

February 7, 2014

SEC Grants No-Action Guidance Regarding “Knowledgeable Employees”

On February 6, 2014, the staff of the SEC’s Division of Investment Management issued a no-action letter to the Managed Funds Association providing important guidance with respect to who may qualify as a “knowledgeable employee” under the Investment Company Act of 1940, as amended (the “Investment Company Act”). Private funds (which typically rely on the exceptions from registration provided by Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act) often offer interests to knowledgeable employees. Importantly, knowledgeable employees are: (i) excluded for purposes of determining whether a 3(c)(7) fund’s outstanding securities are owned exclusively by qualified purchasers; and (ii) not required to be counted for purposes of the 100 beneficial owner limitation in a 3(c)(1) fund.

Among the clarifications are:

- **Principal Business Unit, Division or Function.** Under Rule 3c-5 of the Investment Company Act, an “executive officer” is a knowledgeable employee, which is in turn defined to include a “president, any vice president in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy-making function, or any other person who performs similar policy making functions.” The guidance confirms that: (i) determining what constitutes a principal business unit depends on the relevant facts and circumstances of a particular investment adviser’s operations; (ii) several business units, divisions or functions within an investment adviser may each be considered a principal unit, division, or function; (iii) the unit, division or function need not form part of the investment activities of an investment adviser’s private fund(s) to be considered a principal unit, division, or function. The no-action letter cites an investment adviser’s information technology department as a group that may be deemed a principal business unit.
- **Employees Who Make Policy.** An employee may serve a policy-making function regardless of such employee’s title, and employees may satisfy this standard either individually or as part of a group.
- **Employees Who Participate in Investment Activities.**
 - *Participating in Part of a Fund Portfolio.* An employee may be participating in the investment activities of a private fund even if his or her functions relate only to a portion of a portfolio of a private fund rather than the entire fund.

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- *Analysts, Risk Managers, Tax Professionals and Attorneys.* Importantly, employees who form part of analytical or risk teams, tax professionals or attorneys whose analysis or advice is material to an investment adviser’s investment decisions may all be considered to participate in investment activities depending on the facts and circumstances.
 - **Fund Participation by Knowledgeable Employees.** A person who qualifies as a knowledgeable employee of an investment adviser or one of its relying advisers may be treated as such with respect to any private fund managed by the filing investment adviser or one of its relying advisers.
 - **Other Employees.** The list of employees identified in the guidance is not intended to be exclusive and other employees not specifically identified may also qualify as “knowledgeable employees” depending on the facts and circumstances.

Separate Accounts. For purposes of the rule, an employee’s participation in the investment activities of a separate account (rather than a private fund) will qualify such employee for knowledgeable employee status if the separate account is established for a client that is a “qualified client” and is otherwise eligible to invest in the private fund(s) advised by the investment adviser or its relying advisers and the account pursues an investment objective or strategy substantially similar to one pursued by one or more of the investment adviser’s or relying adviser’s private funds.

You may access a copy of the no-action letter by clicking [here](#).

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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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