SEC Adopts Rules Implementing Dodd-Frank Amendments to Investment Advisers Act; Compliance Deadline Extended to March 30, 2012

On June 22, 2011, the Securities and Exchange Commission (the "SEC") adopted new rules pursuant to Title IV of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* ("Dodd-Frank") which modify the registration requirements for investment advisers under the Investment Advisers Act of 1940 (the "Advisers Act"). The new rules are substantially similar to those proposed initially by the SEC,[1] and will subject private advisers, namely hedge fund, private equity fund, and other pooled investment vehicle advisers to registration with the SEC by a compliance date of March 30, 2012.[2]

The expanded scope of required SEC registration for investment advisers is due to Dodd-Frank's elimination of the "private adviser" exemption, a *de minimus* "fewer than 15 clients exemption" that had been used by many advisers to private funds.[3] The approved SEC rules now create three new exemptions[4] from registration which include (1) advisers solely to venture capital funds, (2) advisers solely to private funds with less than $150 million in assets under management ("AUM"), and (3) certain foreign advisers with no place of business in the United States. In addition, the SEC adopted the proposed exemption for advisers who solely advise "family offices."[5]

I. New $100 million AUM Threshold for SEC Registration

Mid-sized advisers ($25 - $100 million) are no longer subject to SEC oversight.

- The new SEC rules implement the Dodd-Frank Act amendment to section 203A of the Advisers Act by shifting regulatory oversight for "mid-sized" advisers with AUM between $25 million and $100 million from the SEC to the states. These advisers are now prohibited from registering with the SEC, but only: (1) if there is a state statute requiring registration as an investment adviser with a securities officer of the state in which the adviser maintains its principal office and place of business; and (2) if the state examines registered advisers.[6] Minnesota, New York, and Wyoming do not meet these requirements. Accordingly, investment advisers with a principal office in those states and AUM within the $25 million to $100 million range must continue to register with the SEC.

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1 For additional information about the proposed rules, please see our Firm memorandum dated November 30, 2010, available at http://www.cahill.com/news/memoranda/100254.

2 Since the statutory period between first filing a Form ADV and the granting of a registration order is 45 days, first time registrants should file at least by February 14, 2012. *Rules Implementing Amendments to the Investment Advisers Act of 1940*, Release No. IA-3221 at 94, available at http://www.sec.gov/rules/final/ia-3221.pdf ("Release 3221").

3 Section 203(b)(3) of the Advisers Act.

4 See *Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers*, Release No. IA-3222, available at http://www.sec.gov/rules/final/2011/ia-3222.pdf.

5 See *Family Offices*, Release No. IA-3220, available at http://www.sec.gov/rules/final/2011/ia-3220.pdf.

6 See Section 410 of the Dodd-Frank Act.

II. New Reporting Requirements for Hedge Funds and Other Investment Advisers

In addition to the fact that many fund advisers will be new registrants with the SEC, the adviser registration form (Form ADV) has been amended to require the following information[7] for risk management, regulatory oversight and census-type reporting purposes:

- Basic organizational and operational information about funds, including:
  - Type of fund;
  - Size and ownership information;
  - General fund data; and
  - Services adviser provides to the fund.
- List of "Gatekeepers" that perform critical role in advisory process, including:
  - Auditors;
  - Prime Brokers;
  - Custodians;
  - Administrators; and
  - Marketers.
- Additional information about the adviser's business, including:
  - Description of types of clients, employees and advisory activities; and
  - Disclosure of any business practices that may present significant conflicts of interest.

III. New Exemptions from SEC Registration

The approved SEC rules implement the following new non-mandatory exemptions:

Exemption for Advisers to Venture Capital Funds[8]

- The new SEC rule[9] defines a venture capital firm for the purpose of the registration exemption as a private fund[10] that:
  - Holds no more that 20 percent of the fund's capital commitments in non-qualifying investments (other than short-term holdings) ("qualifying investments" generally consist of equity securities of "qualifying portfolio companies" acquired directly by the fund);

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7 See amended Form ADV; Release 3221.

