Clients&FriendsMemo

SEC Adopts Dodd-Frank Act Investment Adviser Rules and Delays Implementation of Some Deadlines

June 27, 2011

During an open meeting on June 22, 2011, the Securities and Exchange Commission (the "**SEC**") approved the adoption of new rules under the Investment Advisers Act of 1940, as amended (the "**Advisers Act**"), as mandated by Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "**Dodd-Frank Act**"). These rules, which are spelled out in three releases, will require advisers to hedge funds and other private funds to register with the SEC, establish new exemptions from SEC registration for certain advisers, reallocate regulatory responsibility for advisers between the SEC and states, expand Form ADV disclosure by investment advisers, revise the SEC's "pay-to-play" rule for advisers, and exclude certain "family offices" from the Advisers Act. While the Dodd-Frank Act amendments to the Advisers Act are generally effective as of July 21, 2011, the new SEC rules delay implementation of the new compliance requirements in a number of respects. Following is a brief summary of the changes effected by the Dodd-Frank Act and the new SEC rules.

Private Advisers Registration

Historically, many advisers to hedge funds and other private investment vehicles relied on a registration exemption under Section 203(b)(3) of the Advisers Act for advisers with fewer than 15 clients (or funds) which don't "hold themselves out." Section 403 of the Dodd-Frank Act will eliminate this exemption as of July 21, 2011, requiring many previously unregistered advisers to register with the SEC and become subject to its rules and oversight.

However, new Advisers Act Rule 203-1(e) pushes back the deadline for registration compliance by such previously-exempt private advisers until March 30, 2012 (meaning that a registration application will have to be filed with the SEC by no later than February 14, 2012 to satisfy the 45-day review period).

Reporting Requirements for Private Fund Advisers

In addition to information required to be provided by all registered advisers, Item 7.B of Part 1A of amended Form ADV will require advisers to private funds (*i.e.*, those relying on the exclusions in

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either Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act of 1940, as amended (the "**Investment Company Act**")) to provide information for each fund they advise, including: (i) general information about the fund; (ii) the amount of assets under management; (iii) certain non-personal information concerning the fund's beneficial owners (other than for the adviser and certain of its related persons); (iv) whether the adviser is a subadviser and whether it solicits its own clients to invest in the fund; (v) whether the fund is offered pursuant to SEC Regulation D under the Securities Act of 1933, as amended (the "**Securities Act**"); and (vi) information concerning the fund's auditors, prime brokers, custodians, administrators, and marketers.

New Exempt Advisers

Sections 403, 407, and 408 of the Dodd-Frank Act created three new registration exemptions under the Advisers Act. These exemptions are for (i) certain "foreign private advisers," (ii) private advisers solely to "venture capital funds," and (iii) advisers solely to private funds if the adviser has aggregate assets under management in the United States of less than $150 million.

1. *Foreign Private Adviser Exemption*

Amended Section 203(b)(3) of the Advisers Act exempts a "foreign private adviser," defined in new Advisers Act Section 202(a)(30) as any investment adviser that: (i) has no place of business in the United States; (ii) has, in total, fewer than 15 clients in the United States (including investors in the United States in private funds advised by the investment adviser); (iii) has aggregate assets under management attributable to clients in the United States (including investors in the United States in private funds advised by the investment adviser) of less than $25 million; and (iv) does not hold itself out generally to the public in the United States as an investment adviser.

Under new Advisers Act Rule 202(a)(30)-1, a foreign private adviser generally need not "look through" entities it advises (other than private funds) to count the owners of the entity in the United States as separate "clients"; in the case of any private funds it advises, however, a foreign private adviser must "look through" and count all U.S. beneficial owners of the fund's outstanding securities (including short-term paper issued by the fund).

An adviser's clients or investors in a private fund it advises will generally be deemed to be "in the United States" if they are "U.S. persons" as defined in Rule 902(k) of SEC Regulation S under the Securities Act.

