the European Parliament and of the Council on Alternative Investment Fund Managers and Amending Directives 2004/39/EC and 2009/.../EC*, COM (2009) 207 final (Apr. 30, 2009); Bianchi & Drew, *supra* note 15, at 16–25; Geene, *supra* note 6, at 2; Kaal, *supra* note 26, at 410–13; Oesterle, *supra* note 1, at 13; *Alternative Investments*, EUR. COMMISSION, http://ec.europa.eu/internal_market/investment/alternative_investments_en.htm (last updated Apr. 25, 2013) (providing additional materials on AIFM).
76. *See* Tom Braithwaite, *U.S. Senate Passes Financial Reform*, FT.COM (July 16, 2010, 1:01 AM), http://www.ft.com/intl/cms/s/0/6b9d4542-9026-11df-ad26-00144feab49a.html#axzz2DrwfWezl ("The financial reform legislation approved by Congress today represents a welcome and far-reaching step toward preventing a replay of the recent financial crisis." (quoting Ben Bernanke) (internal quotation marks omitted)).
77. *See* Dodd-Frank Act §§ 401–416.
78. H.R. REP. NO. 111-517, at 866–67 (2010) (Conf. Rep.), *available at* http://www.gpo.gov/fdsys/pkg/CRPT-111hrpt517/pdf/CRPT-111hrpt517.pdf.
79. *Id.*

The Act mandates hedge fund adviser registration to increase record keeping and disclosure.[80] Under the PFIARA, hedge funds with more than $150 million assets under management (AUM) are required to register as investment advisers and have to disclose information about their trades and portfolios to the SEC.[81] The Dodd-Frank Act also directs the SEC to set up rules for the registration and reporting of hedge fund managers who were previously exempt from registration.[82] By registering private fund advisers, the SEC may collect necessary information to curtail those who operate in the "shadows of our markets,"[83] prevent fraud, limit systemic risk, and provide information to investors.[84]

Title IV of the Dodd-Frank Act also requires registered investment advisers to maintain records and any other information that may be necessary and appropriate to avoid systemic risk.[85] Advisers are required to provide confidential reports with respect to certain information related to systemic risk,[86] such as trading practices; trading and investment positions;

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80. *See* Dodd-Frank Act § 408 ("The Commission shall require investment advisers exempted by reason of this subsection to maintain such records and provide to the Commission such annual or other reports as the Commission determines necessary or appropriate in the public interest or for the protection of investors.").

81. *Id.* ("The Commission shall provide an exemption from the registration requirements under this section to any investment adviser of private funds, if each of such investment adviser acts solely as an adviser to private funds and has assets under management in the United States of less than $150,000,000."); *see also* Dodd-Frank Act § 403 (striking private adviser exemption under section 203(b)(3) of the Advisers Act, thereby precluding many private fund advisers from avoiding registration); Rules Implementing Amendments to the Investment Advisers Act of 1940, 76 Fed. Reg. 42,950, 42,955 (July 19, 2011) (to be codified at 17 C.F.R. pts. 275 & 279) ("We are adopting revisions to the instructions to Part 1A of Form ADV to implement a uniform method for advisers to calculate assets under management that will be used under the Act for regulatory purposes in addition to assessing whether an adviser is eligible to register with the Commission."); Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, 76 Fed. Reg. 39,646, 39,666 (July 6, 2011) (to be codified at 17 C.F.R. pt. 275) (providing an exemption from registration for advisers with less than $150 million in private fund assets under management in the United States); U.S. SEC. & EXCH. COMM'N, FORM ADV: INSTRUCTIONS FOR PART 1A, at 6–9 (2011), *available at* http://www.sec.gov/about/forms/formadv-instructions.pdf (explaining how to calculate regulatory assets under management); FORM ADV, *supra* note 18, pt. 1A, at 5 (requiring exempt reporting advisers to check that they qualify for an exemption from registration: (i) "as an adviser solely to one or more venture capital funds" or (ii) because they act "solely as an adviser to *private funds* and have assets under management in the United States of less than $150 million").

82. Dodd-Frank Act § 404.

83. 155 CONG. REC. H14420 (daily ed. Dec. 9, 2009) (statement of Rep. Paul Kanjorski).

84. 156 CONG. REC. S5925–26 (daily ed. July 15, 2010) (statement of Sen. Richard Durbin).

85. Dodd-Frank Act §§ 404–405.

86. *Id.* § 404(b)(3).

the amount of AUM; valuation policies; side letters; the use of leverage, including off-balance sheet leverage; counterparty credit risk exposures; and other information deemed necessary.[87] The PFIARA also makes it mandatory for registered advisers to maintain records and any other information the SEC and the systemic risk regulators may deem necessary.[88]

The legislation was divisive in the drafting process. The legislators supporting the Dodd-Frank Act wanted the SEC to be able to obtain sufficient information necessary to protect against systemic risk, prevent fraud, and provide investors with useful information about the funds, even funds that are exempt from registration.[89] Representatives supporting the new hedge fund rules maintained that years without regulation ushered in the financial crisis.[90] Others were concerned the exemptions in Title IV could make the regulation of hedge funds less effective.[91] Legislators opposed to the new regulations alleged that the SEC failed to sufficiently curtail hedge funds under the existing rules[92] and argued that hedge funds did not create systemic risk, played no role in the financial crisis, and were irrelevant to the financial system as a whole.[93]

1. Registration

Hedge fund registration rules can be categorized into rules addressing Dodd-Frank's exemptions from registration enacted in connection with its repeal of section 203(b)(3) of the Advisers Act, rules addressing provisions in the Dodd-Frank Act that delegate responsibility for midsized investment advisers to state regulatory authorities rather than the SEC,

87. *Id.*
88. *Id.* § 404(b)(1)(A).
89. *See, e.g.*, 156 CONG. REC. S5912–13 (daily ed. July 15, 2010) (statement of Sen. Patrick Leahy) (supporting the hedge fund manager registration requirement in Dodd-Frank). *But see id.* at S5875–78 (statement of Sen. Richard Shelby) (questioning the effectiveness of the Dodd-Frank Act for reducing systemic risk and criticizing its reliance on massive bureaucracy).
90. 155 CONG. REC. H14,412–13 (daily ed. Dec. 9, 2009) (statement of Rep. Barney Frank); *id.* at H14,418 (statement of Rep. Henry Waxman).
91. *See* 156 CONG. REC. H5235–39 (daily ed. June 30, 2010) (statement of Rep. Paul Kanjorski) (outlining concerns with several of the exemptions).
92. *Id.*
93. *See* 156 CONG. REC. S5876 (statement of Sen. Shelby) ("[T]he bill gives the Securities Exchange and Commission . . . a new systemic risk mandate to oversee advisers to hedge funds and private equity funds. Yet no one contends private funds were a cause of the recent crisis or that the demise of any private fund during the crisis resulted in a systemwide shock.").

and amendments to Form ADV implemented by the SEC to reflect the new registration requirements under the Dodd-Frank Act.

In addition to exempting private fund advisers with less than $150 million AUM from registration,[94] the PFIARA provisions of the Dodd-Frank Act also exempt advisers with less than $100 million AUM who provide advice to clients on investments other than private funds,[95] venture capital fund advisers,[96] and foreign private advisers with fewer than fifteen clients and investors in the United States.[97] Although the entities that fall under the exemption criteria are not per se required to register, advisers with less than $150 million AUM have to maintain records and provide the SEC with annual reports or any other reports that the SEC deems appropriate or necessary to protect investors.[98] To determine the systemic risk of hedge funds and to impose registration and examination procedures accordingly, the PFIARA requires the SEC to examine factors including the investment strategy, size, and governance of an investment adviser.[99] The Dodd-Frank Act also empowers the SEC to utilize its rulemaking authority to prevent the exemptions from registration to "swallow the rules."[100]

The Dodd-Frank Act created the category of "mid-sized investment advisers."[101] A midsized adviser is generally defined as an investment adviser with between $25 and $100 million in AUM that is subject to registration and examinations with the state in which it maintains its principal office and place of business.[102] Dodd-Frank delegates responsibility for midsized investment advisers away from the SEC to state regulatory authorities.[103] Midsized advisers that do not fall under

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94. Dodd-Frank Act, Pub. L. No. 111-203, § 408, 124 Stat. 1376, 1575 (2010).

95. *Id.* § 410.

96. *Id.* § 407.

97. *Id.* §§ 402–403 (stating that in order to qualify for the exemption, foreign private advisers cannot have a place of business in the United States, cannot hold themselves out to the U.S. public as an investment adviser, and cannot have more than $25 million AUM attributed solely to U.S. clients and investors). *But see id.* § 402(a) (allowing the SEC to exercise its rulemaking powers and raise this amount).

98. *Id.* § 408.

99. *Id.*

100. 154 CONG. REC. H5238 (daily ed. June 30, 2010) (statement of Rep. Paul Kanjorski).

101. Dodd-Frank Act § 410 (amending section 203A(a)(2) of the Advisers Act); *see also* Rules Implementing Amendments to the Investment Advisers Act of 1940, 76 Fed. Reg. 42,950, 42,960–61 (July 19, 2011) (to be codified at 17 C.F.R. pts. 275 & 279).

102. Dodd-Frank Act § 410.

103. *Id.*; *see also* National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, § 303, 110 Stat. 3416, 3437 (providing for state regulation of investment advisers with less than $25 million AUM); *Protect Your Money: Check Out Brokers and Investment Advisers*, U.S. SEC. & EXCH. COMM'N, http://www.sec.gov/investor/brokers.htm (last modified Jan. 24, 2012); Luis A. Aguilar, Comm'r, U.S. Sec. & Exch. Comm'n,

the SEC registration requirements are instead required to register with the state securities commissioner or similar agency in the state of their principle place of business.[104] In some states, however, registered advisers are not subject to examination. The SEC will oversee midsized advisers in those states that will not provide appropriate oversight.[105]

Most important for the survey study in this Article, the SEC amended Form ADV, a disclosure document with periodic amendments, to reflect the new registration requirements under Dodd-Frank. Any investment adviser registering with the SEC is required to file Form ADV.[106] Investment advisers that were registered with the SEC on January 1,

Address at the NASAA/SEC 19(d) Conference: Advocating for Greater Federal and State Securities Regulatory Cooperation and Collaboration (May 7, 2012), *available* at http://www.sec.gov/news/speech/2012/spch050712laa.htm ("The oversight of investment advisers has always been a partnership between state and federal regulators. Congress reinforced this when it enacted Section 410 of the Dodd-Frank Act to expand state authority to include mid-sized investment advisers with $25 million to $100 million in assets." (footnotes omitted)).

104. Rules Implementing Amendments to the Investment Advisers Act of 1940, 76 Fed. Reg. at 42,952 (stating that a midsized adviser should determine whether she is "required to be registered" or "subject to examination" by a state securities authority, by consulting Item 2.b. of the Instructions for Part 1A of Form ADV); *Frequently Asked Questions Regarding Mid-Sized Advisers*, U.S. SEC. & EXCH. COMM'N, http://sec.gov/divisions/investment/midsizedadviserinfo.htm (last modified June 28, 2011) (stating that all state securities authorities other than New York and Wyoming have advised the SEC that advisers registered with them are subject to examination). This is no longer true for Minnesota. *See Investment Advisers: How To Register and Obtain a License in Minnesota*, MINN. DEP'T COM., http://mn.gov/commerce/licensees/Register-a-Security/Requirements/Investment-Adviser-Requirements.jsp (last visited Apr. 7, 2013).

105. Rules Implementing Amendments to the Investment Advisers Act of 1940, 76 Fed. Reg. at 42,952 & n.22 (citing data from the Investment Adviser Registration Depository and estimating that "approximately 3,200 SEC-registered advisers will be required to withdraw their registration and register with one or more state securities authorities").

106. FORM ADV, *supra* note 18; *see also* 17 C.F.R. § 279.1 (2012) (establishing filing requirements for Form ADV); Michael P. Coakley & Matthew P. Allen, *The New Form ADV Part 2 and the "Plain English" Movement of the SEC, FINRA, and Michigan's OFIR*, MICH. BUS. L.J., Spring 2001, at 19, 19 ("The SEC requires all investment advisers . . . registered with the SEC to complete and file a Form ADV with the SEC . . . ."); James F. Koehler & P. Wesley Lambert, *Impact of the Dodd-Frank and Registration Acts of 2010 on Investment Advisers*, 13 DUQ. BUS. L.J. 29, 34–35 (2011) (explaining how the rules require private fund advisers to mail additional disclosures to the SEC); Marybeth Sorady et al., *Summary and Analysis of Dodd-Frank Rules for Investment Advisers: Registration Requirements, Exemptions, Family Offices, Performance Fee Eligibility*, 12 J. INVESTMENT COMPLIANCE 4, 4 (2011) (explaining the rules recently adopted by the SEC under the provisions of the Dodd-Frank Act relating to the increased asset threshold for federal registration as an investment adviser and "focusing in particular on analyzing the impact of the Rules on U.S. and non-U.S. advisers to private funds").

2012, were required to file the amendment to Form ADV by March 30, 2012.[107]

Under amended Form ADV, registered investment advisers and exempt reporting advisers[108] are required to report to the SEC information regarding the private funds they manage.[109] The required disclosures include information regarding the investment strategy, the fund structure, ownership, the gross asset value, the scope of services provided, and the fund's use of consultants and other gatekeepers.[110] Another requirement under amended Form ADV is for registered advisers to disclose the number and types of their clients, including an assessment of the percentage of AUM attributable to each client type.[111] Nonadvisory activities and financial industry affiliations also have to be disclosed.

The AUM managed by an adviser determines whether the adviser must register with the SEC.[112] The Advisers Act defined Regulatory Assets Under Management (RAUM) as "the 'securities portfolios' with respect to which an adviser provides 'continuous and regular supervisory or management services.'"[113] Under revised Form ADV, advisers must report their gross RAUM rather than net; this means they will no longer be able to deduct outstanding debt or other accrued but unpaid liabilities from their totals.[114] To increase consistency, revised Form ADV also gives

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107. *See* 17 C.F.R. § 275.203A-5(b) (2012); *see also* Rules Implementing Amendments to the Investment Advisers Act of 1940, 76 Fed. Reg. at 42,953–54 (discussing rule 203A-5(b), which provides that SEC-registered advisers not required to file an annual updating amendment between January 1, 2012, and March 30, 2012, will file an other-than-annual amendment, but they will complete all of the items on Part 1A of Form ADV, not just the items required to be updated in a typical other-than-annual amendment).

108. FORM ADV, *supra* note 18, pt. 1A, at 5–6 (requiring exempt reporting advisers to disclose only a limited subset of items on Form ADV).

109. *Id.*

110. Rules Implementing Amendments to the Investment Advisers Act of 1940, 76 Fed. Reg. at 42,965–66 (requiring advisers to complete section 7.B.(1) of Schedule D for any private fund that the adviser manages when, previously, Item 7 required advisers only to complete section 7.B.(1) of Schedule D for "investment-related" limited partnerships or limited liability companies that the adviser or a related person advised). Part A of Section 7.B.(1) "requires an adviser to provide basic information regarding the size and organizational, operational, and investment characteristics of each fund." *Id.* at 42,965. Part B of the same section "requires advisors to report information concerning five types of [private fund] service providers that generally perform important roles as 'gatekeepers'"—which will both identify gatekeepers and give investors an idea of what kinds of roles particular gatekeepers play. *Id.* at 42,968. For example, advisers must indicate if a prime broker has custody of fund assets. *Id.* Information reported on this section of Schedule D will be publicly available. *Id.* at 42,965.

111. FORM ADV, *supra* note 18, pt. 1A, at Item 5.C–D.

112. Rules Implementing Amendments to the Investment Advisers Act of 1940, 76 Fed. Reg. at 42,955.

113. *Id.* (quoting Advisers Act § 203A(a)(3)).

114. *Id.* at 42,956.

investment advisers less room to exercise discretion in counting or excluding assets from RAUM.[115]

In order to provide the SEC with data, help it understand the respective adviser's business, and assist the SEC in preparing for on-site examinations, revised Form ADV requires advisers to disclose their clients, employees, compensation arrangements, and advisory activities.[116] Required disclosures include the number of employees;[117] the number of employees who perform advisory functions, are registered representatives of broker-dealers, are registered with state authorities as investment adviser representatives, and are insurance agents;[118] and the number of nonemployees—firms or other persons—who solicit advisory clients on the adviser's behalf.[119]

To help the SEC identify the entities and individuals with exposure to hedge fund investments, advisers are required to identify their clients by type including, for example, nonhigh and high net worth individuals, investment companies, banks, charities, and insurance companies.[120] Advisers must also identify what percentage of the adviser's total RAUM is owned by each particular type of client[121] and what compensation arrangements the adviser uses.[122] Investment advisers are also required to disclose the type of services they provide, including financial planning services, portfolio management, pension consultation, security rating, or educational seminars.[123]

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115. *Id.*; *see also id.* at 42,955 (precluding advisers from excluding family assets, proprietary assets, assets managed without compensation, and assets of foreign clients when calculating RAUM). The Dodd-Frank Act gives the SEC authority to require reporting and record keeping for assets carrying systemic risk. Dodd-Frank Act, Pub L. No. 111-203, § 404, 124 Stat. 1376, 1571 (2010); Rules Implementing Amendments to the Investment Advisers Act of 1940, 76 Fed. Reg. at 42,955.

