July 25, 2011

SEC Adopts Final Rules Implementing Advisers Act Provisions of the Dodd-Frank Act; Registration Deadline Extended until March 30, 2012

On June 22, 2011, the U.S. Securities and Exchange Commission (the "SEC") adopted final rules, rule amendments (such rules and rule amendments, the "Final Rules") and Form ADV amendments[1] under the Investment Advisers Act of 1940, as amended (the "Advisers Act") implementing the provisions of Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). The Final Rules require certain advisers to private equity funds, hedge funds and other private funds to register as investment advisers with the SEC and establish exemptions from SEC registration for venture capital fund advisers, private fund advisers with assets under management of less than $150 million and foreign private advisers. The Final Rules were adopted substantially as they were proposed in November 2010.[2] Importantly, the Final Rules extend until March 30, 2012 the deadline for SEC registration for investment advisers that will no longer be exempt from SEC registration as a result of the repeal of the "private adviser exemption" contained in Section 203(b)(3) of the Advisers Act. The private adviser exemption allowed an investment adviser with fewer than 15 clients in the United States during the preceding 12 month-period to operate without registering with the SEC, provided it did not hold itself out as an investment adviser to the U.S. public. Historically, many investment advisers to private equity and hedge funds have relied on this provision to remain exempt from SEC registration. The SEC also extended certain related reporting and filing dates until 2012 as more fully discussed below.

I. Timetable for Required Filings

A. Newly Registering Investment Advisers

Under final Rule 203-1(e), an investment adviser that was relying on, and was entitled to rely on, the "private adviser exemption" under Section 203(b)(3) on July 20, 2011, is exempt from registration with the SEC until March 30, 2012.[3] ***Because initial applications for***

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[1] See SEC Release No. IA-3221 entitled "Rules Implementing Amendments to the Investment Advisers Act of 1940" (June 22, 2011) at http://www.sec.gov/rules/final/2011/ia-3221.pdf (the "Implementing Adopting Release") and SEC Release No. IA-3222 entitled "Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers" (June 22, 2011) at http://www.sec.gov/rules/final/2011/ia-3222.pdf (the "Exemptions Adopting Release").

[2] The proposed rules were summarized in the Paul, Weiss Client Memoranda dated December 21, 2010, entitled "SEC Proposes New Rules to Implement Advisers Act Provisions of the Dodd-Frank Act – Implications for U.S. Advisers" and "SEC Proposes New Rules to Implement Advisers Act Provisions of the Dodd-Frank Act – Implications for Non-U.S. Advisers," both available at http://www.paulweiss.com/resources/pubs/.

[3] Under the transition provisions of final Rule 204-2, the "books and records" rule, an investment adviser that was, prior to July 21, 2011, exempt from registration pursuant to the "private adviser exemption" is not

registration can take up to 45 days to be approved by the SEC, investment advisers relying on this transition provision should file a complete Form ADV (Parts 1 and 2) with the SEC no later than February 14, 2012. In order to qualify for this transition provision, an investment adviser must, during the course of the preceding 12 months, have had fewer than 15 clients and neither hold itself out generally to the public as an investment adviser nor act as an investment adviser to a registered investment company or business development company. The transition period will provide an investment adviser with additional time to come into compliance with the substantive provisions of the Advisers Act.

B. Currently Registered Investment Advisers

Every investment adviser already registered with the SEC on January 1, 2012 must file an amendment to its Form ADV no later than March 30, 2012 (regardless of its fiscal year end and annual filing deadline)***.*** This date coincides with the filing deadline for most registered investment advisers' required annual updating amendment, eliminating the requirement that they file an additional annual updating amendment to their Form ADV. Among other things, each investment adviser must report the current market value of its regulatory assets under management determined within 90 days of the filing. Each investment adviser must also either confirm the basis for its continued SEC registration or, with respect to Exempt Reporting Advisers (as more fully discussed below), confirm the registration exemption on which it relies.

C. Exempt Reporting Advisers

Exempt Reporting Advisers (as defined below) must file a subset of items on Part IA of Form ADV with the SEC between January 1 and March 30, 2012. Also, an SEC registered investment adviser that is switching to being an Exempt Reporting Adviser must first file a Form ADV-W to withdraw its SEC registration before submitting its first report as an Exempt Reporting Adviser.

II. Exempt Reporting Advisers

The Dodd-Frank Act creates a new category of investment adviser, the "Exempt Reporting Adviser," which does not need to register with the SEC but is required to file and report certain information to the SEC.

