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No Further Hedge Fund Regulation - For Now

On February 22, 2007, the President's Working Group On Financial Markets issued a long-awaited report on hedge fund regulation. In response to the rapid growth of the hedge fund industry, the SEC had adopted regulations. But these were nullified by the U.S. Court of Appeals for the D.C. Circuit in the case of *Goldstein v. SEC* (in which McKenna Long & Aldridge represented the lead plaintiff). And the principal question confronting the President's Working Group was whether additional regulation of hedge funds and private equity funds is necessary to reduce the risk of the funds' destabilizing the financial markets. The President's Working Group On Financial Markets consists of the heads of the Department of Treasury, the Federal Reserve and the SEC.

In its report released on Thursday, the Working Group concluded that no further federal regulations were needed at this time. The Working Group took the position that any risk posed by these private pools of capital to the financial system could be mitigated through investor discipline, including the possibility of better delineated financial qualifications for investors. The Working Group also concluded that risk could be further mitigated if financial institutions (such as banks, mutual funds, and other counterparties), which do business with these hedge funds, more closely scrutinize their relationships.

This renewed focus on private pools of capital may still stimulate efforts to impose more regulations on the industry at both the Federal and State levels. Specifically, the SEC has already mentioned trying to effect who can invest in hedge funds by modifying the threshold for individuals who qualify as "accredited investors" – a key criteria for purchasing interests in privately held partnerships. Additionally, there may be increased pressure or regulatory requirements imposed on banks, mutual funds, and brokerage houses to require more disclosures from those hedge funds and private equity funds in which they are investors. The House Financial Services Committee is expected to begin hearings on hedge funds in the coming months. The State Attorneys General, such as Attorney General Richard Blumenthal of Connecticut, have expressed concern over the lack of federal regulation and have indicated that they will begin to push for state level regulation.

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