116. FORM ADV, *supra* note 18, pt. 1A, at Item 5; *see* Rules Implementing Amendments to the Investment Advisers Act of 1940, 76 Fed. Reg. at 42,970 (adopting amendments to Item 5 largely as they were originally proposed, with only a few minor changes).

117. FORM ADV, *supra* note 18, pt. 1A, at Item 5.A.

118. *Id.* at Item 5.B.

119. *Id.*; *see also id.* at Items 5.C, 5.H (specifically excluding as clients investors in private funds that the adviser advises unless that investor also has a separate advisory relationship with the adviser); *id.* at Item 5.C.(1)–(2) (asking for the number of clients and what percentage are non-U.S. persons).

120. *Id.* at Item 5.D.(1).

121. *Id.* at Item 5.D.(2).

122. *Id.* at Item 5.E.

123. *Id.* at Item 5.G.; *see also id.* at Item 5.H (requiring disclosures pertaining to the number of clients the adviser provided with financial planning services); *id.* at Item 5.I

To avoid potential conflicts of interest between the different types of businesses and services the adviser may engage in,[124] Form ADV requires advisers to identify their types of business activity,[125] if one of those businesses is primary to the adviser,[126] and whether the adviser provides any services other than investment advice to advisory clients.[127] Because conflicts of interest may arise in direct transactions between advisers or related persons and clients, advisers are also required to disclose such transactions.[128] Other disclosures in this context include related-persons status of brokers and dealers,[129] soft dollar benefits, that is, research or other products and services in connection with client transactions,[130] and compensation for client referrals.[131]

(asking whether the adviser participates in a wrap fee program); *id.* at Item 5.J (asking whether the adviser previously indicated that it provides investment advice only with respect to limited types of investments).

124. Rules Implementing Amendments to the Investment Advisers Act of 1940, 76 Fed. Reg. 42,950, 42,970 (July 19, 2011) (to be codified at 17 C.F.R. pts. 275 & 279).

125. FORM ADV, *supra* note 18, pt. 1A, at Item 6.A (providing that business activities include broker-dealer, futures commission merchant, real estate broker, banking, legal work, or accounting).

126. *Id.* at Item 6.B.(1)–(2).

127. *Id.* at Item 6.B.(3) (asking the adviser to describe other products and services).

128. Rules Implementing Amendments to the Investment Advisers Act of 1940, 76 Fed. Reg. at 42,971; FORM ADV, *supra* note 18, pt. 1A, at Item 8.A (requiring disclosure as to whether the adviser or related person buys securities from or sells securities to advisory clients, buys securities for himself that he also recommends to advisory clients, or recommends securities to advisory clients in which the adviser or related person has a proprietary ownership interest other than the two described immediately above); *id.* at Item 8.B (requiring disclosure as to whether the adviser or related person acts as a broker-dealer or a registered representative of a broker-dealer in securities trades for brokerage customers in which advisory client securities are sold or bought, recommends the purchase of securities for which the adviser or related person is an underwriter, general or managing partner, or purchaser representative, or recommends purchase or sale of securities to advisory clients for which the adviser or any related person has any other sales interest); *id.* at Item 8.C (requiring disclosure as to whether the adviser or related person has discretionary authority to determine what securities should be sold on a client's account or the amount of securities to be sold on that account, to determine the broker or dealer to be used for purchases or sales for a client's account, or to determine the commission rates to be paid to a broker or dealer for a client's account).

129. *Id.* at Items 8.D, 8.F.

130. *Id.* at Item 8.G.

131. *Id.* at Items 8.H–I; *see* Rules Implementing Amendments to the Investment Advisers Act of 1940, 76 Fed. Reg. at 42,971–72 (adopting three amendments to Item 8: (1) an adviser who indicates that he has discretionary authority to determine brokers or dealers or that recommends brokers or dealers must report whether any of those brokers or dealers are related persons; (2) advisers receiving soft dollar benefits must report whether they are eligible for research or brokerage services under § 28(e) of the Exchange Act's safe harbor; and (3) an adviser must report whether it or its related person receives direct or indirect compensation for client referrals); *see also* FORM ADV, *supra* note 18, pt. 1A, at Items 8.C.3, 8.D–F, 8.G.(2); Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of

To assess investment advisers' custodial practices, the SEC, in revised Form ADV, requires disclosure as to whether the adviser or a related person has custody of client assets,[132] cash, bank accounts, or securities.[133] The adviser must indicate the total U.S. dollar amount held in custody and the total number of clients' cash, bank accounts, or securities subject to adviser or related-person custody.[134] If the adviser or a related person has custody of client assets, revised Form ADV requires disclosure of any irregularities to prevent fraud or mistakes.[135] The adviser must also indicate the number of persons, including the adviser and related persons, acting as qualified custodians for clients in connection with advisory services provided to those clients.[136]

2. Disclosure

In addition to making registration mandatory, the Dodd-Frank Act requires registered hedge fund advisers to file periodic reports.[137] The Commodity Futures Trading Commission (CFTC) and the SEC jointly proposed new Form PF in January 2011.[138] The SEC enacted Form PF

1934, Exchange Act Release No. 34-54165, 71 Fed. Reg. 41,978, 41,981–82 (July 24, 2006), *available at* http://www.sec.gov/rules/interp/2006/34-54165fr.pdf (providing interpretive guidance in determining whether soft dollar benefits fit under the safe harbor of § 28(e) of the Securities Exchange Act).

132. FORM ADV, *supra* note 18, pt. 1A, at Item 9; *see also* U.S. SEC. & EXCH. COMM'N, FORM ADV: GLOSSARY OF TERMS 2, *available at* http://www.sec.gov/about/forms/formadv.pdf#glossary ("[An adviser has] custody if a *related person* holds, directly or indirectly, client funds or securities, or has any authority to obtain possession of them, in connection with advisory services [the adviser] provides to clients.").

133. FORM ADV, *supra* note 18, pt. 1A, at Item 9.A–B.

134. *Id.*

135. *Id.* at Item 9.C (requiring advisers to disclose whether clients with assets under custody receive statements, whether an independent public accountant audits client accounts, or whether an independent public accountant prepares an internal control report with respect to custodial services).

136. *Id.* at Item 9.D (asking whether the adviser or a related person acts as a "qualified custodian" for clients in connection with advisory activities provided to clients and requiring the adviser to identify any related person who acts as a qualified custodian in § 7.A of Schedule D, regardless of whether the person is operationally independent under rule 206(4)-2 of the Advisers Act).

137. Dodd-Frank Act, Pub L. No. 111-203, § 404(b), 124 Stat. 1376, 1571 (2010); 17 C.F.R. § 275.204(b)-1 (2012); Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, 76 Fed. Reg. 71,128, 71,140 (Nov. 16, 2011) (to be codified at 17 C.F.R. pts. 275 & 279), *available at* http://www.gpo.gov/fdsys/pkg/FR-2011-11-16/pdf/2011-28549.pdf.

138. 17 C.F.R. § 275.204(b)-1 (requiring private fund advisers to file Form PF with the SEC periodically); 17 C.F.R. § 4.27 (2012) (requiring private fund advisers to file

in October 2011.[139] The reporting requirement in Form PF is intended to enable the Financial Stability Oversight Council (FSOC),[140] a council of banking and securities regulators, to "facilitate [the] monitoring of systemic risk in U.S. financial markets."[141] The SEC and the CFTC can utilize the information collected on Form PF for investigations and examinations.[142]

In adopting the final rules, the SEC had to balance the FSOC's interest in quality information to monitor systemic risk with industry concerns. Investment advisers are required to file Form PF if they hold $150 million RAUM or more attributable to private funds at the end of their most recently completed fiscal year, they are registered or are required to register with the SEC, and they advise a single private fund or several

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Form PF if they are registered as commodity pool operators or commodity trading advisers); Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, 76 Fed. Reg. at 71,129.

139. *See* 17 C.F.R. § 275.204(b)-1; Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, 76 Fed. Reg. at 71,239.

140. *See* Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, 76 Fed. Reg. at 71,128–30 (establishing the FSOC to monitor and assess risks to the U.S. financial system and to promote financial stability); *see also* Dodd-Frank Act § 112(d)(1) (authorizing the FSOC to collect information to support its functions); Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, 76 Fed. Reg. at 71,142 ("Form PF has been designed to collect information to assist FSOC in monitoring and assessing systemic risks that private funds may pose . . . .").

141. Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, 76 Fed. Reg. at 71,129; *see also* Dodd-Frank Act § 112 ("The purposes of the Council are—(A) to identify risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected bank holding companies or nonbank financial companies, or that could arise outside the financial services marketplace; (B) to promote market discipline, by eliminating expectations on the part of shareholders, creditors, and counterparties of such companies that the Government will shield them from losses in the event of failure; and (C) to respond to emerging threats to the stability of the United States financial system."); EDWARD V. MURPHY & MICHAEL B. BERNIER, CONG. RESEARCH SERV., FINANCIAL STABILITY OVERSIGHT COUNCIL: A FRAMEWORK TO MITIGATE SYSTEMIC RISK (2011), *available at* http://www.llsdc.org/attachments/wysiwyg/544/CRS-R42083.pdf (describing the mission, membership, and scope of the FSOC and providing an analysis of FSOC-related policy issues Congress may face); Saule T. Omarova, *Bankers, Bureaucrats, and Guardians: Toward Tripartism in Financial Services Regulation*, 37 J. CORP. L. 621, 627 (2012) (explaining the FSOC's charge to monitor and regulate systemic risk "throughout the entire U.S. financial sector"); Jason Rudderman, Article, *Eliminating Wall Street's Safety Net: How a Systemic Risk Premium Can Solve "Too Big To Fail,"* 11 FLA. ST. U. BUS. REV. 39, 46 (2012) (describing the responsibilities tasked to the FSOC).

142. Anita K. Krug, *Institutionalization, Investment Adviser Regulation, and the Hedge Fund Problem*, 63 HASTINGS L.J. 1, 27 (2011); Cheryl Nichols, *Addressing Inept SEC Enforcement Efforts: Lessons from Madoff, the Hedge Fund Industry, and Title IV of the Dodd-Frank Act for U.S. and Global Financial Systems*, 31 NW. J. INT'L L. & BUS. 637, 683 (2011).

private funds.[143] The total number of investment advisers filing Form PF will be relatively small but is likely to represent a substantial portion of the assets of the industry. The SEC estimates that 230 U.S. hedge fund advisers with at least $1.5 billion in RAUM attributable to hedge funds at the end of any month in the prior fiscal quarter will file Form PF.[144] The SEC expects this relatively small number of advisers to account for 80% of total hedge fund assets under management in the United States.[145] Similarly, the approximately 155 investment advisers managing over $2 billion in private equity fund assets may represent roughly 75% of the U.S. private equity fund industry.[146]

Form PF filing requirements depend partially on the size of the investment adviser. The SEC takes a tiered approach intended to reflect the relative risks of each type of fund.[147] Hedge fund advisers with less than $1.5 billion RAUM attributable to hedge funds are required to complete and file Form PF on an annual basis.[148] Large hedge fund advisers, advisers with at least $1.5 billion RAUM attributable to hedge funds,[149] however, are required to update Form PF filings on a quarterly

143. 17 C.F.R. § 275.204(b)-1; Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, 76 Fed. Reg. at 71,132 (listing three criteria for filing Form PF that represent an initial threshold for the minimal Form PF requirements). Most private fund advisers who meet these three criteria will only be required to file Section 1 of Form PF. *Id.* Remaining sections of Form PF will be filed by "large private fund advisers." *Id.* at 71,132–33. There are three types of large private fund advisers: (1) "[a]ny adviser having at least $1.5 billion in [RAUM] attributable to hedge funds as of the end of any month in the prior fiscal quarter;" (2) "[a]ny adviser managing a liquidity fund having at least $1 billion in combined [RAUM] attributable to liquidity funds and registered money market funds as of the end of any month in the prior fiscal quarter;" and (3) "[a]ny adviser having at least $2 billion in [RAUM] attributable to private equity funds as of the last day of the adviser's most recently completed fiscal year." *Id.* (footnotes omitted).

144. Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, 76 Fed. Reg. at 71,135.

145. *Id.*

146. *Id.* (citing PREQIN, PRIVATE EQUITY INDUSTRY DATA PROVIDED BY PREQIN (2011), *available at* http://www.sec.gov/comments/s7-05-11/s70511-69.pdf; PREQIN, PRIVATE EQUITY INDUSTRY DATA PROVIDED BY PREQIN (2010), *available at* http://www.sec.gov/comments/s7-05-11/s70511-1.pdf).

147. *Id.* at 71,136.

148. *See id.*; *see also* FORM PF, *supra* note 18, at Instruction 9 (providing different filing periods for different types of advisers).

149. *See* Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, 76 Fed. Reg. at 71,132–33 (defining "large private fund adviser").

basis.[150] Mandatory quarterly reporting for large hedge fund advisers in the United States aligns with international trends and is intended "to provide the FSOC with timely data to identify emerging trends in systemic risk."[151]

The disclosure requirements in Form PF pertain to several categories, including information pertaining to the investment adviser, the funds managed by the investment adviser, and information about individual investors.[152] Other categories that require disclosure under Form PF include the products used by the investment adviser, performance and changes in performance, financing information, risks metrics, strategies used, credit exposure, and positions held by the investment adviser, among others.[153]

Form PF disclosure requirements pertaining to the hedge funds advised by investment advisers require a breakdown of Net Asset Value (NAV) managed by the adviser by hedge fund strategy[154] and the percentage of the reporting fund's NAV managed by using computer-driven trading algorithms.[155] In the context of counterparty credit exposure, Form PF requires hedge fund advisers to disclose the five trading counterparties to which the reporting fund has the greatest net counterparty credit exposure,[156] the name of the creditor, and the dollar amount owed to each creditor.[157] Other information required in this context includes information about the collateral and other credit support counterparties posted to the respective reporting funds[158] and changes in market factors and their effect on the long and short components of the portfolio as a percentage of NAV.[159]

Form PF also requests information regarding the investment adviser's use of trading and clearing mechanisms.[160] To enable the SEC to understand the exposure of the advised hedge funds and their assets, Form PF requires disclosure pertaining to the exposure of long and short

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150. *Id.* at 71,140; FORM PF, *supra* note 18, at Instruction 9 ("[Y]ou [large hedge fund advisers] must file a *quarterly update* that updates the answers to all Items in this Form PF relating to the *hedge funds* that you advise.").

151. Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, 76 Fed. Reg. at 71,130–31, 71,140.

152. *See* 17 C.F.R. § 279.9 (2012) (establishing filing requirements for Form PF); FORM PF, *supra* note 148, § 1a–b.

153. *See* FORM PF, *supra* note 18, *passim*.

154. *Id.* § 1a, Item B.3 (including the following private fund categories: (a) hedge funds, (b) liquidity funds, (c) private equity funds, (d) real estate funds, (e) securitized asset funds, (f) venture capital funds, (g) other private funds, (h) funds and accounts other than private funds).

155. *Id.* § 1c, Item B.21.

156. *Id.* § 1c, Items B.22–23.

157. *Id.* § 2b, Item D.47.

158. *Id.* § 2b, Item B.36.

159. *Id.* § 2b, Item C.42.

160. *Id.* § 1c, Item B.24.

positions[161] and the value of turnover by asset class in the respective reporting month.[162] To help the SEC understand the liquidity of the reporting fund's portfolios, Form PF requires the investment adviser to disclose the reporting fund's positions and the time it would take to liquidate them.[163] In addition, investment advisers have to disclose information regarding the value of each of the advised funds' borrowings and the types of creditors[164] and the aggregate value of all derivative positions for each advised fund.[165] Finally, Form PF requires disclosure of information pertaining to investor liquidity—time period and percentage of NAV locked[166]—and the reporting fund's restrictions of investor withdrawals and redemptions.[167]

III. METHODOLOGY

This empirical study analyzes the sampling of individual investment advisers from a population of investment advisers registered in the United States to make statistical inferences about the population using the sample. The modes of data collection included e-mails with electronic surveys, faxes with survey questionnaires, and phone interviews.[168] Respondents received no financial incentives. Nonfinancial incentives included the Author's promise to share the results of the survey study with respondents upon completion.

The survey questions for this study were evaluated and tested through more than twenty rounds of test runs with registered industry representatives and academics working in the field. A large proportion of the survey questions were open-ended questions. Open-ended questions were coded into response clusters. Close-ended questions were only used to quantify items. The response options for close-ended questions were exhaustive and mutually exclusive. Close-ended questions were dichotomous and continuous.

