December 21, 2010

SEC Proposes New Rules to Implement Advisers Act Provisions of the Dodd-Frank Act — Implications for Non-U.S. Advisers

The Private Fund Investment Advisers Registration Act (the **"Private Fund Legislation**") adopted as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**") amended various provisions of the U.S. Investment Advisers Act of 1940 (the "**Advisers Act**") to impose SEC registration obligations on investment advisers to hedge funds and other private pools of capital. It also directed the U.S. Securities and Exchange Commission (the "**SEC**") to promulgate rules in support of the new statutory provisions.

On November 19, 2010, the SEC proposed new rules and rule amendments[1] under the Advisers Act (the "**Proposed Rules**") to give effect to the Private Fund Legislation and, among other things:

- clarify the eligibility requirements for registration of investment advisers with the SEC and the transition process to state registration;
- address registration of investment advisers to hedge funds and other private funds with the SEC;
- amend Form ADV to, among other things, require disclosure of more information by investment advisers and the private funds they manage;
- implement the Dodd-Frank Act's mandate to require reporting by certain "exempt reporting advisers;"
- define "venture capital fund" for purposes of the exemption to SEC registration for investment advisers solely advising venture capital funds; and
- provide clarity with respect to the exemptions to SEC registration for (a) investment advisers solely advising private funds and with aggregate regulatory assets under management of less than $150 million and (b) "foreign private advisers."

The most significant aspect of the Private Fund Legislation is the elimination of the so-called "15-client rule" (also referred to as the "private adviser exemption") on which many advisers to private equity funds, hedge funds and other private pools of capital relied to operate without SEC registration. The 15-client rule allowed an investment adviser with fewer than 15 clients in the United States during the preceding 12 month-period to operate

[1] The Proposed Rules were published in two SEC releases, Rules Implementing Amendments to the Investment Advisers Act of 1940 and Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers with less than $150 Million in Assets under Management, and Foreign Private Advisers.

without registering with the SEC, provided it did not hold itself out as an investment adviser to the U.S. public. At the same time, when counting clients for purposes of the private adviser exemption, an investment adviser to private pools of capital was able to treat the fund it advised as one client, rather than counting each investor in the fund as a separate client.

The Private Fund Legislation, including the repeal of the private adviser exemption, is effective July 21, 2011. The Proposed Rules are to become effective on July 21, 2011. Comments on the Proposed Rules are due January 24, 2011.

This alert focuses on the implications of the Proposed Rules for non-U.S. investment advisers that have advisory clients in the United States or act as managers to hedge funds, private equity funds or other private pools of capital that have raised funds in the United States.

Foreign Private Adviser Exemption

The Private Fund Legislation provides a new exemption from registration for "foreign private advisers" (the "**Foreign Private Adviser Exemption**"). Under this exemption, an adviser is not required to register with the SEC if it:

- has no ***place of business*** in the United States;
- has a total of fewer than 15 ***clients*** in the ***United States*** and ***investors*** in the United States in private funds[2] advised by the adviser;
- has aggregate ***assets under management*** attributable to clients and investors in the United States in private funds advised by such adviser of less than $25 million; *and*
- neither holds itself out generally to the public in the United States as an investment adviser nor acts as an investment adviser to any investment company registered under the Investment Company Act or any business development company.

The Proposed Rules clarify certain terms used in the Foreign Private Adviser Exemption.

Place of Business. The Proposed Rules define a "place of business" of an investment adviser as (a) any office where the investment adviser regularly provides investment advisory services, solicits, meets with, or otherwise communicates with clients; and (b) any other location that is held out to the general public as a place where the investment adviser provides any such activities.

Clients. The Proposed Rules include "safe harbors" for counting clients similar to those currently in effect under the "private adviser" exemption (repealed by the Dodd-Frank Act as

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[2] The Act defines a "private fund" as any issuer that would be an investment company under Section 3 of the Investment Company Act of 1940 (the "**Investment Company Act**"), but for the exception provided by either Section 3(c)(1) (it has no more than 100 owners) or Section 3(c)(7) (offers to qualified purchasers only) thereunder.

of July 21, 2011)[3] as modified to eliminate the provision that allows advisers not to count clients from which the adviser receives no compensation. As clarified by the Proposed Rules, only clients in the United States should be counted. The Proposed Rules avoid potential double-counting by providing that an adviser need not count a private fund as a client if any investor in the private fund was counted as an investor for purposes of determining the availability of the Foreign Private Adviser Exemption.

Investors. The definition of "investors" in the Proposed Rules is made by reference to the counting methods required by Section 3(c)(1) (the "not more than 100 owners" exemption) and Section 3(c)(7) (the "qualified purchasers only" exemption) of the Investment Company Act. As such, an "investor" would be any person that would be included in the determination of (a) the number of beneficial owners of the private fund's outstanding securities under Section 3(c)(1), or (b) whether the private fund's outstanding securities are owned exclusively by qualified purchasers under Section 3(c)(7).