"Exempt Reporting Advisers" are:

- investment advisers advising solely private funds and having aggregate assets under management in the United States of less than $150 million (the "Private Fund Adviser Exemption"); or

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required to maintain or preserve books and records that would otherwise be required to be maintained or preserved under the Rule to the extent those books and records pertain to the performance or rate of return of a private fund or other account advised by such investment adviser for any period ended prior to such investment adviser's registration; however, to the extent that the investment adviser preserved these performance-related records without being required to do so by the Rule, such investment adviser must continue to preserve them.

- investment advisers advising solely venture capital funds (the "Venture Capital Exemption").

These exemptions are not mandatory. Thus, an investment adviser that qualifies for either exemption could choose to register (or remain registered) with the SEC, subject to the other provisions of Section 203A of the Advisers Act.

A. Private Fund Adviser Exemption

The Dodd-Frank Act, through Section 203(m) of the Advisers Act, directs the SEC to exempt from registration any investment adviser that advises solely private funds and that has aggregate assets under management in the United States of less than $150 million. The SEC has adopted Rule 203(m)-1 to clarify interpretative matters with respect to whether an investment adviser qualifies for this Private Fund Adviser Exemption. The final Rule is substantially similar to the proposed rule, with a few important modifications.

Qualifying Private Funds. Rule 203(m)-1 limits an investment adviser with its "principal office and place of business"[4] in the United States (a "U.S. adviser") relying on the Private Fund Adviser Exemption to advising solely "qualifying private funds." A "qualifying private fund" is defined as any "private fund"[5] that is not registered under Section 8 of the Investment Company Act and has not elected to be treated as a business development company under the Investment Company Act. The final Rule clarifies that an issuer that qualifies for an exclusion from the definition of "investment company" as defined in Section 3 of the Investment Company Act (*e.g.*, a real estate fund that relies on Section 3(c)(5)(C)) while at the same time qualifying for an exclusion provided by either Section 3(c)(1) or 3(c)(7) of the Investment Company Act may be treated as a "private fund," provided that the investment adviser treats the issuer as a private fund for all purposes under the Advisers Act, including for example, reporting on Form ADV. An investment adviser that has one or more clients that are not qualifying private funds (*i.e.*, a separately managed account) is not eligible for the exemption and must register under the Advisers Act unless another exemption is available. In addition, the Exemptions Adopting Release notes that whether a single-investor fund could be a private fund for purposes of this exemption depends on the applicable facts and circumstances (*i.e.*, a fund that seeks to raise capital from multiple investors but has only a single, initial investor for a period of time could be a private fund).

Calculation of Private Fund Assets. All of the qualifying private fund assets of a U.S. adviser would be deemed to be "assets under management in the United States," although day-to-day management of certain assets may also take place outside the United States. Rule 203(m)-1 requires investment advisers to calculate assets under management by reference to Item 5F of Form ADV which provides a new, uniform method of calculating regulatory assets under management (as more fully discussed below) for regulatory purposes

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4 "Principal office and place of business" of an investment adviser means the executive office of the investment adviser from which the officers, partners or managers of the investment adviser direct, control and coordinate the activities of the investment adviser.

5 A "private fund" is defined as any issuer that would be an investment company under Section 3 of the Investment Company Act of 1940, as amended (the "Investment Company Act"), but for the exception provided by either Section 3(c)(1) or Section 3(c)(7) thereunder.

under the Advisers Act. For purposes of this calculation, an investment adviser must calculate qualifying private fund assets on an annual basis (rather than quarterly as was originally proposed) and within 90 days preceding the filing of its annual updating amendment.

Transition Period. Rule 203(m)-1 also includes a provision giving an investment adviser 90 days to register with the SEC after reporting on its annual updating amendment that it is no longer eligible to rely on the Private Fund Adviser Exemption due to an increase in the value of its private fund assets under management. This 90-day period is intended to enable the investment adviser to take steps to register and otherwise come into compliance with the requirements of the Advisers Act applicable to registered investment advisers, including the adoption and implementation of compliance policies and procedures.