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161. *Id.* § 2a, Item B.26; *id.* § 2b, Item B.30 (pertaining to investment advisers that advise more than one hedge fund).
162. *Id.* § 2a, Item B.27.
163. *Id.* § 2b, Item B.32.
164. *Id.* § 2d, Item D.43.
165. *Id.* § 2b, Item D.45.
166. *Id.* § 2b, Item E.50.
167. *Id.* § 2b, Item E.49.
168. Mode effects are insignificant because each data collection method was based on the same questionnaire and respondents were asked the same sequence of questions. Furthermore, only a small portion of responses was obtained via phone interviews.

The Author trained a team of research assistants throughout the test phase on how to engage with respondents and how to code initial responses or nonresponses. Interviewers recorded any responses, nonresponses, and miscellaneous reactions in a coding sheet. The Author and several senior assistants supervised the interviewers during the data collection and the coder during the coding processes.[169] Data files and coding were regularly checked for accuracy and internal consistency.

A. *Data Sources, Sampling, and Coding*

To investigate the possible effects of hedge fund adviser registration requirements under the Dodd-Frank Act, this study surveyed hedge fund advisers in the United States that are subject to the registration requirement. The SEC collects data pertaining to registered hedge fund advisers on its Investment Adviser Registration Depository (IARD) website.[170] The Author obtained from the IARD website a dataset for the relevant population, comprising 12,598 registered investment adviser firms.[171] The Author applied several filters to ensure the sample is random, not biased toward certain subgroups of hedge fund advisers, and representative of the rest of the population of interest. The resulting dataset of 1264 firms includes investment adviser firms who (1) advise private funds, (2) have contact information in the United States, (3) completed the November 2011 version of Form ADV, and (4) have a status effective date as of November 1, 2011. The Author had no control over the selection of the sample. All respondents were approached using the same methodology and volunteered their participation.

The filters were applied using several predefined parameters. The Author filtered for affirmative responses to Item 7.B in Form ADV, "Are you an adviser to any *private fund*?"[172] This initial filter decreased the dataset significantly, as 4054 firms responded in the affirmative and 327 firms did not answer the question, for a total of 4381 firms. To ensure only U.S. hedge fund advisers were included in the population, the Author removed investment adviser firms that had not reported a

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169. Interviewers were physically located in separate rooms but next to the senior assistant. Interviewers were able to get feedback and support as needed.

170. *Historical Archive of Investment Adviser Reports*, U.S. SEC. & EXCHANGE COMMISSION, http://www.sec.gov/foia/iareports/inva-archive.htm (last modified May 1, 2013); *see also Division of Investment Management: Electronic Filing for Investment Advisers on IARD*, U.S. SEC. & EXCHANGE COMMISSION, http://www.sec.gov/divisions/investment/iard.shtml (last modified Aug. 6, 2012) (providing information on the IARD and how to register or obtain information on investment advisers).

171. *See Historical Archive of Investment Adviser Reports*, *supra* note 170 (using dataset dated May 1, 2012).

172. FORM ADV, *supra* note 18, pt. 1A, at Item 7.B.

U.S. phone and fax number, including any firms that reported phone or fax numbers with more than ten numbers. Thereafter, the Author filtered for firms that had completed the revised version of Form ADV, dated November 2011.[173] These filters resulted in a subset of 3824 investment advisers. Finally, the Author filtered the dataset for investment adviser firms with the status effective dates as of November 1, 2011, resulting in 1264 firms. The Author added three investment advisers that volunteered responses without direct solicitation by the Author after confirming that these three investment advisers were listed in the SEC database, bringing the total number of firms to 1267.

The survey instrument in the Appendix asks hedge fund advisers in the United States to describe the possible effects of hedge fund manager registration requirements under the Dodd-Frank Act relating to several categories, including compliance measures, strategic responses, long-term effect of reporting and disclosure rules on private funds, long-term effect of reporting and disclosure rules on the private fund industry, cost of compliance, effect of the regulatory regime on AUM, and effect of the regulatory regime on profitability.

173. *See id.* (inquiring about private funds and stating that advisers must complete section 7.B.(1) of Schedule D for each private fund they advise, except when they "seek to preserve the anonymity of a private fund client by maintaining its identity in [their] books and records in numerical or alphabetical code, or similar designation, pursuant to rule 204-2(d)"); *see also* Rules Implementing Amendments to the Investment Advisers Act of 1940, 76 Fed Reg. 42,950, 42,992 n.634 (July 19, 2011) (to be codified at 17 C.F.R. pts. 275 & 279) (describing Form ADV Item 7.B); *Electronic Filing for Investment Advisers on IARD: Forms, Policy, and Law*, U.S. SEC. & EXCHANGE COMMISSION, http://www.sec.gov/divisions/investment/iard/iastuff.shtml (last modified Sept. 12, 2012) (providing current and historical ADV forms and relevant SEC releases).

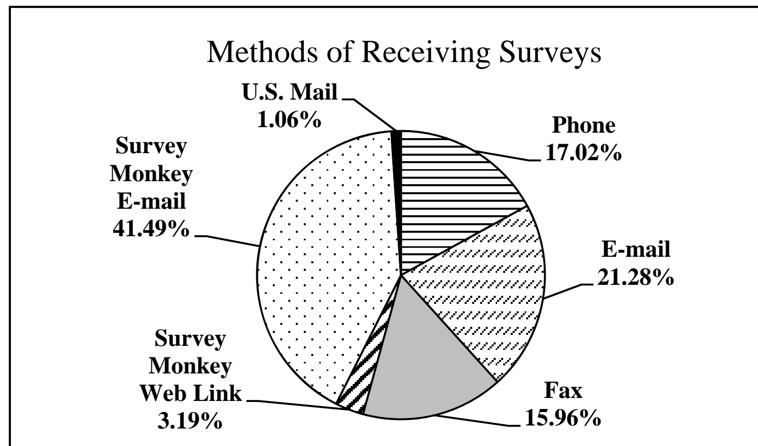

Figure 1.0, Methods of Receiving Surveys.

Figure 1.0 shows that the research team obtained sixteen responses (17.02% of sample) via telephone interviews. The research assistants completed the survey by hand when talking to firms on the phone. The research team obtained fifteen responses (15.96% of sample) directly from the investment adviser firms who completed the survey questionnaire by hand and faxed it to the University of Saint Thomas School of Law. A large proportion of the responses, thirty-nine responses (41.49% of sample), was received via the e-mail link in Survey Monkey. The second most common method of response was e-mail. The research assistants gathered twenty responses (21.28% of sample) by advisers e-mailing an electronic version of the survey to the research team. One survey was received via U.S. mail, and three surveys were completed via a web link. All completed questionnaires were scanned and saved electronically, including backup copies. The research team matched most of the responses to the Form ADV data collected by the SEC and maintained on the IARD website. Of the ninety-four responses, seven (7.45% of the sample) could not be linked to Form ADV data. The remaining eighty-seven responses (92.55% of the sample) contained information that allowed the research team to correspond the survey responses to the Form ADV information.

Affirmative responses in "Yes" and "No" categories were coded as "1." Survey questions two, three, four, five, nine, ten, eleven, and twelve allowed respondents to provide open-ended answers. Firms' responses to these open-ended questions were copied into a separate worksheet, along with a specifically assigned identification number for the survey response. The identification number was used to facilitate coding of the clustered

responses into the combined coding sheet. The answers could then be tied to other Form ADV information and other survey questions.

For each open-ended question—survey questions two, three, four, five, nine, ten, eleven, and twelve—the coder created a separate worksheet.[174] The coder summarized the basic idea or ideas in each response to an open-ended question in the top row of each worksheet and placed a check mark in the column that corresponded to the adviser firm that provided the response. The coder used a check mark for each subsequent response that fit into existing clusters. If the response did not fit into an existing

174. Question 2 asked, "Which of the following actions have you taken to assure compliance with Dodd-Frank Act registration and reporting requirements?" Option "n." was "Other" and provided a blank for details. Twenty-four firms checked the "Other" option, and one of those firms did not provide details. The other twenty-three firms provided thirty-six discrete responses. There were thirteen different potential clusters, but only five met the criteria for being a cluster—at least three responses. Question 3 asked, "Do you plan to implement strategic responses to the new registration and disclosure requirements?" Question 3.b further probed, "If yes, what strategic responses do you plan to implement?" Eighty-six firms answered Question 3 and twenty-four of them responded "yes." Three of those twenty-four firms did not provide an open-ended response. From the twenty-one firms that said "yes" and provided a response, there were thirty-five discrete answers that fell into twelve potential clusters. Six of the potential clusters met the cluster criteria. Question 4 asked, "In what ways will the new registration and disclosure rules affect your fund(s) in the next 5 years?" Eighty-two firms answered the question. There were thirty-seven potential clusters based on 162 discrete responses. Sixteen of those potential clusters met the cluster criteria. Question 5 asked, "In what ways will the new registration and disclosure rules affect your industry in the next 5 years?" Seventy-eight firms answered the question. There were 140 discrete responses and forty-three potential clusters. Only ten of the potential clusters met the criteria for a cluster. Question 9 asked, "What affected your response to Item 8 [After the enactment of Dodd-Frank Act reporting and disclosure requirements, what assets size (AUM) would you desire to operate your fund(s)?]?" Sixty-two firms answered Question 9. There were 109 responses that broke into thirty-five potential clusters. Eleven potential clusters met the criteria. Question 10 asked, "Would you take the Form PF threshold for quarterly reporting of $1.5 bil assets (AUM) into account in determining the appropriate size of assets (AUM) for your fund(s)? . . . If yes, how would you take it into account?" Eighty-seven firms answered the question, and seventeen of those firms said "yes." Eight of those seventeen firms did not provide any answer to the open-ended question. The remaining nine provided twelve answers that did not fit into a cluster. Question 11 asked, "Have the new registration and disclosure requirements affected your fund's earnings / net rate of return to your investors? . . . If yes, how?" Ninety-two firms answered the question, and only twenty-two said "yes." Those twenty-two firms provided forty discrete responses that fit into fourteen potential clusters. Six of those potential clusters met the criteria for a cluster. Question 12 asked, "Have the new registration and disclosure requirements affected the profits of your investment management company? . . . If yes, how?" Ninety-two firms answered the question, and seventy-two said "yes." Those seventy-two firms provided 112 discrete answers, which fit into fourteen potential clusters. Seven of those potential clusters met the criteria of a cluster.

cluster, the coder created a new cluster. Upon coding all of the responses for one question, the coder counted the responses for each cluster. The Author determined that at least three firms providing similar responses to a question, either by using identical words or meaning, justifies the creation of a cluster category. The coder adjusted cluster categories when coding had been too narrow or too broad. For example, in Question 4, the initial cluster was "increased procedures, reporting, and monitoring." However, after reviewing all responses, the coder determined that "increased procedures," "increased reporting," and "increased monitoring" could be included as separate cluster categories because some firms did not mention all three. The coder reviewed the terminology used in noncluster responses to determine if they could be included in an existing cluster. The Author used responses by fewer than three firms in an established cluster for the analysis of existing clusters but did not create a separate cluster for those responses.

B. Sample Size and Sampling Constraints

Hedge fund managers have a tendency to disfavor any form of public exposure for a variety of economic, performance, privacy-related, and idiosyncratic reasons. Given the particular concern in the hedge fund industry regarding confidentiality and privacy, obtaining a substantial effective sample size for this study proved difficult. If hedge fund advisers in the identified population did not respond, the Author and his team of researchers approached each nonrespondent via fax and e-mail and followed up with a phone call if there was no response. This procedure proved successful and yielded ninety-four completed surveys, a response rate of 7.42% of a population of 1267. This response rate is substantially higher than the response rate of prior surveys in a related context.[175]

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175. *See, e.g.*, EISNERAMPER SURVEY, *supra* note 1, at 5 (seeking the opinions of hedge fund managers on the Dodd-Frank Act, its impact on their organization, and the future of the hedge fund industry, and obtaining forty-one responses through in-depth phone interviews of twelve senior managers of hedge funds and asset management firms, plus twenty-nine detailed e-mail surveys also completed by senior hedge fund executives); ROTHSTEIN KASS, INDUSTRY OUTLOOK: HEDGE FUNDS 2.0: EVOLUTION IN ACTION 4, 18 (2012), *available at* http://www.rkco.com/Corporate/Admin/Attachment Files/proprietary_research/2012/RothsteinKass_HedgeFunds2.0F.pdf (surveying 400 hedge fund firms, of which "51.5 percent think that reporting set to be implemented in the next 18 months, most notably Form PF, is a significant concern"); Tom Easton, *Too Big Not To Fail: Flaws in the Confused, Bloated Law Passed in the Aftermath of America's Financial Crisis Become Ever More Apparent*, ECONOMIST (Feb. 18, 2012), http://www.economist.com/node/21547784 ("[A]ccording to an informal survey of hedge-fund managers, the cost of filling [the new Dodd-Frank form] out will be $100,000–150,000 for each firm the first time it does it. After having done it once, those costs might drop to $40,000 in every later year."); Svea Herbst-Bayliss, *Hedge Fund Managers a Gloomier Lot in 2012-Survey*, REUTERS (Apr. 24, 2012, 1:08 PM),

The overwhelming majority of hedge fund advisers, 1173 (92.58% of a population of 1267), did not respond. Some hedge fund managers cited the advice of counsel as a reason not to participate in the survey. Other hedge fund managers who declined to join the survey cited a general policy not to partake in any surveys for privacy concerns, among other reasons. The most common reason provided by interviewees for not participating in the survey was that it went against company policy. Respondents who participated in the study often repeatedly asked for confidentiality pertaining to their survey responses or participated only on the condition of confidentiality. The Author kept any details pertaining to the identity of respondents or their firms strictly confidential. The researchers observed a polarized distinction between large and small companies, as well as those firms located in New York, or on the east coast, and those located elsewhere. Most of the larger adviser firms and those located on the east coast who did not participate cited company policy. Follow-up questions as to the reasons for that company policy indicated that interviewees did not want to divulge the company's—or its clients'—financial status.

The Author and his team of researchers encountered a number of problems during the process of collecting survey responses. The identity and contact information for the chief compliance officer and chief legal officer of the firms were not publicly available. Although Form ADV requires advisers to disclose the contact information for their chief compliance officer, the dataset provided by the SEC did not list this information and did not include e-mail addresses. The filed copy of Form ADV on the IARD website also did not contain chief compliance officer information.[176] The dataset obtained from the SEC did not include the e-mail addresses, and neither did the individual Form ADVs on the IARD website.

Because of the limited information available from the dataset, the Author and his team of researchers faxed the survey to the entire population of

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http://www.reuters.com/article/2012/04/24/hedgefunds-survey-idUSL2E8FIL2Q20120424 (reviewing Rothstein Kass's survey of 400 hedge fund managers in January 2012); Hofstra Univ., *supra* note 1 ("A new report . . . [conducted] by the Frank G. Zarb School of Business at Hofstra University in conjunction with accounting firm EisnerAmper LLP . . . [interviewed m]ore than 40 senior managers from hedge funds and asset management firms . . . .").

176. The Author and his team of researchers inquired with the IARD about why the information was not available. The IARD stated that information about the chief compliance officer was mainly for the SEC and the Author could reach adviser firms via the other contact information provided on Form ADV.

1264 investment adviser firms on May 15, 2012. The team of research assistants followed up via telephone with those firms that had not previously responded. After two weeks, the time elapsed between the fax and the follow-up phone call resulted in a lower response rate. Increasingly, firms reached via phone requested the survey by e-mail. Therefore, the Author and his team of research assistants obtained the general inquiry e-mail address for each of the 1264 adviser firms via the Internet. Each week, the research assistants e-mailed the link to the Survey Monkey questionnaire to all firms with obtainable e-mail addresses, including firms that had not completed the survey or had not responded to the requests to participate. The procedure was repeated and modified where necessary to attain the highest possible response rate.

C. Selection Bias

The literature has voiced doubts about the ability of surveys to reliably yield representative samples for some time.[177] Selection bias can occur when researchers use a sample that is based on the nonrandom selection of cases and draw inferences that are not statistically representative of the population.[178] The potential for sample selection bias exists when researchers selected cases because they show and share the trait the researcher hopes to explain[179] and the researcher uses nonstatistical selection procedures.[180] It remains unclear, however, if increasing the

177. *See* Thomas W. Hall et al., *The Effectiveness of Increasing Sample Size To Mitigate the Influence of Population Characteristics in Haphazard Sampling*, 20 AUDITING: J. PRAC. & THEORY 169, 169 (2001).

178. Richard A. Berk, *An Introduction to Sample Selection Bias in Sociological Data*, 48 AM. SOC. REV. 386, 391 (1983); David Collier, *Translating Quantitative Methods for Qualitative Researchers: The Case of Selection Bias*, 89 AM. POL. SCI. REV. 461, 462 (1995).