Under the Proposed Rules, investment advisers would have to "look-through" nominee and similar arrangements to the underlying holders of private fund-issued securities to determine whether they have fewer than 15 clients and private fund investors in the United States. In a master-feeder structure, for example, the investors in the feeder funds – and not the feeder funds themselves – would count as investors in the master fund. Moreover, any holder of an instrument that effectively transfers the risk of investing in the private fund (*e.g.*, a total return swap) from the record owner of the private fund's securities would need to be counted as an investor even though such person is not the record owner of securities.

Under the Proposed Rules, knowledgeable employees with respect to the private fund (and certain persons related to them) and beneficial owners of short-term paper issued by the private fund would count as investors, even though these persons are not counted as beneficial owners for purposes of Section 3(c)(1) and knowledgeable employees are not required to be qualified purchasers under Section 3(c)(7).

In the United States. The Proposed Rules define "in the United States" by incorporating certain defined terms used in Regulation S under the Securities Act of 1933. In general, a place of business is in the United States if it is in the "United States" as defined in Regulation S, and a client or investor is in the United States if it is a "U.S. person" as defined in Regulation S. A person that is "in the United States" may be treated as ***not*** being in the "United States" if such person was not "in the United States" at the time it becomes a client or,

[3] The Proposed Rules allow an investment adviser to treat as a single client a natural person and certain members of its family, as well all accounts and trusts of which the natural person and/or certain members of the person's family who has the same principal residence are the only primary beneficiaries. The Proposed Rules would also permit an investment adviser to treat as a single client (*i.e.*, the adviser would not need to "look-through" to count holders of the securities) (a) a corporation, general partnership, limited partnership, limited liability company, trust, or other legal organization to which the investment adviser provides investment advice based on the organization's investment objectives; and (b) two or more legal organizations that have identical shareholders, partners, limited partners, members, or beneficiaries. A foreign private adviser must also count as a client any person for whom the investment adviser provides investment advisory services without compensation (*e.g.*, knowledgeable employees).

in the case of an investor in a private fund, at the time the investor acquires the securities issued by the fund.

Assets Under Management. The Proposed Rules include a new uniform method for calculating an investments adviser's assets under management. Pursuant to the Proposed Rules, "assets under management" would be defined by reference to the requirements of revised Form ADV (renamed as the "Uniform Application for Investment Adviser Registration and Reporting Form By Exempt Reporting Advisers"). Pursuant to the Proposed Rules, all investment advisers would be required to include in their assets under management securities portfolios for which they provide continuous and regular supervisory or management services, regardless of whether these assets are proprietary assets, assets managed without receiving compensation or assets of non-U.S. clients, all of which an investment adviser currently may exclude. In addition, the SEC would not allow an investment adviser to subtract outstanding indebtedness and other accrued but unpaid liabilities, which remain in a client's account and are managed by the investment adviser.

Other Exemptions available to Non-U.S. Advisers

The Private Fund Legislation created a new category of investment adviser, the "exempt reporting adviser," which does not need to register with the SEC but is required to maintain records and provide certain information to the SEC. (For a discussion of the reporting requirements and SEC examination and oversight with respect to exempt reporting advisers, see our memorandum entitled "SEC Proposes New Rules to Implement Advisers Act Provisions of the Dodd-Frank Act – Implications for U.S. Advisers" in http://www.paulweiss.com/resources/pubs/.)

Exempt reporting advisers are:

- investment advisers solely advising venture capital funds; or
- investment advisers solely advising private funds and having aggregate assets under management in the United States of less than $150 million.

Private Fund Adviser Exemption. The Private Fund Legislation directs the SEC to exempt from registration an investment adviser that *solely* advises private funds and has less than $150 million in assets under management[4] in the United States. The requirements of the exemption depend on whether an adviser has its *principal office* in the United States or outside the United States. As addressed in the Proposed Rules, the SEC would look to an adviser's principal office and place of business as the location where the adviser controls, or has ultimate responsibility for, the management of private fund assets,

[4] With respect to investment advisers to private funds, the SEC would require an investment adviser to include in its assets under management the fair value of any private fund over which it exercises continuous and regular supervisory or management services, regardless of the nature of the assets held by the fund, as well as the amount of any uncalled capital commitments made to the fund. If a private fund's governing documents provide for a specific process for calculating fair value (e.g., the general partner has discretion over the determination of the fair value of the private fund's assets), then the adviser may rely on such process for calculating its assets under management.

and therefore as the place where all the advisers' assets are managed, although day-to-day management of certain assets may also take place at another location.

The Proposed Rules make the Private Fund Adviser Exemption available to an adviser with a principal office and place of business outside the United States so long as all the adviser's clients who are U.S. persons (as defined in Regulation S) are private funds ***even if*** the adviser has non-U.S. clients who are not private funds. For a non-U.S. investment adviser to determine the availability of the Private Fund Adviser Exemption, the Proposed Rules clarify that the adviser would only need to count towards the $150 million-asset limit private fund assets it manages from a place of business in the United States, which means that the type and number of non-U.S. clients would not be taken into account.