8 New Section 203(l) of the Advisers Act.

9 Rule 203(l)-1.

10 Consistent with the statutory provision under section 408 of Dodd-Frank, "private fund" is defined as an entity that would be an investment company as defined in section 3 of the Investment Company Act (the "ICA") but for section 3(c)(1) or 3(c)(7) thereof. Section 3(c)(1) exempts from registration funds having not more than 100 security holders and section 3(c)(7) exempts from registration funds having only "qualified purchasers" as security holders and in each case, such funds must not make or propose to make a public offering of their securities.

- Is not leveraged except for a minimal amount on a short-term basis;
- Does not offer redemption rights to investors and prospective investors;
- Represents itself as pursuing a venture capital strategy; and
- Is not registered under the Investment Company Act and has not elected to be treated as a business development company.

- The new rule also includes a grandfathering provision for funds that began raising capital by the end of 2010 and represented themselves to investors as pursuing a venture capital strategy.

Private Fund Adviser Exemption[11]

- The rule provides for the statutory exemption for advisers solely to private funds with less than $150 million in AUM in the United States. An adviser that has at least one client that is not a private fund is not eligible for the exemption and must register under the Advisers Act or find another available exemption.
  - The method of calculation for private fund assets with respect to the $150 million threshold is set forth in the instructions in Form ADV and follows the uniform method of calculating AUM under the Advisers Act.

Exemption for Foreign Private Advisers[12]

- Section 403 of Dodd-Frank amended the Advisers Act to provide an exemption from SEC registration for foreign private advisers that do not hold themselves out generally to the public in the United States as an investment adviser, have no place of business in the United States, have fewer than 15 U.S. clients, and have less than $25 million in aggregate AUM from U.S. clients and private fund investors.

- The newly adopted SEC rules define the terms (1) "investor," (2) "in the United States," (3) "place of business," and (4) "assets under management" for advisers determining their qualification under this exemption.[13]

Exemption for Family Offices

- The SEC adopted the exemption for advisers that solely advise "family offices." The final rule restricts the availability of the exemption only to those offices that provide advice about securities strictly to "family clients," broadly defined to include current and former family members, certain key employees of the family office, charities funded exclusively by family clients, and several trust structures.[14] Under the rule, a "family member" includes all lineal descendants of a common

11 New Section 203(m) of the Advisers Act.

12 Amended Section 203(b)(3) of the Advisers Act.

13 New Rule 202(a)(30)-1 which defines terms in Section 202(a)(30) of the Advisers Act.

14 New Rule 202(a)(11)(G)-1(b)(1).

ancestor (who may be living or deceased) as well as current and former spouses or spousal equivalents of those descendants, provided that the common ancestor is no more than 10 generations removed from the youngest generation of family members.[15]

IV. Reporting Requirements for Advisers Exempt from Registration

Despite the exemption from registration, the SEC will require investment advisers exempt under the venture capital and private funds exceptions to comply with reporting requirements that the SEC deems necessary or appropriate or useful for the assessment of systemic risk pursuant to section 404 of the Dodd-Frank Act.[16]

- Under the new rules, exempt reporting advisers will be required to file in the first quarter of 2012, and periodically update, reports with the SEC, which include the following information:
  - Basic identifying information for the adviser and the identity of its owners and affiliates;
  - Information about the private funds the adviser manages, and any other business activities the adviser and its affiliates are engaged in which might present conflicts of interest; and
  - Any disciplinary history of the adviser and its employees that reflect the integrity of the firm.

V. Conclusion

The final rules adopted by the SEC are substantially similar to those that were initially proposed by the SEC on November 19, 2010. For the previously unregistered advisers that will now be required to register with the SEC, including some advisers to hedge funds and other private funds that were outside of the SEC's regulatory oversight, the compliance date to meet the new obligations is March 30, 2012.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; John Schuster at 212.701.3323 or jschuster@cahill.com.

15 Rule 202(a)(11)(G)-1(d)(6).

16 Amended Section 204 of the Advisers Act.