179. *See* Barbara Geddes, *How the Cases You Choose Affect the Answers You Get: Selection Bias in Comparative Politics*, 2 POL. ANALYSIS 131, 140 (1990).

180. *See* PETER JONES, STATISTICAL SAMPLING AND RISK ANALYSIS IN AUDITING 11–12 (1999); DONALD A. LESLIE ET AL., DOLLAR-UNIT SAMPLING: A PRACTICAL GUIDE FOR AUDITORS 36–37 (1980); ARTHUR J. WILBURN, PRACTICAL STATISTICAL SAMPLING FOR AUDITORS 4–6 (1984); Herbert Arkin, *Statistical Sampling in Auditing*, 27 N.Y. CERTIFIED PUB. ACCT. 454, 457 (1957); W. Edwards Deming, *On the Contributions of Standards of Sampling to Legal Evidence and Accounting*, 19 CURRENT BUS. STUD. 14, 18–21 (1954); Hall et al., *supra* note 177, at 170; Thomas W. Hall et al., *The Use of and Selection Biases Associated with Nonstatistical Sampling in Auditing*, 12 BEHAV. RES. ACCT. 231, 232–33 (2000); Clive S. Lennox et al., *Selection Models in Accounting Research*, 87 ACCT. REV. 589, 611 (2012); Jennifer Wu Tucker, *Selection Bias and Econometric Remedies in Accounting and Finance Research*, 29 J. ACCT. LITERATURE 31, 32 (2010); Neal B. Hitzig, *Statistical Sampling Revisited*, CPA J., May 2004, at 30, *available at* http://www.nysscpa.org/cpajournal/2004/504/essentials/p30.htm; Tom Hall et al., Haphazard Selection: Is It Time To Change Audit Standards? 1, 3–4 (Aug. 1, 2010) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1687443.

sample size can increase representativeness and compensate for the potential selection bias of nonstatistical techniques.[181]

Sample selection bias is mostly "a generic problem in social research . . . when [researchers] do[] not observe a random sample of a population of interest."[182] Many research traditions rely on designs that can be subject to sample selection biases.[183] In fact, exclusive reliance on observational schemes that are free from selection bias could mean ignoring significant findings with substantial policy implications.[184] Moreover, selection results naturally from human behavior,[185] and the assumptions about how selection occurs are important for selection bias models.[186] Simulation studies have shown that many of the techniques used to prevent selection bias problems have mixed success rates, can worsen rather than improve estimates, and may skew results under ordinary circumstances.[187]

The evaluation of the effects of hedge fund manager registration in this Article rests on the subset of hedge fund managers who are subject

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181. *See* DAN M. GUY ET AL., PRACTITIONER'S GUIDE TO AUDIT SAMPLING 160 (1998); JONES, *supra* note 180; RICHARD L. RATLIFF ET AL., INTERNAL AUDITING: PRINCIPLES AND TECHNIQUES 628 (2d ed. 1996); Arkin, *supra* note 180, at 460; Deming, *supra* note 180, at 23; Hall et al., *supra* note 177, at 170.

182. *See* Christopher Winship & Robert D. Mare, *Models for Sample Selection Bias*, 18 ANN. REV. SOC. 327, 328 (1992).

183. *See id.*

184. *See id.*

185. *See generally* Reuben Gronau, *Wage Comparisons—A Selectivity Bias*, 82 J. POL. ECON. 1119 (1974); James J. Heckman & Guilherme Sedlacek, *Heterogeneity, Aggregation, and Market Wage Functions: An Empirical Model of Self-Selection in the Labor Market*, 93 J. POL. ECON. 1077 (1985); James J. Heckman & Guilherme L. Sedlacek, *Self-Selection and the Distribution of Hourly Wages*, 8 J. LAB. ECON. S329 (1990); James J. Heckman & Bo Honoré, *The Empirical Content of the Roy Model*, 58 ECONOMETRICA 1121 (1990); H. Gregg Lewis, *Comments on Selectivity Biases in Wage Comparisons*, 82 J. POL. ECON. 1145 (1974); A.D. Roy, *Some Thoughts on the Distribution of Earnings*, 3 OXFORD ECON. PAPERS 135 (1951); Robert J. Willis & Sherwin Rosen, *Education and Self-Selection*, 87 J. POL. ECON. S7 (1979).

186. *See* Winship & Mare, *supra* note 182, at 328. *See generally* DRAWING INFERENCES FROM SELF-SELECTED SAMPLES (Howard Wainer ed., 1986); NONPARAMETRIC AND SEMIPARAMETRIC METHODS IN ECONOMETRICS AND STATISTICS: PROCEEDINGS OF THE FIFTH INTERNATIONAL SYMPOSIUM IN ECONOMIC THEORY AND ECONOMETRICS (William A. Barnett et al. eds, 1991); Arthur S. Goldberger, *Abnormal Selection Bias*, *in* STUDIES IN ECONOMETRICS, TIME SERIES, AND MULTIVARIATE STATISTICS 67 (Samuel Karlin et al. eds., 1983); Lung-Fei Lee, *Some Approaches to the Correction of Selectivity Bias*, 49 REV. ECON. STUD. 355 (1982); Abbas Arabmazar & Peter Schmidt, Note, *An Investigation of the Robustness of the Tobit Estimators to Non-Normality*, 50 ECONOMETRICA 1055, 1055 (1982).

187. *See* Ross M. Stolzenberg & Daniel A. Relles, *Tools for Intuition About Sample Selection Bias and Its Correction*, 62 AM. SOC. REV. 494, 494 (1997).

to the SEC registration requirement. The Author chose a sample that is expected to be representative of the population of hedge fund managers who were exposed to the treatment—registration—without the use of probabilistic randomizing aids. Randomizing the sample by including respondents from outside of the hedge fund industry or respondents other than hedge fund advisers would not have yielded representative responses for the treatment group, hedge fund managers who had to register, and population of interest, hedge fund advisers. Interviewing the treatment group, hedge fund managers who had to register, and a control group, hedge fund managers who did not have to register, would not have yielded appropriate responses because the control group would have had no exposure to the effect of the treatment, registration. Identifying hedge fund managers who had been exposed to the treatment and decided to avoid the treatment, by changing their organizational structure, AUM, et cetera, proved practically and administratively very difficult and would have resulted in a very small sample size for the control group.

The sample size (n=94), 7.42% of the identified population of 1267 hedge fund advisers, represents the population of hedge fund managers who were exposed to the treatment, registration, and responded to the survey. Increasing the sample size for this study proved particularly difficult because hedge fund managers have a tendency to shy away from and disfavor any form of public exposure for a variety of economic and idiosyncratic reasons. Even respondents who did agree to participate in the survey study often repeatedly asked for confidentiality pertaining to their survey responses or participated only on the condition of confidentiality.

The Author had no control over the selection of the sample. All respondents were approached using the same methodology and were volunteer participants.[188] Each member of the identified population of hedge fund advisers had a known, nonzero chance of being selected as part of the sample. The descriptive statistics demonstrate that the sample is not biased and does not favor a particular subgroup of hedge fund advisers.[189] There is no indication that respondents who did respond to the survey were different from individuals who did not respond.

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188. Obtaining information through voluntary responses can create an inherent bias because people with a special interest may be more likely to respond. However, the descriptive statistics demonstrate that the sample is representative of the population, at least under the examined parameters.

189. *See infra* Part IV.

IV. DESCRIPTIVE STATISTICS

Figures 2.0 to 2.8 demonstrate that the sample of hedge fund advisers (n=94) in this study is representative of the population of 1267 investment adviser firms.[190]

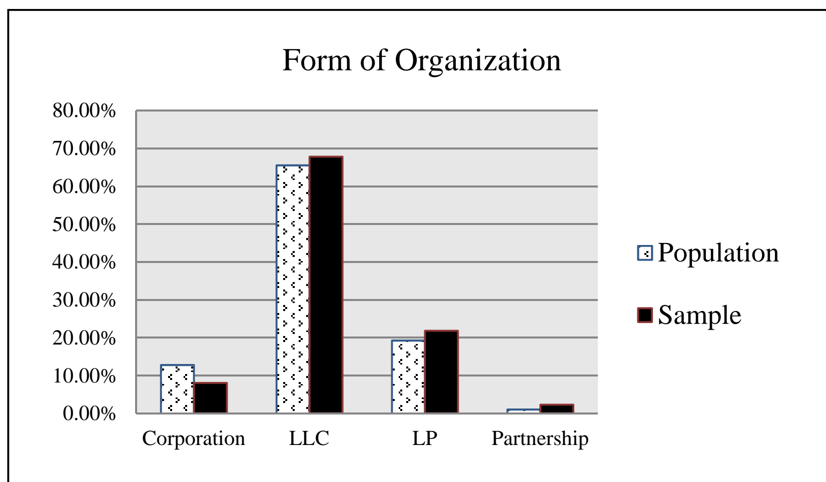

Figure 2.0, Comparison Form of Organization.

Figure 2.0 compares the form of organization in the population of 1267 identified advisers with the sample of hedge fund advisers that completed the survey. The form of organization is reported on Form ADV, Part 1A, Item 3.A.[191] In the sample, 67.82% of the advisers used a limited liability company (LLC) compared to 65.51% of the population. In addition, 8.05% of advisers in the sample utilized the corporate form in comparison with 12.79% of advisers in the population. The advisers in the sample used a limited partnership (LP) in 21.84% of the cases, and the population used an LP in 19.26% of the cases. Given these small variances, the sample is representative of the population because the sample closely mirrors the percentages and relative values of the population in terms of the form of organization used.

190. The sample of hedge fund advisers in Figures 2.0 to 2.8 is n=87 because the research team matched the advisers' responses to Form ADV data.

191. FORM ADV, *supra* note 18, pt. 1A, at Item 3.A.

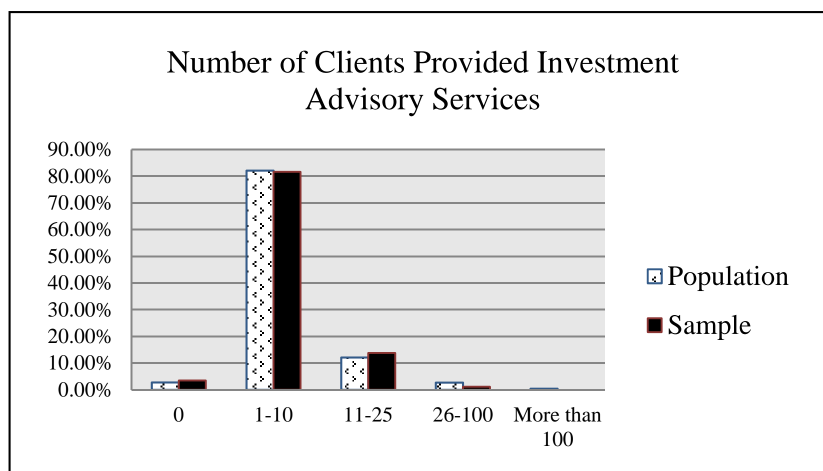

Figure 2.1, Comparison of the Number of Clients Who Received Investment Advisory Services During the Past Fiscal Year.

Figure 2.1 compares the number of clients to whom advisers provided investment advisory services in the most recent fiscal year in the population of the 1267 identified advisers with the sample of investment advisers who completed surveys. The number of clients is reported on Form ADV, Part 1A, Item 5.C.[192] In the sample, 81.61% of the advisers had between one and ten clients compared to 82.08% of the population. In the sample, 13.79% of advisers had eleven to twenty-five clients, and in the population, 12.08% of advisers had eleven to twenty-five clients. Of the advisers in the sample, 1.15% had twenty-six to one hundred clients, whereas 2.68% of the advisers in the population serviced twenty-six to one hundred clients. Form ADV does provide a "0" option for advisers who did not provide investment advisory services to any clients in the most recently completed fiscal year. Overall, the sample is representative of the population because the sample closely mirrors the percentages and relative values of the population in terms of the number of clients provided with investment advisory services.

192. *Id.* at Item 5.C.

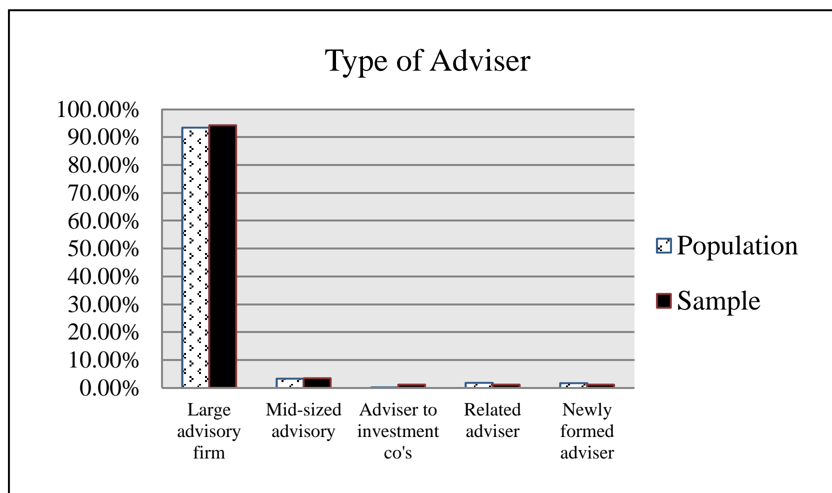

Figure 2.2, Comparison of the Type of Adviser.

Figure 2.2 compares the type of advisers in the population of the 1267 identified advisers with the sample of investment advisers who completed surveys. The type of adviser is reported on Form ADV, Part 1A, Item 2.A.[193] In the sample, 94.25% of the advisers were a large advisory firm compared to 93.45% of the advisers in the population. The SEC defines large advisory firms as either having RAUM of $100 million or RAUM of $90 million at the time of the firm's most recent annual updating amendment registered with the SEC.[194] In the sample, 3.45% of advisers were midsized and 3.31% of the advisers in the population were midsized. Overall, the sample is representative of the population because the sample closely mirrors the percentages and relative values of the population in terms of the type of adviser, as defined by the SEC on Form ADV.

193. *Id.* at Item 2.A.
194. *See id.*

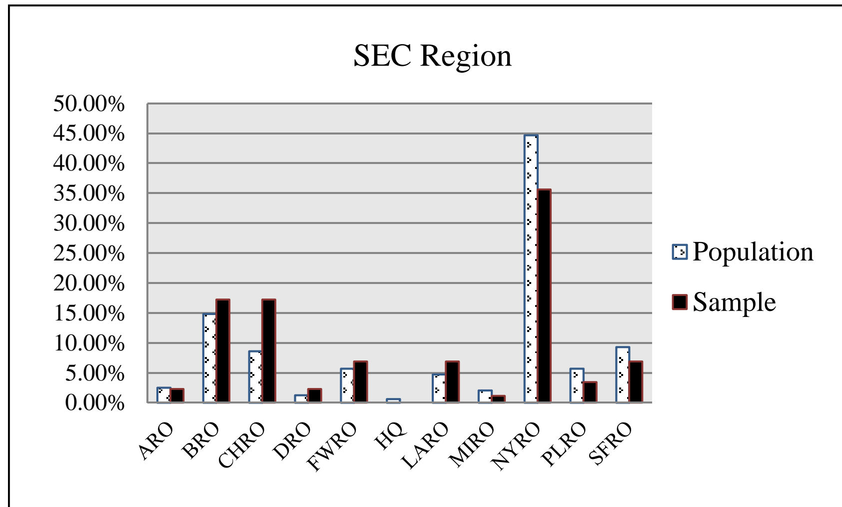

Figure 2.3, Comparison of the SEC Region.

Figure 2.3 compares the SEC Region of the population of the 1267 identified advisers with the sample of investment advisers who completed surveys. The SEC Region is determined by the geographic location of the principal office of the adviser. In the sample, 35.63% of the advisers were from NYRO (New York region) compared to 44.67% of the population. In the sample, 17.24% of advisers were located in BRO (Boston region), whereas 14.84% of the population was in the Boston region. CHRO (Chicago region) accounted for 17.24% of the sample and 8.60% of the population. Advisers in the New York region were less responsive to the survey than those in the Boston and Chicago regions. Overall, the sample adequately represents the geographical variance seen in the population as respondents voluntarily engaged in the survey, and they were selected randomly.

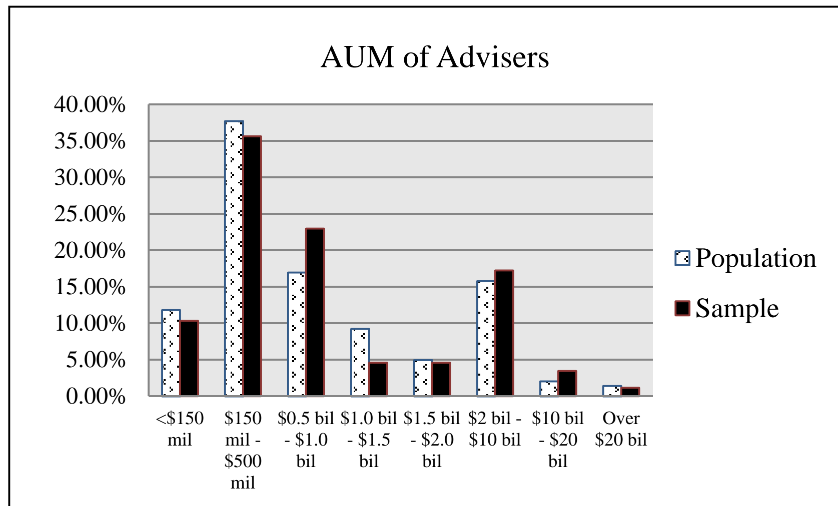

Figure 2.4, Comparison of the AUM of Firms.

