

## CLIENT ALERT

### SEC Ramps Up Hedge Fund Enforcement

Aug.03.2007

The Securities and Exchange Commission has created a hedge fund unit within its Division of Enforcement to coordinate and enhance its efforts to combat insider trading. The unit will work in cooperation with other federal law enforcement agencies and self-regulatory organizations.

SEC Chairman Cox announced the creation of the new unit during prepared testimony before the Senate Banking, Housing and Urban Affairs Committee on July 31, 2007. The introduction of this unit follows the recent adoption of an antifraud rule that allows the SEC to sue hedge fund advisors who make false or misleading statements. New Rule 206(4)-8 under the Investment Advisers Act of 1940 (“Advisers Act”), adopted on July 11, 2007, will make it a fraudulent, deceptive, or manipulative act, practice, or course of business for an investment adviser to a pooled investment vehicle to make false or misleading statements to, or otherwise to defraud, investors or prospective investors in that pool. Notably, this rule is not restricted to fraud in connection with the purchase or sale of securities and could be applied whether or not an investor actually purchases an interest in the fund. The new rule has not yet been published and the Commission has not issued the formal release relating to its adoption. The rule will take effect 30 days after its publication in the Federal Register.

Chairman Cox noted that the rule responds to the 2006 *Goldstein v. SEC* decision, which created uncertainty about whether the Advisers Act’s antifraud provisions protect investors in the hedge fund rather than just the fund itself. In *Goldstein*, the United States Court of Appeals for the District of Columbia Circuit struck down Rule 203(b)(3)-2 under the Advisers Act which required certain hedge fund managers to register with the SEC as investment advisors. The Circuit held that the Hedge Fund Registration Rule’s definition of “client” did not meet the standard of reasonableness for administrative agency rulemaking. New Rule 206(4)-8 seeks to eliminate any limitation from the *Goldstein* court relating to the SEC’s ability to bring enforcement actions under the Advisers Act against a hedge fund adviser or manager who is alleged to have defrauded investors or prospective investors.

In his statement before the Senate Committee, Chairman Cox noted that in “the past few years, the Commission has brought numerous enforcement actions alleging that hedge fund portfolio managers engaged in insider trading” and highlighted several specific examples of actions against hedge funds and their portfolio managers. The formation of the unit within the enforcement division, as well as Chairman Cox’s continued focus on hedge funds suggests that there will be an increased number of hedge fund investigations in the near future.

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.

**Thomas A. Hanusik**

Partner – Washington, D.C.

Phone: +1 202.624.2530

Email: [thanusik@crowell.com](mailto:thanusik@crowell.com)