Venture Capital Exemption. The Private Fund Legislation amended the Advisers Act to exempt investment advisers that solely manage "venture capital funds" from registration under the Advisers Act. The SEC proposed to define "venture capital fund" in the Proposed Rules (see our memorandum entitled "SEC Proposes New Rules to Implement Advisers Act Provisions of the Dodd-Frank Act – Implications for U.S. Advisers" in http://www.paulweiss.com/resources/pubs/ for a discussion of this exemption). A non-U.S. investment adviser may rely on the venture capital exemption if all of its clients, U.S. and non-U.S., are venture capital funds.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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Appendix I

Newly Proposed Rules Implementing Advisers Act Provisions of the Dodd-Frank Act		
Type of Investment Adviser	**Description**	**Reporting Requirements and Filing Deadlines**
SEC-Registered (or required to be registered) IAs	an IA that • is a large IA (having $100 million or more of AUM); • is a mid-sized IA that does not meet the criteria for state registration and examination; • has its principal office and place of business in Wyoming (which does not regulate IAs) or outside the United States; • meets the requirements under one or more of the exemptions from prohibition on SEC registration under Rule 203A (*e.g.*, pension consultants); • is an IA (or subadviser) to a registered investment company; • is an IA to a business development company and has at least $25 million of AUM; or • has some other basis for registering with the SEC	**August 20, 2011** – Amendment to Form ADV due with respect to every IA registered with the SEC on July 21, 2011, including new calculation of regulatory AUM and more detailed information about advisory business, conflicts of interest, non-advisory activities, financial industry affiliations, private funds advised and service providers to such private funds If IA was, prior to July 21, 2011, exempt from registration pursuant to the "private adviser exemption" (and did not actually register with the SEC), IA not required to maintain or preserve books and records pertaining to the performance or rate of return of such private fund or other account advised by such investment adviser for any period ended prior to July 21, 2011; however, to the extent that the IA preserved these performance-related records without being required to do so by current Rule 204-2, such an IA required to continue to preserve them Amendments to Form ADV required: • at least annually, within 90 days of the end of the IA's fiscal year; or • more frequently if specifically required by the instructions to Form ADV
Mid-Sized IAs	an IA that • has AUM between $25 million and $100 million; • is required to be registered in the state where it maintains its principal office and place of business; and • if so required to register, would be subject to examination by such state	**August 20, 2011** –Amendment to Form ADV due with respect to every IA registered with the SEC on July 21, 2011, including new calculation of regulatory AUM and more detailed information about advisory business, conflicts of interest, non-advisory activities, financial industry affiliations, private funds advised and service providers to such private funds **October 19, 2011** – Form ADV-W due withdrawing such an IA's SEC registration; prior to such date, applicable state registration(s) must be completed, including acquiring any relevant licenses and taking any relevant examinations
Venture Capital IAs	• an IA that solely advises venture capital funds, defined as a private fund that: • represents to investors and potential investors that it is a venture capital fund; • owns solely (x) equity securities issued by one or more "qualifying portfolio companies," and at least 80% of the equity securities of each qualifying portfolio company owned by the fund was acquired directly from the qualifying portfolio company; and (y) cash and cash equivalents and U.S.	**August 20, 2011** – subset of Part 1A of Form ADV due (specifically, Items 1, 2C, 3, 6, 7, 10 and 11 and Schedules A, B, C and D) Amendments to Form ADV required: • at least annually, within 90 days of the end of the IA's fiscal year; or • more frequently if specifically required by the instructions to Form ADV

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Type of Investment Adviser	**Description**	**Reporting Requirements and Filing Deadlines**
	Treasuries with a remaining maturity of 60 days or less; • directly, or through its investment advisers, offers or provides significant managerial assistance to, or controls, the qualifying portfolio company; • does not borrow, issue debt obligations, provide guarantees or otherwise incur leverage, in excess of 15% of the private fund's aggregate capital contributions and uncalled committed capital, and any such borrowing, indebtedness, guarantee or leverage is for a non-renewable term of no longer than 120 calendar days; • does not offer its investors redemption or other similar liquidity rights except in extraordinary circumstances; and • is not registered under the ICA and has not elected to be treated as a business development company; or • pursuant to a grandfathering provision, a private fund that: (i) represented to investors and potential investors at the time the fund offered its securities that it is a venture capital fund; (ii) has sold securities to one or more investors prior to December 31, 2010; and (iii) does not sell any securities to, including accepting any additional capital commitments from, any person after July 21, 2011	
Private Fund IAs	an IA that: • solely advises private funds; and • has aggregate AUM in the United States of less than $150 million	**August 20, 2011** – subset of Part 1A of Form ADV due (specifically, Items 1, 2C, 3, 6, 7, 10 and 11 and Schedules A, B, C and D) Amendments to Form ADV required: • at least annually, within 90 days of the end of the IA's fiscal year; or • more frequently if specifically required by the instructions to Form ADV
Foreign Private IAs	an IA that: • has no place of business in the United States; • has a total of fewer than 15 clients in the United States and investors in the United States in private funds advised by the adviser; • has aggregate AUM attributable to clients and investors in the United States in private funds advised by such adviser of less than $25 million; and does not hold itself out generally to the U.S. public	None