Figure 2.4 compares the AUM of the population of the 1267 identified advisers with the sample of investment advisers who completed surveys. Advisers provided AUM data on Form ADV, Part 1A, Item 5.F.(2).[195] The form does not provide predetermined ranges for AUMs.[196] The advisers simply provide a number.[197] For this analysis, the Author chose AUM ranges for the above graph. The sample contains more advisers with $2 billion to $10 billion (17.24%) compared to the population (15.79%). Further, the sample includes more advisers with $0.5 billion to $1 billion in AUM (22.99%) versus the population (16.97%). On the other hand, the sample slightly underrepresents the population in the following areas: less than $150 million AUM (sample 10.34%, population 11.84%), $150 million to $500 million AUM (sample 35.63%, population 37.73%), and $1.0 billion to $1.5 billion AUM (sample 4.60%, population 9.23%). Overall, the sample adequately represents the diversity of the AUM seen in the population.

195. *Id.* at Item 5.F.(2).
196. *See id.*
197. *See id.*

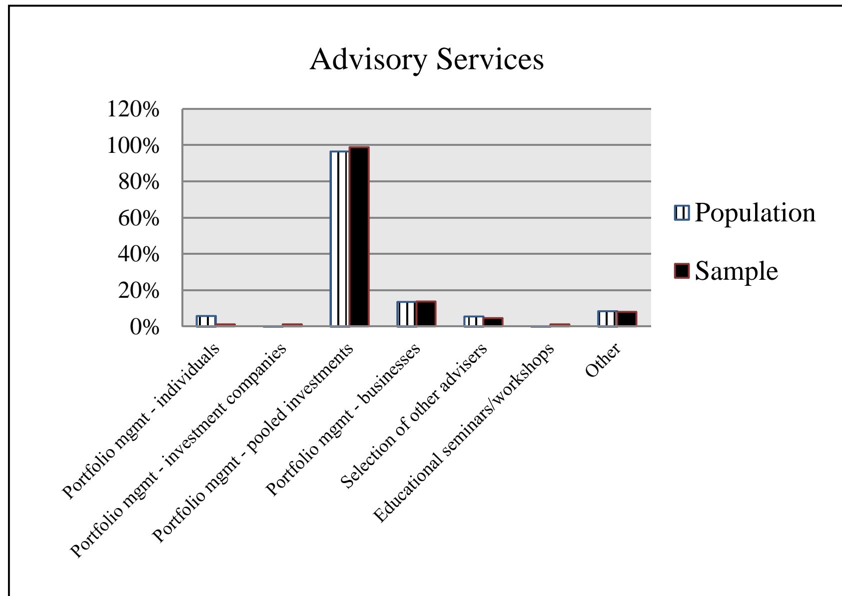

Figure 2.5, Comparison of the Advisory Services.

Figure 2.5 compares the type of advisory services provided by the population of the 1267 identified advisers with the sample of investment advisers who completed surveys. Advisers disclosed the types of advisory services on Form ADV, Part 1A, Item 5.G.[198] In the sample, 98.85% of the advisers provided portfolio management for pooled investment vehicles versus 96.53% of the population. In the sample, 13.79% had portfolio management for businesses or institutional clients compared to 13.65% in the population. Advisers providing portfolio management services for individuals accounted for only 1.15% of the sample and 5.84% of the population. Several other categories of services did not warrant discussion and were excluded from the graph. Overall, the sample is representative of the population in terms of advisory services offered by advisers.

198. *Id.* at Item 5.G.

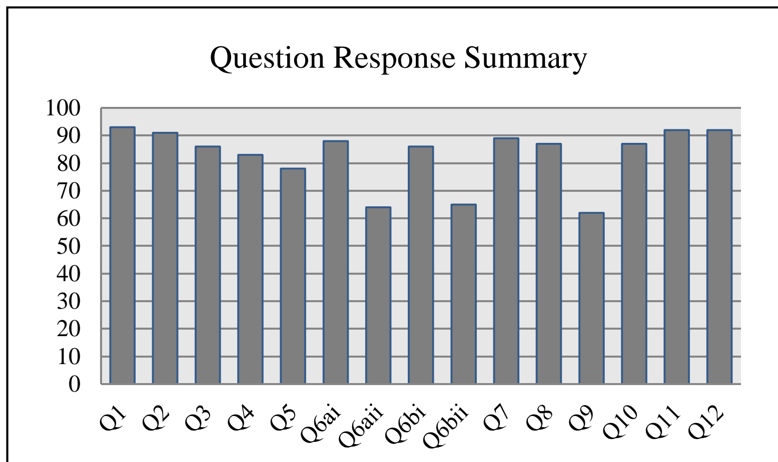

Figure 2.6, Response Summary for Each Survey Question.

Figure 2.6 shows the number of responses to each question in the survey instrument. Overall, participants completed the entire survey. The three questions with the fewest responses were open-ended questions. Question 6.a.ii asked, "Compliance with all federal rules and procedures (Treasury, SEC, CFTC etc.) will take approximately: ____ hours per year." Question 6.b.ii inquired, "Compliance with all federal rules and procedures (Treasury, SEC, CFTC etc.) will annually cost approximately: _____." Question 9 stated, "What affected your response to Item 8 [After the enactment of the Dodd-Frank reporting and disclosure requirements, what assets size (AUM) would you desire to operate your fund(s):]?"

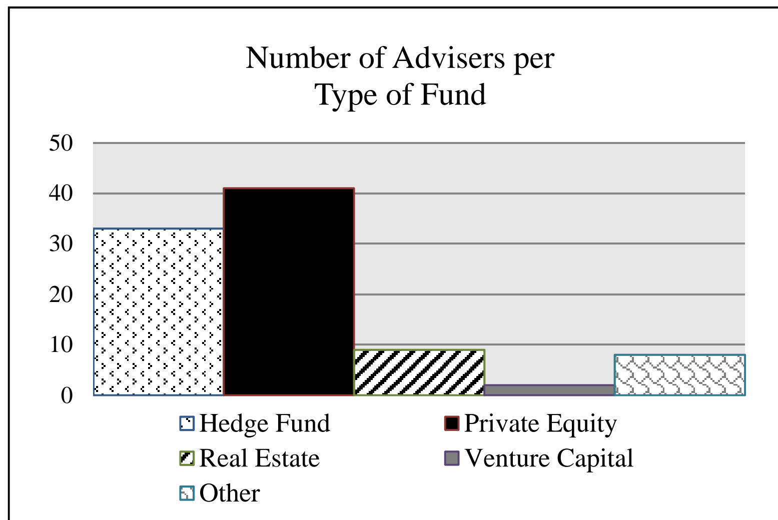

Figure 2.7, Number of Advisers Advising Each Type of Private Fund.

Figure 2.7 shows how many advisers in the sample advised each type of private fund. Advisers disclosed what types of private funds they advise on Form ADV, Part 1A, Schedule D, section 7.B.(1).[199] Advisers complete that section for each fund they advise. In the sample, thirty-three advisers reported having at least one hedge fund. Additionally, forty-one advisers had at least one private equity fund. The sample included nine advisers with at least one real estate fund and two firms with at least one venture capital fund.

199. *Id.* at Item 7.B; *id.* at Schedule D, § 7.B.(1).

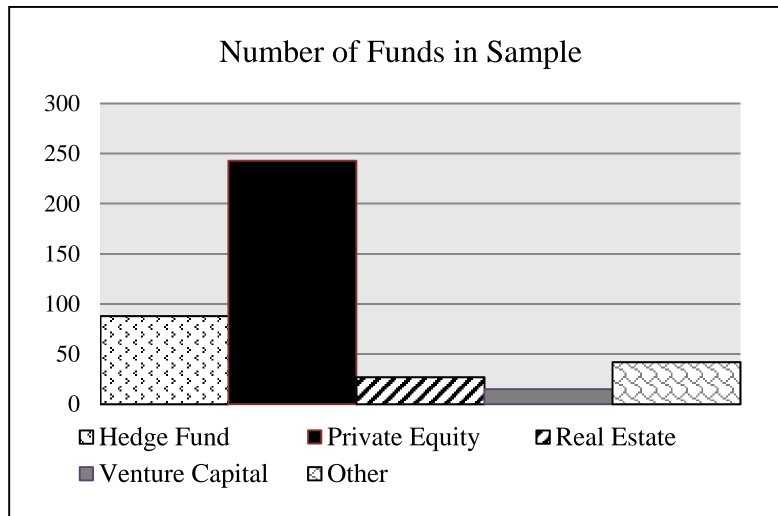

Figure 2.8, Number of Private Funds in the Sample.

Figure 2.8 shows the number of private funds in the sample. The advisers in the sample managed 88 hedge funds, 243 private equity funds, 27 real estate funds, 15 venture capital funds, and 42 other funds.

V. RESULTS

The findings of this survey study are intended to support policymakers who are implementing new rules pertaining to the hedge fund industry. This is the first observational study conducted after the registration effective date with a population of registered private fund advisers who are based in the United States. The study quantifies compliance costs; it assesses compliance measures and the hedge fund industry's strategic responses to the implementation of the Dodd-Frank Act; and it investigates the possible long-term effects of hedge fund registration and the implications of the disclosure requirements in the Dodd-Frank Act pertaining to hedge funds. The study also evaluates the long-term effects of reporting and disclosure rules on private funds and the private fund industry, the effect of the regulatory regime on AUM, and the effect of the regulatory regime on profitability. The findings of this survey study can be categorized into: (1) Common Actions, (2) Strategic Responses,

(3) Compliance Cost, (4) AUM, (5) Fund Earnings, and (6) Investment Management Company.

A. Common Actions

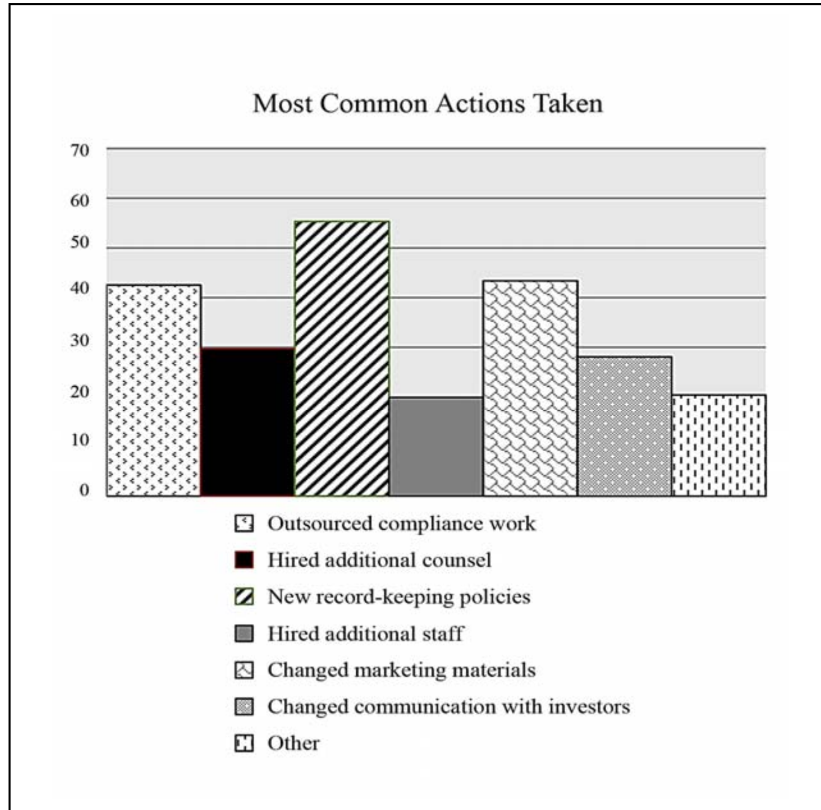

Figure 3.0, Common Actions Taken in Response to Dodd-Frank.

Figure 3.0 shows that a majority of respondents have instituted measures to respond to the new registration and disclosure requirements. The most common actions taken include: (1) outsourced compliance work, (2) hired additional counsel, (3) instituted new record-keeping policies, (4) hired additional staff, (5) changed marketing materials, and (6) changed communications with investors.

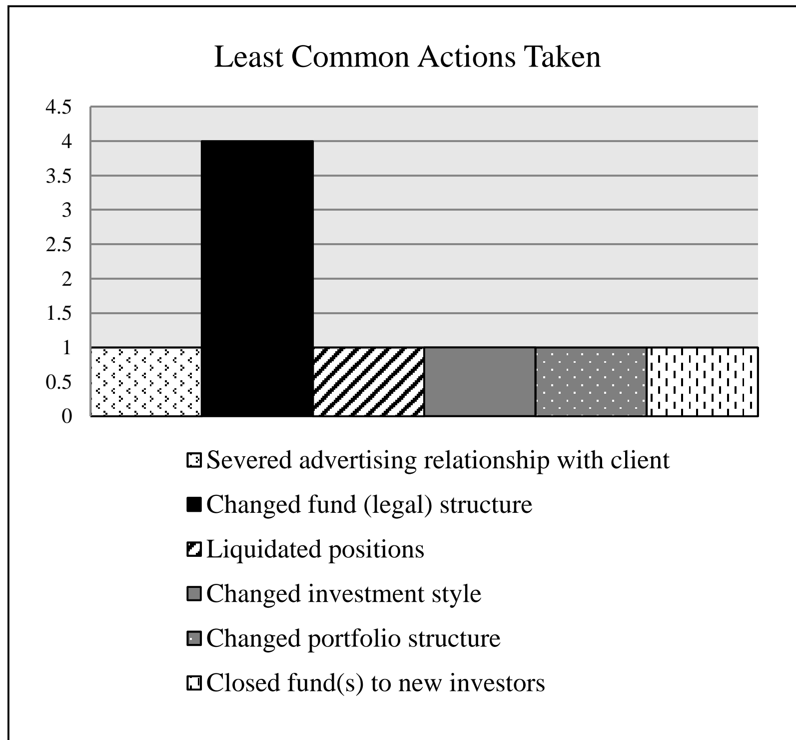

Figure 3.1, Least Common Actions Taken in Response to Dodd-Frank.

Figure 3.1 shows the least common actions taken to respond to the registration and reporting requirements. Hedge fund advisers in the sample did not terminate existing employment relationships. A minority of respondents: (1) severed an advising relationship, (2) changed funds' (legal) structure, (3) liquidated positions, (4) changed investment styles, (5) changed portfolio structure, or (6) closed funds to new investors.

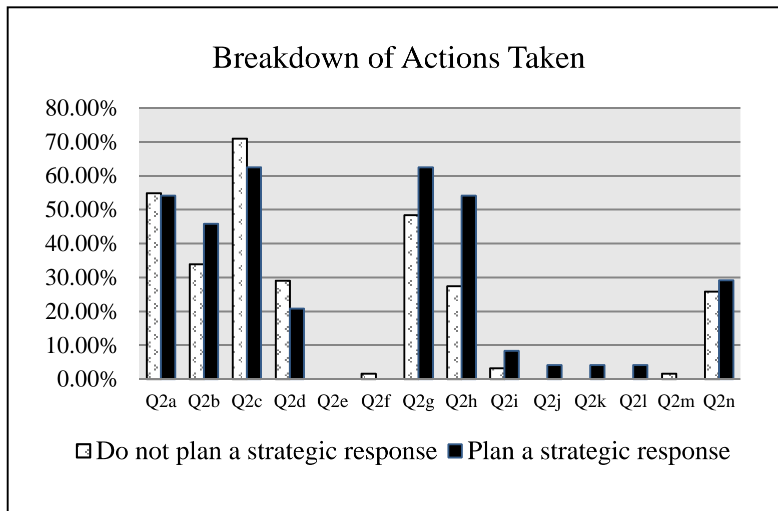

Figure 3.2, Breakdown of Actions Taken in Response to Dodd-Frank.

Figure 3.2 shows the difference in the percentage of advisers who planned specific actions, based on how they answered the question: "Do you plan to implement strategic responses to the new registration and disclosure requirements?" For the sample of ninety-four advisers, the advisers who planned a strategic response (twenty-four advisers) were much more likely to: outsource compliance work (Question 2.b), change marketing materials (Question 2.g), and change communications with investors (Question 2.h). Those same advisers were slightly less likely to institute new record-keeping policies (Question 2.c) and hire new staff (Question 2.d) compared with advisers who did not plan a strategic response (sixty-two advisers) to Dodd-Frank.