2. *Venture Capital Fund Adviser Exemption*

New Advisers Act Section 203(l) creates an exemption for advisers solely to venture capital funds. The term "venture capital fund" is generally defined in new SEC Rule 203(l)-1 as a private fund

that: (i) represents that it pursues a venture capital strategy; (ii) invests primarily in "qualifying investments" (in particular, equity securities issued by a company which isn't subject to the reporting requirements under Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended (the "**Exchange Act**"), or which has a security listed or traded on a foreign exchange or organized market, and is not affiliated with a company which files such reports or whose securities are so traded, as well as certain short-term holdings), but allowing for a 20% basket of the fund's capital contributions and uncalled commitments in non-qualifying investments; (iii) does not borrow or otherwise incur leverage, other than limited short-term borrowing; (iv) does not offer its investors redemption or other similar liquidity rights except in extraordinary circumstances; and (v) is not registered under the Investment Company Act and has not elected to be treated as a business development company under the Investment Company Act. Venture capital funds that began raising capital prior to December 31, 2010 and don't sell additional securities (including on a committed capital basis) after July 21, 2011 will be considered venture capital funds under a grandfathering provision.

3. *Private Fund Adviser Exemption*

New Advisers Act Section 203(m) creates an exemption for advisers solely to private funds, provided they have assets under management in the United States of less than $150,000,000. New Advisers Act Rule 203(m)-1 provides for a bifurcated treatment of U.S.-based and foreign-based advisers. Thus, an adviser with its principal office and place of business in the United States must count the assets of all private funds it advises, irrespective of whether it may manage those assets from a foreign office. However, an adviser with its principal office and place of business outside the United States must only count the assets of private funds it manages at a place of business in the United States ("place of business" being defined in Advisers Act Rule 222-1 as an office at which, or a location held out to the general public as a location at which, the adviser regularly provides advisory services, solicits, meets with, or otherwise communicates with clients). Thus, a foreign adviser solely to private funds in the United States and which either has no place of business in the United States, or doesn't manage any such fund from a place of business in the United States, may rely on this exemption, irrespective of the amount of assets of such funds that it manages. Advisers Act Rule 203(m)-1 also modifies the definition of "private fund" for purposes of the Section 203(m) exemption to include any private fund not registered under Section 8 of the Investment Company Act and which has not elected to be treated as a business development company under the Investment Company Act, and which also qualifies for another exclusion from the definition of "investment company" in Section 3 of the Investment Company Act.

4. *Reporting Requirements for Exempt Venture Capital and Private Fund Advisers*

While they are exempt from full registration under the Advisers Act, exempt advisers to venture capital funds and private funds (together, "**Exempt Reporting Advisers**") are subject to certain

reporting requirements. Over the dissent of Commissioners Casey and Paredes, the SEC adopted Advisers Act Rule 204-4, requiring Exempt Reporting Advisers to file Part 1A of Form ADV within 60 days of first relying on the exemption (the first such filing must be made between January 1 and March 30, 2012), and then annually thereafter (subject to interim amendment requirements), including: (i) basic identifying information for the adviser and the identity of its owners and affiliates, (ii) information about the adviser's private funds and business activities that may present significant conflicts of interest, and (iii) the disciplinary history of the adviser and its employees.

Commissioner Schapiro noted during the open meeting that the SEC will reconsider the sufficiency of such requested information in a year's time, and, although it has the authority to do so, the SEC does not intend to perform routine examinations of Exempt Reporting Advisers.

Increase in Assets Under Management Threshold for SEC Registration; "Mid-Sized Advisers"

Previously, an investment adviser generally could not register with the SEC unless it had at least $25 million of assets under management, leaving the registration of advisers with less assets under management to the individual states. The Dodd-Frank Act raises this threshold to $100 million, with a $10 million buffer above and below so advisers will not have to frequently switch between federal and state registration.

Section 410 of the Dodd-Frank Act created a new category of "mid-sized advisers." A mid-size adviser may not register with the SEC if it is required to be registered as an investment adviser in the state in which it maintains its principal office and place of business, would be subject to examination as an adviser by that state's securities regulator, and has assets under management between $25 million and $100 million.

A mid-sized adviser must register with the SEC, however, (i) if the adviser is not required to be registered as an investment adviser in the state in which it maintains its principal office and place of business; or (ii) if registered with that state, the adviser would not be subject to examination as an investment adviser by that state's securities regulator. Based on a survey conducted by the SEC, mid-sized advisers in Minnesota, New York, and Wyoming must register with the SEC unless otherwise exempt (Minnesota and New York don't examine investment advisers, while Wyoming is the only state with no registration requirement for investment advisers, so advisers based in Wyoming must register with the SEC even if they don't satisfy the $25 million threshold). A mid-sized adviser may also register with the SEC if it would otherwise be required to register with 15 or more states, or if it is otherwise exempt from registration in the state where it has its principal office and place of business under that state's law.

A mid-sized adviser required to switch from state to SEC registration must do so by March 30, 2012, while an adviser permitted to remain registered with the SEC must file an amendment to its

Form ADV no later than March 30, 2012. Advisers no longer eligible for SEC registration will have to withdraw their registration by filing a Form ADV-W and switch to state registration by June 28, 2012.

Pay-to-Play

The SEC amended Advisers Act Rule 206(4)-5, the "pay-to-play" rule, which is designed to prevent an adviser from seeking to influence government-awarded advisory contracts with political contributions. As amended, the Rule will apply to exempt foreign private advisers, as well as Exempt Reporting Advisers, and will permit an adviser to pay a registered municipal advisor to act as a placement agent to solicit government entities on its behalf, provided such municipal advisor is registered under Section 15B of the Exchange Act and is subject to a Municipal Securities Rulemaking Board-adopted pay-to-play rule as stringent as Rule 206(4)-5.

Family Offices

Finally, Dodd-Frank Act Section 409 amended Advisers Act Section 202(a)(11) to exclude "family offices" from the definition of the term "investment adviser." These are entities established by wealthy families to manage their wealth and provide other services to family members, and which historically relied on the registration exemption for advisers with fewer than 15 clients that was removed by the Dodd-Frank Act or in certain instances upon special exemptive orders issued by the SEC under Advisers Act Section 206A. As defined in new Advisers Act Rule 202(a)(11)(G)-1, a "family office" is one that: (i) provides services only to family members, former family members, certain key employees, former key employees, and certain other entities, trusts and estates that are "alter-egos" of family clients but were established for tax reasons, estate planning, or administrative ease (collectively, "**Family Clients**"); (ii) is wholly-owned by Family Clients and is exclusively controlled by family members or family entities; and (iii) does not hold itself out to the public as an investment adviser. Note that "family offices," like other persons excluded from the definition of "investment adviser" in Advisers Act § 202(a)(11), will not be subject to registration as investment advisers under stat Blue Sky laws.

Advisers to Funds or Accounts that Trade in Swaps

In addition to the SEC's rulemaking under Title IV of the Dodd-Frank Act described above, on June 16, 2011, the Commodity Futures Trading Commission (the "**CFTC**") issued a proposed order granting temporary relief from certain provisions of Title VII of the Dodd-Frank Act which would delay the registration of certain advisers whose commodity interest trading advice includes only swaps, or who operate funds that only make commodity interest investments in swaps as commodity trading advisors or commodity pool operators, respectively. The purpose for the delay is that the CFTC and the SEC have yet to further define the term "swap" as directed by the Dodd-

Frank Act, and the new definitions of "commodity trading advisor," "commodity pool operator" and "commodity pool" to come into effect as of July 16, 2011 each include the term "swap."

As drafted, the proposed CFTC order would grant temporary relief from registration requirements for these types of advisers (*i.e.*, those providing commodity interest trading advice or who operate funds that only make investments in currency swaps or broad-based securities index trades) until the earlier of: (1) the effective date of the applicable final rule further defining the term "swap"; or (2) December 31, 2011.

The proposed order was published in the *Federal Register* on June 17, 2011 and comments on the proposed order are due on or before July 1, 2011. The CFTC intends to issue the final order by July 16, 2011.

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