B. Strategic Responses

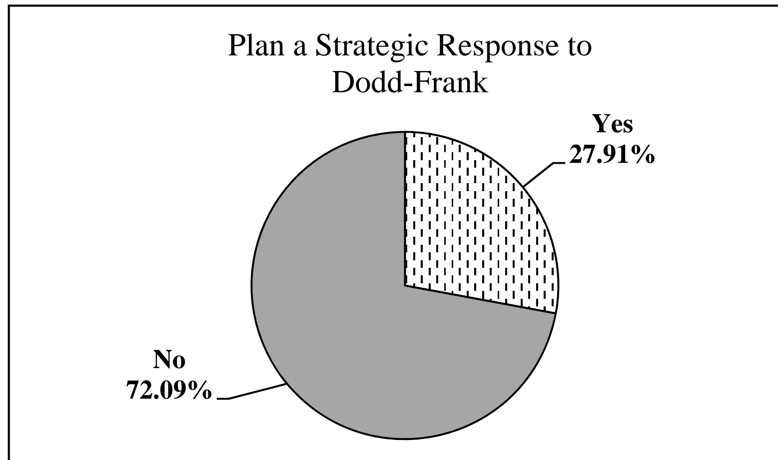

Figure 4.0, Advisers Who Plan a Strategic Response to Dodd-Frank.

Figure 4.0 indicates that a majority (72.09%) of survey respondents do not plan a strategic response to the Dodd-Frank Act registration and reporting requirements. Some responses to survey Question 3 could perhaps be interpreted as inconsistent with responses to survey Question 2 because some respondents may consider their actions in response to survey Question 2 as strategic, others may not.

C. Compliance Cost

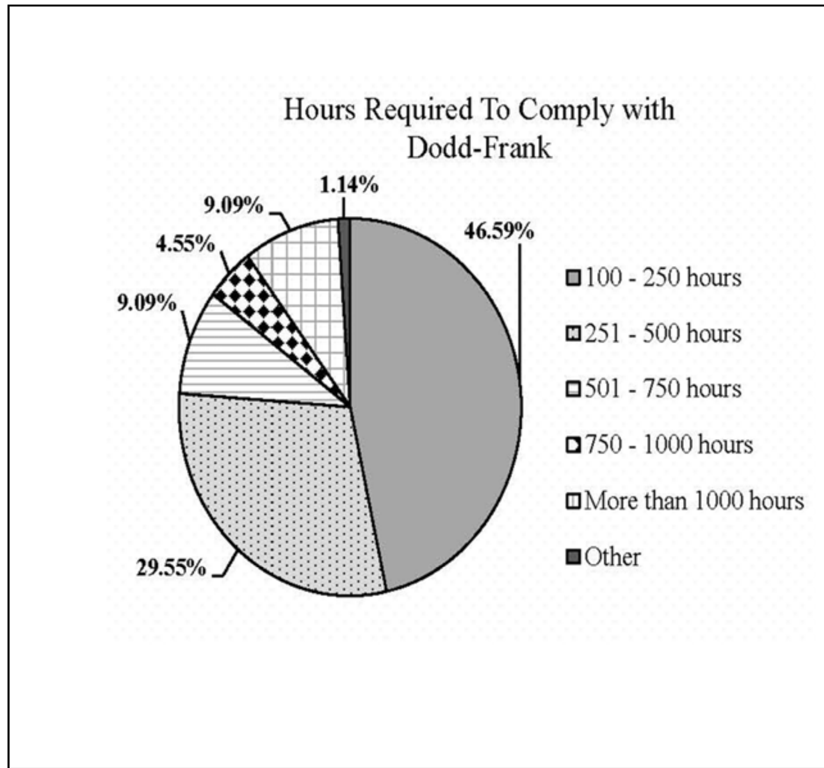

Figure 4.1, Hours Required To Comply with Dodd-Frank.

Figure 4.1 suggests that although a majority of advisers spend less than 500 hours to comply with the new registration and reporting requirements, some funds advisers estimate it will take them between 500 and 1000 hours to comply with the requirements. Some believe more than 1000 hours will be required to comply.

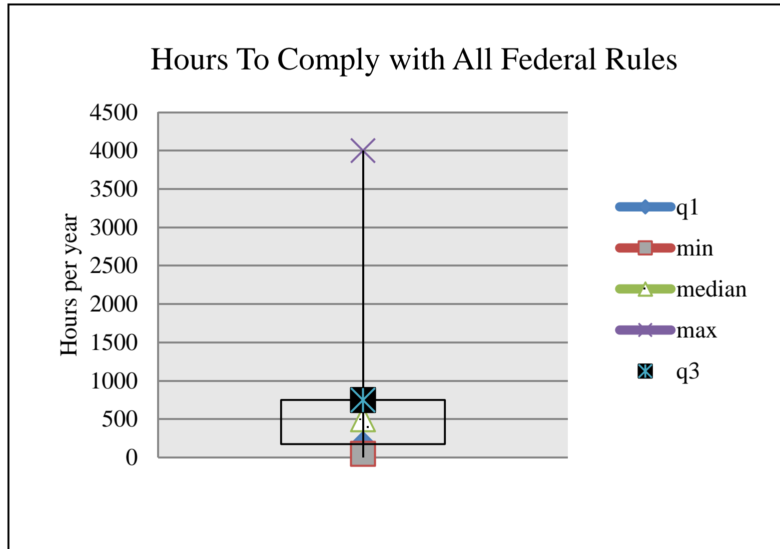

Figure 4.2, Annual Hours Required To Comply with All Federal Rules.

Figure 4.2 suggests that the hours needed to comply with all federal rules and regulations pertaining to hedge fund advisers range from 50 up to 4000 hours per year, with a majority of responses estimating the time requirement will be 750 hours or less per year. The median response was 500 hours per year. Seventy-five percent of respondents believed the federal rules would take 750 hours or less each year. On the other hand, 25% indicated the federal rules would require more than 750 hours.

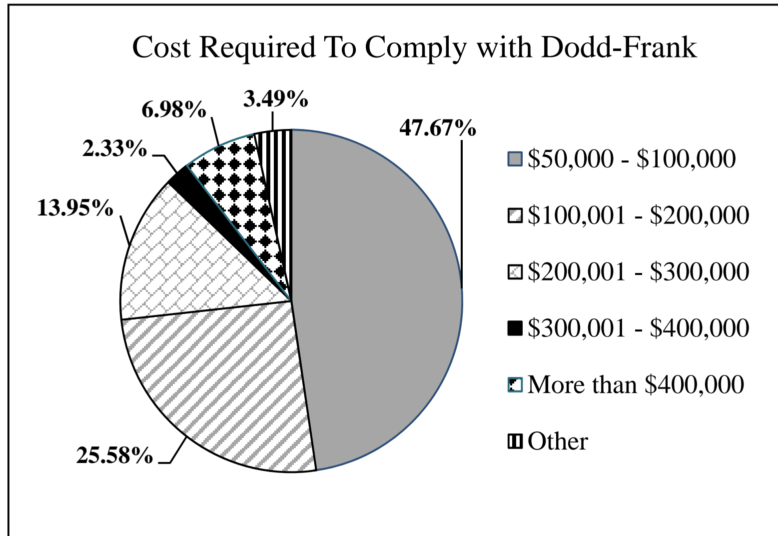

Figure 4.3, Cost of Compliance with Dodd-Frank Reporting Requirements.

Figure 4.3 illustrates the actual cost of compliance with the registration and disclosure requirements. A majority of respondents found the compliance cost will range from $50,000 to $200,000. However, a significant minority estimates the total compliance cost will range from $200,000 to over $400,000.

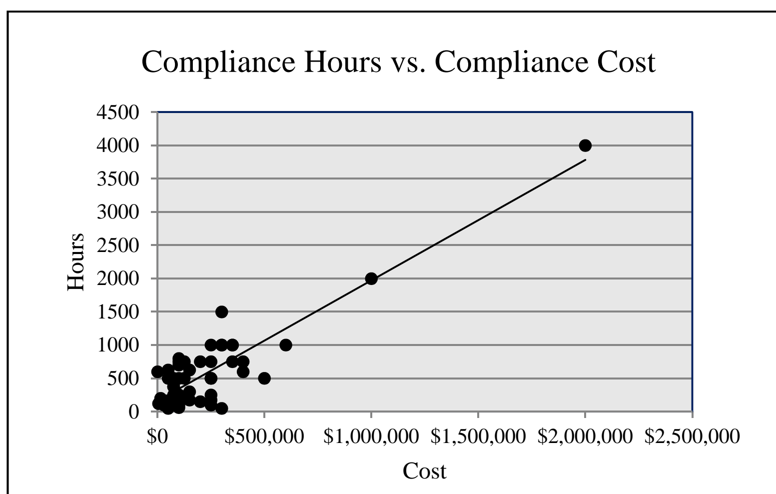

Figure 4.4, Compliance Hours vs. Compliance Cost.

Figure 4.4 shows the relationship between compliance cost and the hours required to fulfill the compliance requirements for the registration and disclosure rules. Each point plots a single respondent's answers for hours and costs. Figure 4.4 shows a fitted upward sloping line. Robust and weighted regression analysis with several independent variables could change the analysis and interpretation of the data in this study but is beyond the scope of this Article.[200]

200. *See* Wulf A. Kaal, Do Compliance Costs of Financial Regulation Affect Smaller Firms More than Larger Firms? Evidence from the Private Fund Industry 27 (June 18, 2013) (unpublished manuscript) (on file with author) (showing that the size of hedge fund managers as measured by AUM is associated with compliance costs and other independent variables).

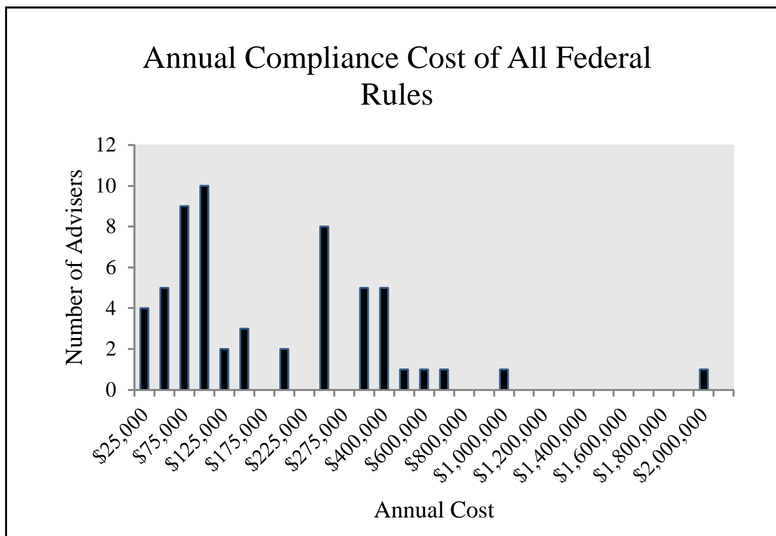

Figure 4.5, Annual Cost of Complying with All Federal Rules.

Figure 4.5 shows a histogram of the median cost for complying with all the federal rules. This question was open-ended, and some respondents provided ranges—for example, 250–500 hours. The Author took the mean number of the range in order to graphically show the results. Consequently, the response "250–500 hours" became "375 hours." The graph shows that a considerable number of respondents believe it will cost $100,000 or less to comply with all the rules. A second significant cluster believes the annual cost will be between $225,000 and $400,000. A small group put the cost of compliance at greater than $500,000 a year.

D. Assets Under Management

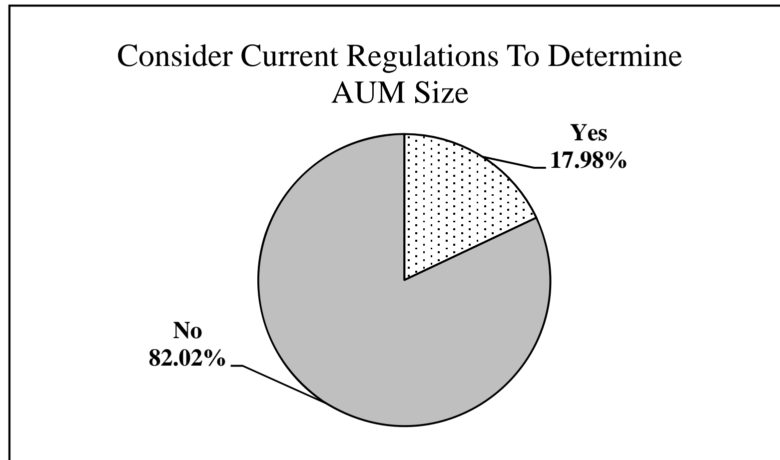

Figure 5.0, Percentage of Advisers Considering the Regulatory Regime in the AUM Decision.

Figure 5.0 illustrates the responses to Survey Questions 7.a and 7.b: "Would you take the current regulatory regime into account in determining the appropriate size of asset[s] (AUM) for your fund(s)?" Of those who responded, 82.02% would not have taken the current regulatory regime into account in determining the AUM size of their funds.

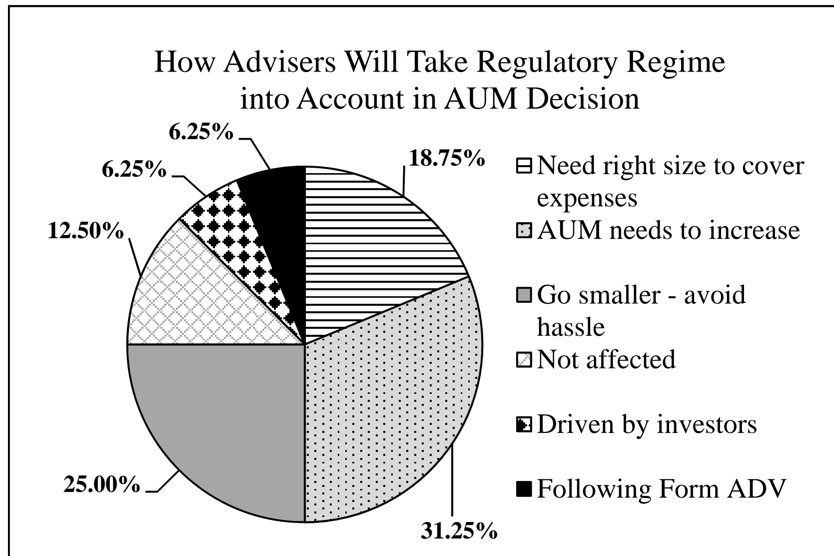

Figure 5.1, How Advisers Account for the Regulatory Regime in the AUM Decision.

Figure 5.1 shows the majority of clustered responses pertaining to Survey Question 7.b.i: "Would you take the current regulatory regime into account in determining the appropriate size of asset[s] (AUM) for your fund(s)? . . . If Yes—How would you take it into account?" A majority of respondents stated that as a result of the current regulatory regime their AUM would need to change. A significant number (25%) would go smaller to avoid the regulatory hassle. A larger percentage (50%) expressed either increasing current AUM size to cover expenses or mentioned the need for a certain size in order to account for the increase in expenses. One response stated that "under $1.5 billion is ideal." On the other hand, one respondent explained, "Our goal is to grow our business and attract additional investors, regardless of regulatory requirements."

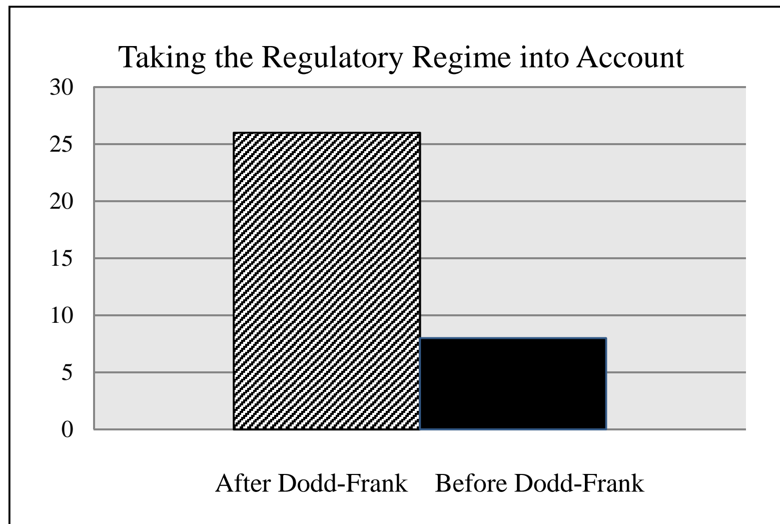

Figure 5.2, When Advisers Considered the Regulatory Regime in the AUM Decision.

Figure 5.2 shows that the majority of respondents placed a greater emphasis on the importance of the regulatory regime in determining the size of AUM for managed funds after the enactment of the Dodd-Frank Act.

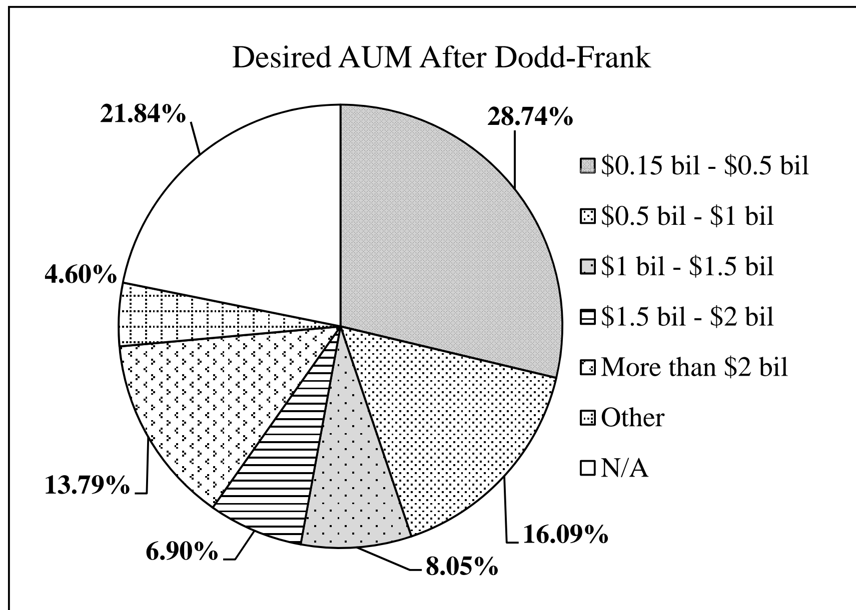

Figure 5.3, Desired AUM After Dodd-Frank.

Figure 5.3 indicates that a majority of respondents prefer an AUM size of between $150 million and $1.5 billion. Although a significant portion of respondents (21.84%) did not indicate a desired AUM size after the enactment of the Dodd-Frank Act, a substantial portion of respondents prefer between $500 million and $2 billion in AUM. Of the respondents, 28.74% desire an AUM size between $150 million and $500 million, 16.09% desire an AUM size between $500 million and $1 billion, and 13.79% of respondents prefer an AUM size of more than $2 billion.

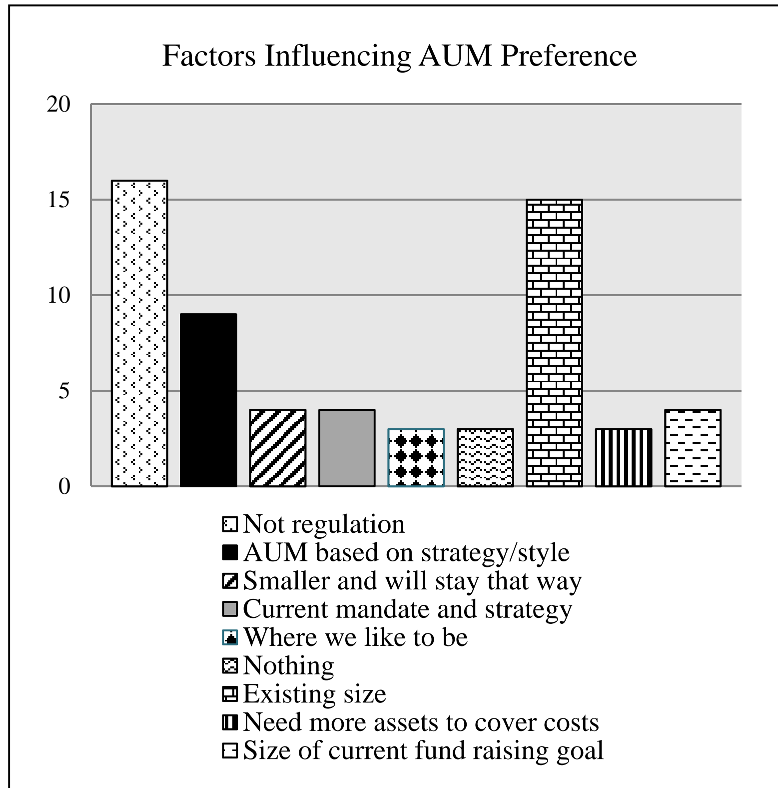

Figure 5.4, Factors Influencing AUM Preference.

Figure 5.4 illustrates the array of responses pertaining to Survey Question 9: "What affected your response to Item 8 [desired AUM size after the enactment of the Dodd-Frank Act]?" The Author and his team of researchers clustered the responses into several categories. A majority of respondents did not want to change the size of their AUM. The majority of respondents did not consider Dodd-Frank Act regulations if they changed the AUM size of their funds. Others expressed a desire to maintain their existing AUM size. Several respondents with a smaller AUM size stated they wanted to maintain their existing AUM size. Some respondents indicated that their responses were affected by their increased expenses as a result of the Dodd-Frank Act requirements.

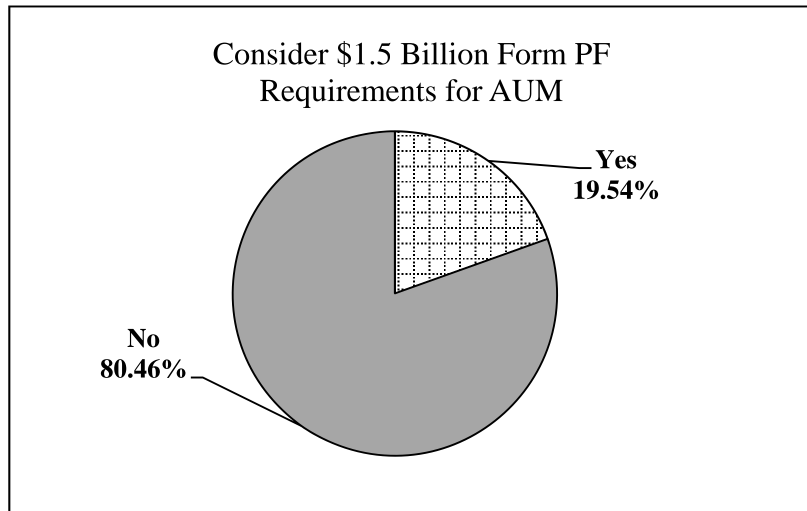

Figure 5.5, Advisers Who Consider the $1.5 Billion Form PF Threshold in the AUM Decision.

Figure 5.5 presents the responses pertaining to Survey Question 10: "Would you take the Form PF threshold for quarterly reporting of $1.5 bil assets (AUM) into account in determining the appropriate size of assets (AUM) for your fund(s)?" Of those who responded, 80.46% would not take the Form PF threshold for quarterly reporting of $1.5 billion AUM into account in determining the appropriate size of AUM for the fund(s) they manage, whereas 19.54% would take it into account. A majority of those respondents who would take it into account plan to stay under the Form PF threshold for quarterly reporting of $1.5 billion AUM. Other respondents indicated that the Form PF threshold was not relevant. Some respondents stated they may close the fund to new investors to stay under the Form PF threshold requirement. Others indicated that they were only subject to part of the Form PF requirement but would still take into account Form PF. Another common theme in responses was the ability to allocate the resources needed to complete Form PF before increasing the AUM.

E. Fund Earnings

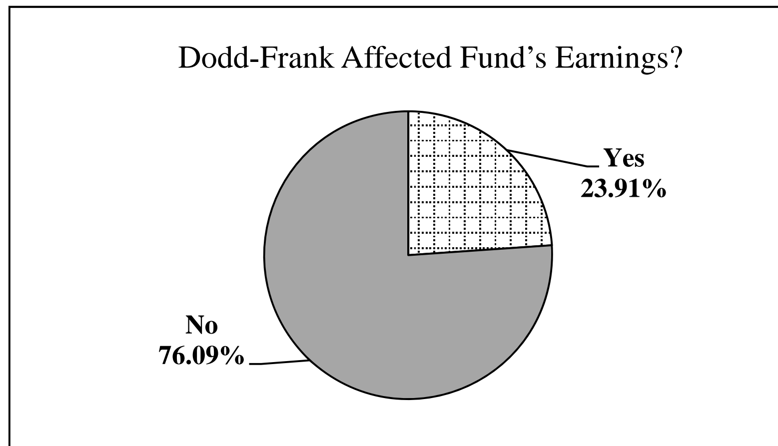

Figure 6.0, Whether Dodd-Frank Affected Fund's Earnings.

Figure 6.0 shows the responses to Survey Questions 11a and 11b: "Have the new registration and disclosure requirements affected your fund's earnings/net rate of return to your investors?" Of those who responded, 76.09% stated that their investors' rate of return has not been affected by the registration and disclosure requirements, whereas 23.91% of respondents believe their investors will be affected by the registration and disclosure requirements.

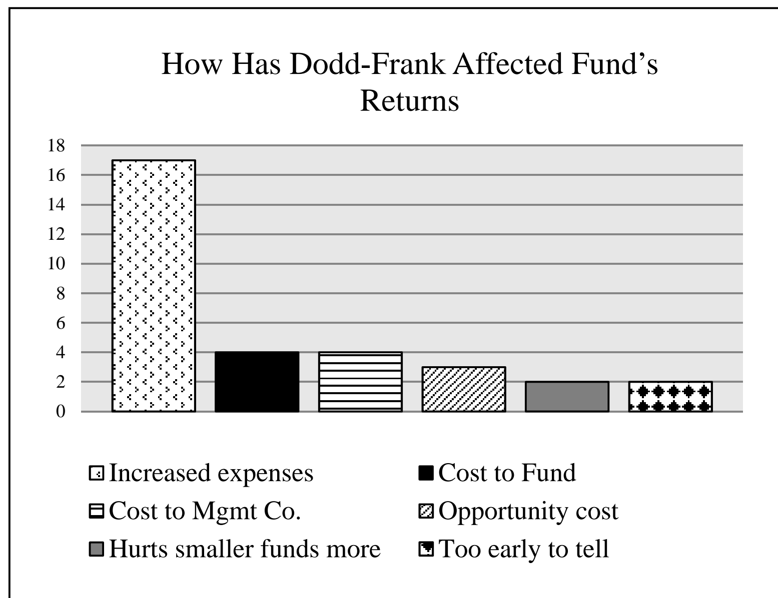

Figure 6.1, How Dodd-Frank Affected Fund's Returns.

Figure 6.1 shows the concerns of the 23.91% of respondents who stated that their investors' rate of return would be affected by the registration and disclosure requirements. The majority of the respondents indicated that the increased expenses caused by the registration and disclosure requirements were the most likely to affect their fund's returns. Other responses worth mentioning include the burden of costs on the management company and undeterminable opportunity costs because of distraction from core fund management. Several respondents stated it is too early to tell if additional burdens stemming from the Dodd-Frank Act will slow down activity and reduce investor returns. Others were concerned by the threat of reduced liquidity because large banks would not be able to participate any longer. Some mentioned the loss of all outside members of the investment committee, the resulting access to fewer deals, the loss of competitive differentiation, and higher cost of capital in the future. Several respondents were unsure what expenses could be passed to the investors.

F. Investment Management Company

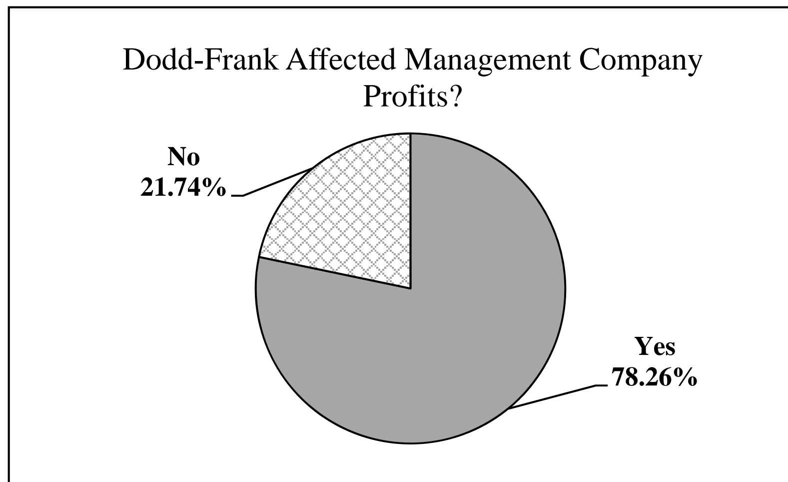

Figure 7.0, Whether Dodd-Frank Affected Management Company Profits.

Figure 7.0 shows the responses to Survey Question 12: "Have the new registration and disclosure requirements affected the profits of your investment management company?" Of those who responded, 78.26% indicated that the profits of their investment management company were affected. In the pool of respondents for this study, the responses seem to indicate that it is the management company that bears the brunt of costs associated with the registration and disclosure requirements. It is unclear whether and how the increased expenses will be passed on to investors over time.

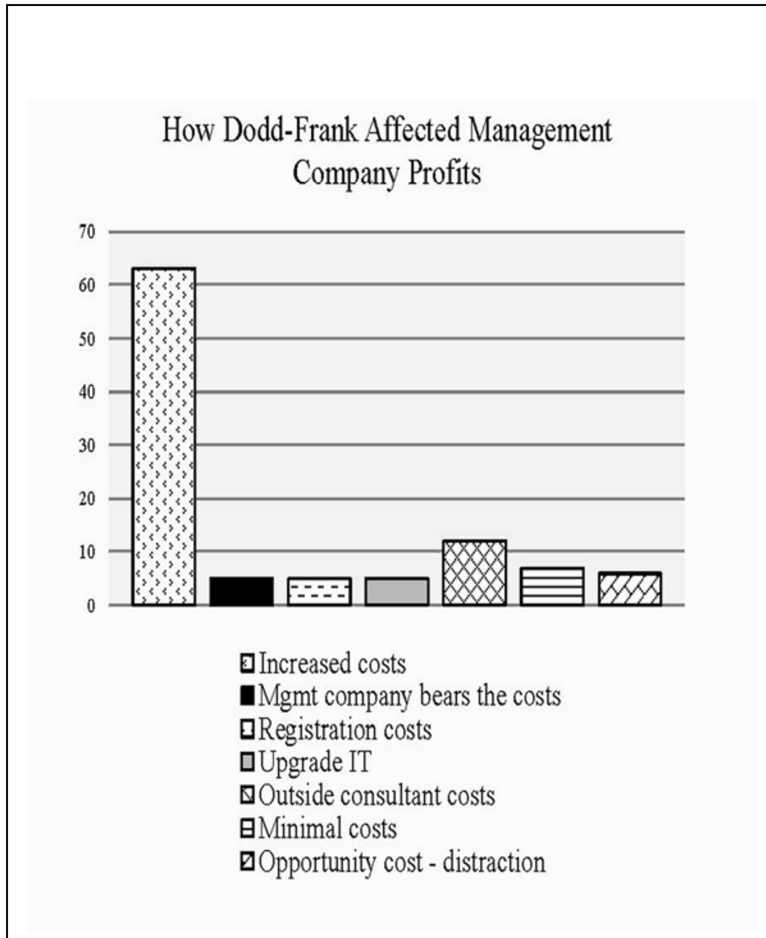

Figure 7.1, How Dodd-Frank Affected Management Company Profits.

Figure 7.1 breaks down the individual responses of the 78.26% of respondents who indicated that the profits of their investment management company were affected. Of those who responded, 87.50% indicated that the profits of their investment company were affected by increased costs and decreased profits as a result of the registration and reporting requirements. Other responses included references to the cost of outside consultants, registration costs, the cost to upgrade IT, general opportunity costs, and the cost to small firms who cannot as easily absorb these costs.

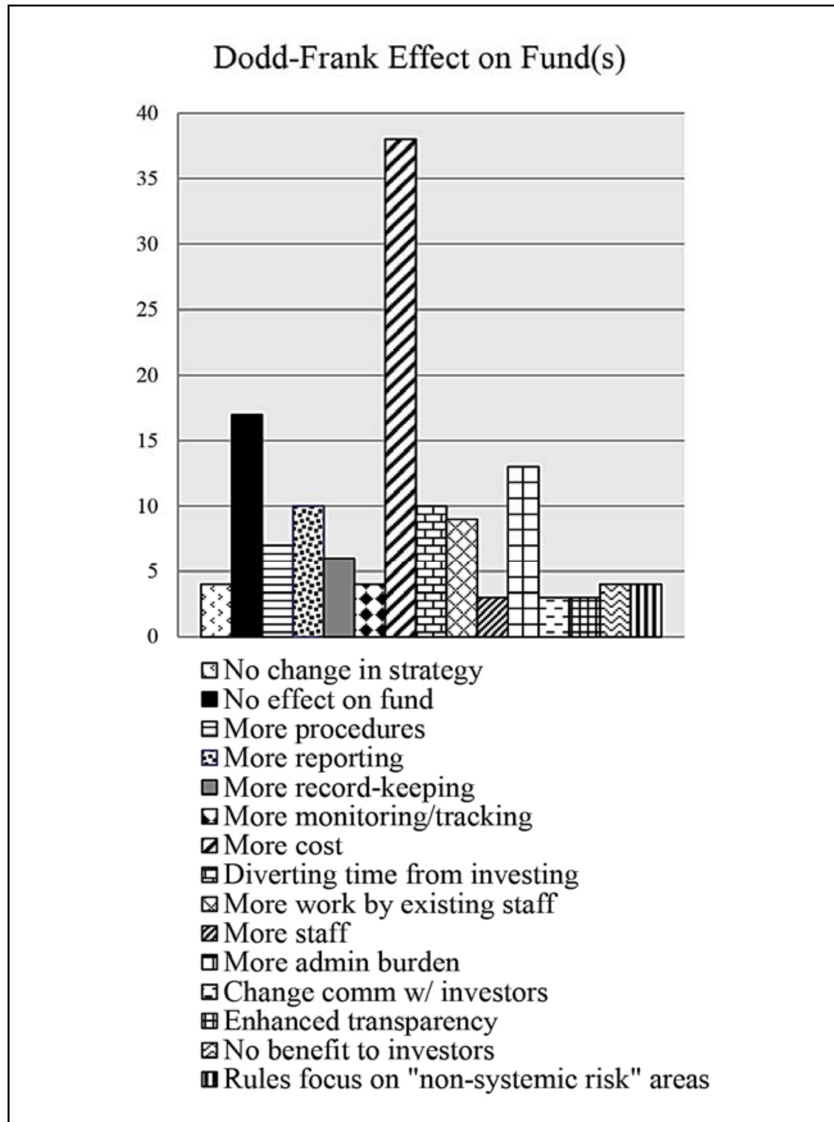

Figure 7.2, How Dodd-Frank Will Affect Fund(s) in the Next Five Years.

Figure 7.2 shows the different response categories to Survey Question 4: "In what ways will the new registration and disclosure rules affect your fund(s) in the next 5 years?" Of those who responded, 46.34% indicated that the Dodd-Frank registration and disclosure rules create higher costs that affect their funds. Only 2.44% of respondents indicated that they would have to change their strategy significantly as a result of the registration and disclosure requirements, but 4.88% reported that the new requirements would not result in a strategy change. According to 15.85% of the respondents, the registration and disclosure requirements increased their administrative burden, while 20.73% reported that the registration and disclosure requirements had no effect on their funds. Other cluster categories with comparatively high response rates include responses pertaining to the diversion of staff time from investing, increased administrative burdens, an increase in required procedures, increased reporting, and additional work for existing staff.

Many comments from respondents that did not justify a cluster category also proved very insightful. One respondent indicated that growing the fund to cover increased overhead at the management company would mean that the management company would need to engage in larger transactions. This would likely lead to staff changes and the need to hire a team that can do larger deals. Another respondent merged its fund with another fund to increase efficiency. Other respondents were concerned about the additional time it would take to raise funds, the prevention of expansion, the general time drain, and being increasingly on the SEC's radar after registration. Some respondents indicated that they are closing multifamily offices to return to a single-family office. Some respondents stated that the registration and disclosure rules require additional communication with investors. Investment advisers whose primary business was not in investing in securities but who held a small pool of securities as part of their business indicated that the registration requirements may result in the divestiture of their securities.

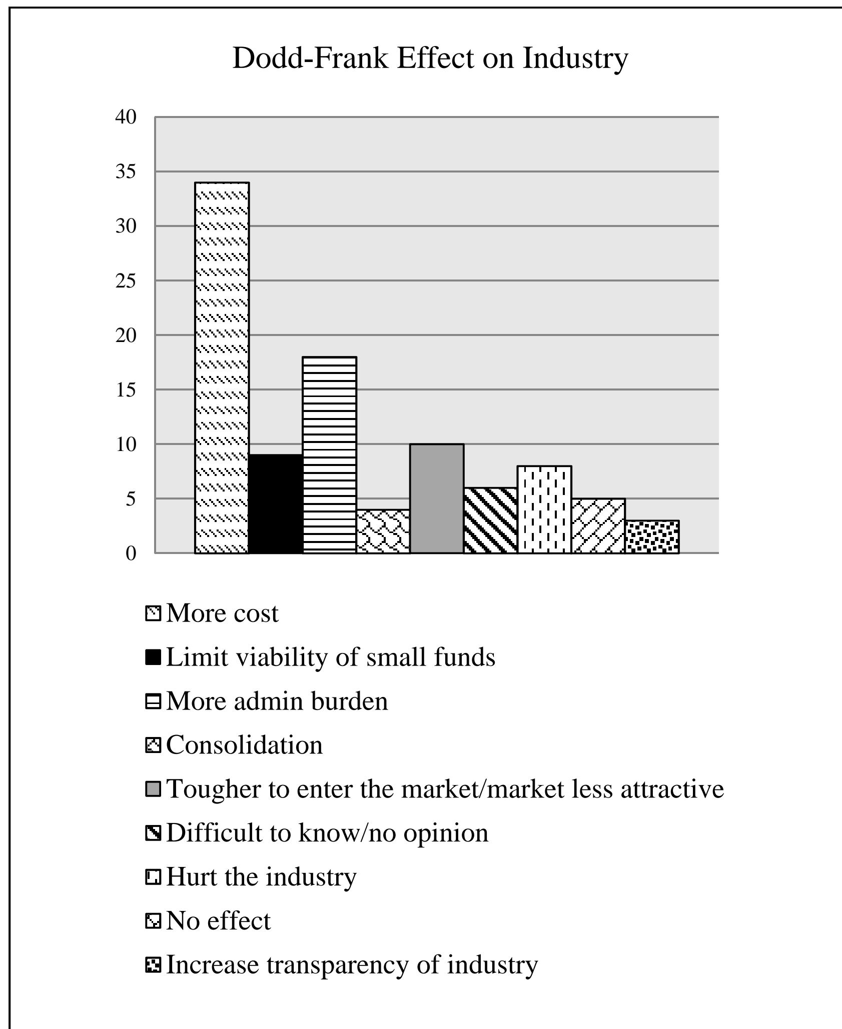

Figure 7.3, How Dodd-Frank Will Affect the Industry in the Next Five Years.

Figure 7.3 illustrates the cluster of responses to Survey Question 5: "In what ways will the new registration and disclosure rules affect your industry in the next 5 years?" Similar to their responses to Survey Question 4, respondents referred mostly to the additional costs resulting from the registration and disclosure rules. According to 43.59% of respondents, the private fund industry is affected by the cost of the registration and disclosure rules under the Dodd-Frank Act. Of those who responded, 23.08% reported that increased administrative burdens constitute an important factor that affects the private fund industry. Another response cluster that merits mentioning is the creation of barriers to entry for other funds because of a less attractive market environment for private funds as a result of the registration and disclosure requirements. Several respondents mentioned the limited viability of small funds and the consolidation of the industry.

Several comments from individual respondents that did not justify a cluster category proved very insightful. One respondent indicated that fundraising would have to be prolonged because of the expanded due diligence from institutional investors that resulted from the changes in the regulatory environment pertaining to the private fund industry. Others believe that some managers will be forced out of the market because of the increased costs of compliance. Another raised concerns over lower middle market fundraising activity that could lead to a lowering of the deal activity. Some respondents welcomed the regulatory changes because it would make funds easier to compare. Some felt that the SEC is giving investors a false sense of comfort that the SEC is taking care of investors' money. Other responses included a concern that the industry may become more competitive and less profitable and that the new regulatory environment would make it tougher to market new funds.

One comment seems worthy quoting here as it explains a significant change for the industry as it pertains to the ability of startup funds to overcome barriers to entry into the market for hedge fund advisers. The respective hedge fund adviser stipulated as follows: "It used to take 25–50 mil. to start a hedge fund in NY and then buil[d] a record and grow. Today it is at least 100 mil. [b]ecause of the increased cost of compliance with the registration and disclosure requirements."

VI. DISCUSSION AND CONCLUSION

Studies conducted before the hedge fund manager registration effective date, March 30, 2012, indicate that hedge fund managers expected Dodd-

Frank Act rules and regulations pertaining to the hedge fund industry to harm U.S. competitiveness.[201] A small group of managers believed the FSOC would be able to address systemic risk in the financial system.[202] Most hedge fund managers expected their operational costs to be affected by increased compliance costs because of Dodd-Frank regulations.[203] These prior studies left many questions unanswered because they were conducted before the registration effective date and had substantially lower sample sizes.[204]

A. Summary of Key Findings

The results reported in this study suggest that the Dodd-Frank Act registration and disclosure requirements and the SEC's implementation of these rules create several areas of concern for the hedge fund industry. Of those who responded, 46.34% indicated that the Dodd-Frank registration and disclosure rules create higher costs that affect the funds they manage, while 78.26% of respondents stated that the profits of their investment management company were affected. According to 87.50% of the respondents, the profits of their investment companies were affected by increased costs and decreased profits as a result of the registration and reporting requirements. A majority of respondents have (1) outsourced compliance work, (2) hired additional counsel, (3) instituted new record-keeping policies, (4) hired additional staff, (5) changed marketing materials, and (6) changed communications with investors. A minority of respondents changed their funds' legal structures in response to the registration and disclosure requirements.

Despite these concerns, the hedge fund industry appears to be only modestly affected by the Dodd-Frank reporting and disclosure requirements and is adapting well to the new regulatory environment. The results show that 82.02% of respondents do not take the current regulatory regime into account in determining the AUM size of their funds. The percentage drops to 72.09% of survey respondents who do not plan a strategic response to the Dodd-Frank Act registration and reporting

201. Hofstra Univ., *supra* note 1; *see also* ROTHSTEIN KASS, *supra* note 175, at 18 (reporting that 51.5% of hedge fund managers polled think that reporting, particularly Form PF, is a "significant concern").
202. *See* Hofstra Univ., *supra* note 1.
203. *Id.*
204. *Compare* ROTHSTEIN KASS, *supra* note 175 (consulting 400 hedge fund firms), *with* EISNERAMPER SURVEY, *supra* note 1 (interviewing forty-one managers).

requirements. Firms that planned a strategic response were smaller than those firms that did not plan a strategic response. Of those who responded, 76.09% stated that their investors' rate of return was not affected by the registration and disclosure requirements.

A majority of advisers quantified the cost of compliance in a range from $50,000 to $200,000. However, a significant minority estimated that the total compliance cost would range between $200,000 to over $400,000. Although a majority of advisers spent less than 500 hours to comply with the new registration and reporting requirements, many fund advisers estimate it will take them between 500 and 1000 hours to comply with the requirements. The hours needed to comply with all federal rules and regulations pertaining to hedge fund advisers range from under 100 up to 4000 hours, with a majority of responses ranging from over 300 hours to 800 hours.

A majority of respondents did not feel the need to change the size of their AUM, and Dodd-Frank Act regulations were not factors a majority of respondents considered if they did change the AUM size of their funds. For 80.46% of respondents, the Form PF threshold for quarterly reporting of $1.5 billion AUM is not taken into account in determining the appropriate size of AUM for the funds they manage. A majority of the 19.54% of respondents who would take the Form PF threshold into account plan to stay under the Form PF threshold for quarterly reporting of $1.5 billion AUM.

B. Private Fund Policy and Future Research

The results reported in this study have implications for private fund policy. The private fund industry seems to be adjusting well, and the impact of the registration and disclosure rules appears to be much less intense than the industry initially anticipated. Although hedge fund advisers may absorb the reported cost implications of registration and disclosure rules relatively quickly after registration, the long-term cost implications of registration and reporting obligations could affect the private fund industry.

Anecdotal evidence suggests that the information disclosed by hedge fund advisers in the required Forms ADV and PF can be presented in ways that in effect "flatten out" and "sanitize" the disclosures. Although the level of sanitizing of disclosures cannot be verified, sanitized disclosures could be less useful for FSCO and SEC evaluation and their determination of the systemic risk posed by private funds.

Although this study shows trends and perceptions within the industry, it does not provide insights on the long-term implications of the registration and disclosure requirements because the data was collected

within a relatively short time period after the registration requirements took effect. The data for this study was collected within three months of the SEC's registration effective date, March 30, 2012. Future studies are needed to determine if the long-term impact of the Dodd-Frank Act is as moderate as this study suggests.

VII. APPENDIX: SURVEY INSTRUMENT

· PRIVATE FUND REGISTRATION & DISCLOSURE

.egal / Compliance Officer
om It May Concern

From: **University of St. Thomas**
School of Law
Professor Wulf Kaal
1000 LaSalle Ave., MSL 400
Minneapolis, MN 55403
Telephone: 1 (651) 962-4972
Cell: 1 (312) 810-4390
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wulfkaal@stthomas.edu
http://www.stthomas.edu/law/f
acultystaff/faculty/kaalwulf/

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: Sir or Madame:

e last two decades, the SEC has repeatedly attempted to register private funds. The
: Act now authorizes the SEC to bring private funds under regulatory supervision.
: of this survey is for researchers at the University of St. Thomas School of Law in
; to learn more about your experiences with recent private fund registration and
equirements under the Dodd-Frank Act.

educe any risks in your participation, we will not identify you or your firm by name
We would be happy to share the results of this survey with you, as they may prove
ative in the administrative management of your fund(s). If deemed desirable and
our consent, we would also be happy to share the results of this survey with your

will follow up with a short phone call. Alternatively, we would be happy to receive
ses via email o[r] fax. We very much appreciate your support.

se feel free to contact us at your convenience with any questions.

rs Sincerely,

. Wulf Kaal

SURVEY QUESTIONS

1. Is your investment adviser / fund manager registered with the SEC?

   a. Yes ☐
   b. No ☐

2. Which of the following actions have you taken to assure compliance with Dodd-Frank Act registration and reporting requirements?

   Please check all that apply:

   a. Outsourced compliance work ☐
   b. Hired additional counsel ☐
   c. Instituted new record-keeping policies ☐
   d. Hired additional staff ☐
   e. Fired staff ☐
   f. Severed an advising relationship with client(s) (i.e. closed fund and went private to escape registration and disclosure requirements) ☐
   g. Changed marketing materials ☐
   h. Changed communications with investors ☐
   i. Changed fund (legal) structure ☐
   j. Liquidated positions ☐
   k. Changed investment style ☐
   l. Changed portfolio structure ☐
   m. Closed fund(s) to new investors ☐
   n. Other ☐

   ____

3. Do you plan to implement strategic responses to the new registration and disclosure requirements?

   a. No ☐
   b. If yes ☐, what strategic responses do you plan to implement?

   ____

4. In what ways will the new registration and disclosure rules affect your fund(s) in the next 5 years?

   ____

5. In what ways will the new registration and disclosure rules affect your industry in the next 5 years?

____

6. Please respond to the questions pertaining to the new registration and reporting requirements in each category:

   a. Time:

      i. Compliance with the Dodd-Frank Act reporting requirements will take approximately:

         1. 100 – 250 hours per year ☐
         2. 250 – 500 hours per year ☐
         3. 500 – 750 hours per year ☐
         4. 750 – 1000 hours per year ☐
         5. More than 1000 hours per year ☐
         6. Other [ ] ☐

      ii. Compliance with all federal rules and procedures (Treasury, SEC, CFTC etc.) will take approximately:

         [ ] hours per year

   b. Cost (defined as actual expenses incurred):

      i. Compliance with the new reporting requirements will annually cost approximately:

         1. $50,000 – $100,000 ☐
         2. $100,000 – $200,000 ☐
         3. $200,000 – $300,000 ☐
         4. $300,000 – $400,000 ☐
         5. More than $500,000 ☐
         6. Other [ ] ☐

      ii. Compliance with all federal rules and procedures (Treasury, SEC, CFTC etc.) will annually cost approximately:

         $[ ]

7. Would you take the current regulatory regime into account in determining the appropriate size of asset (AUM) for your fund(s)?

   a. No. ☐

a. If Yes ☐ –

i. How would you take it into account?

____

ii. Did you take it into account before the Dodd-Frank Act was enacted?

a. No. ☐
b. Yes. ☐

8. After the enactment of the Dodd-Frank Act reporting and disclosure requirements, what assets size (AUM) would you desire to operate your fund(s):

a. $150 mil – $500 mil ☐
b. $500 mil – $1 bil ☐
c. $1 bil – $1.5 bil ☐
d. $1.5 bil – $2 bil ☐
e. More than $2 bil ☐
f. Other ☐
g. N/A ☐

9. What affected your response to Item 8?

____

10. Would you take the Form PF threshold for quarterly reporting of $1.5 bil assets (AUM) into account in determining the appropriate size of assets (AUM) for your fund(s)?

a. No ☐
b. If yes ☐, how would you take it into account?

____

11. Have the new registration and disclosure requirements affected your fund's earnings / net rate of return to your investors?

a. No ☐
b. If yes ☐, how?

____

12. Have the new registration and disclosure requirements affected the profits of your investment management company?

   a. No ☐
   b. If yes ☐, how?