Application to Non-U.S. Advisers. Rule 203(m)-1 provides that an investment adviser whose principal office and place of business is outside of the United States (a "non-U.S. adviser") will be eligible to use the exemption so long as all of such non-U.S. adviser's clients that are U.S. persons (as defined generally by incorporating the definition of a "U.S. person" found in Regulation S under the Securities Act of 1933, as amended (the "Securities Act")[6]) are qualifying private funds – even if the adviser has non-U.S. clients that are not qualifying private funds. For a non-U.S. adviser to determine the availability of the Private Fund Adviser Exemption, such an investment adviser would only need to count towards the $150 million-asset limit private fund assets it manages from a place of business[7] in the United States. The final Rule contains a note that clarifies that a client will not be considered a U.S. person if the client was not a U.S. person at the time of becoming a client of the adviser. This will permit a non-U.S. adviser to continue to rely on the Private Fund Adviser Exemption if a non-U.S. client that is not a private fund relocates to the United States or otherwise becomes a U.S. person.

Effective Date. Rule 203(m)-1 is effective July 21, 2011.

B. Venture Capital Exemption

The Dodd-Frank Act amends the Advisers Act to exempt investment advisers that advise solely venture capital funds from registration, and directs the SEC to define the term "venture capital fund." An investment adviser will be eligible to rely on the Venture Capital Exemption only if it advises solely venture capital funds that meet all of the elements of the definition or if it were grandfathered.

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6 For example, a partnership would be a U.S. person if it is organized under the laws of the United States. There is one difference from the approach taken under Regulation S – any discretionary account or similar account that is held for the benefit of a U.S. person by a non-U.S. dealer or other professional fiduciary would be deemed to be "in the United States" if the dealer or professional fiduciary is a related person of the investment adviser relying on the exemption.

7 "Place of business" means (i) an office at which the investment adviser regularly provides investment advisory services, solicits, meets with or otherwise communicates with clients; and (ii) any other location that is held out to the general public as a location at which the investment adviser provides investment advisory services, solicits, meets with or otherwise communicates with clients. A place of business does not include an office where an investment adviser performs administrative services and back-office activities.

Venture Capital Fund. Final Rule 203(l)-1 modifies the definition of venture capital fund to include an allowance for "non-qualifying investments" rather than the inclusion of only qualifying investments as provided for in the proposed rule. Rule 203(l)-1 defines "venture capital fund" as a "private fund"[8] that: (i) represents to investors that it pursues a venture capital strategy; (ii) immediately after the acquisition of any asset, other than "qualifying investments" or short-term holdings, holds no more than 20% of the amount of the fund's aggregate capital contributions and uncalled committed capital in assets (other than short-term holdings) that are not "qualifying investments," valued at cost or fair value (depending on how the fund has historically valued its investments); (iii) does not borrow or otherwise incur leverage in excess of 15% of the fund's aggregate capital contributions and uncalled committed capital, and any such borrowing or leverage is for a non-renewable term of no longer than 120 calendar days, except that any guarantee by the fund of obligations of a qualifying portfolio company up to the amount of the value of the fund's investment in the qualifying portfolio company is not subject to the 120 calendar day limit; (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.

The inclusion of the 20% basket for non-qualifying investments provides funds with a degree of flexibility to invest in other asset classes without jeopardizing the ability of the adviser to rely on the Venture Capital Exemption.

The final Rule eliminates a requirement included in the proposed rule that the venture capital fund or its adviser offer or provide managerial assistance to, or control, each portfolio company. The final Rule also excludes from the 120-day leverage limit any guarantee of a qualifying portfolio company's obligations by the fund, up to the value of the fund's investment in the qualifying portfolio company. The SEC, among other things, noted that these guarantees by a fund may help a qualifying portfolio company obtain credit for working capital purposes, rather than be used by the fund to leverage its investment in the company, and that such guarantees do not present the same types of systemic risks that Congress meant to address in the Dodd-Frank Act. However, such guarantees would still be subject to the overall 15% leverage limit.

Qualifying Investments. The rule defines "qualifying investments" generally as: (i) any equity security issued by a qualifying portfolio company that has been acquired directly by the fund from the qualifying portfolio company; (ii) any equity security issued by a qualifying portfolio company in exchange for an equity security issued by the qualifying portfolio company described in clause (i) above; or (iii) any equity security issued by a company of which a qualifying portfolio company is a majority-owned subsidiary (or a predecessor), and is acquired by the fund in exchange for an equity security described in clause (i) or (ii) above.

Qualifying Portfolio Company. To qualify as a qualifying portfolio company, a company: (i) at the time of investment by the fund must not be subject to the reporting requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), or listed or traded on any foreign exchange (nor can the qualifying portfolio company control, be controlled by or be

[8] See *supra* note 5.

under common control with such a company); (ii) may not borrow or issue debt obligations in connection with the fund's investment in such company and distribute to the fund the proceeds of such borrowing or issuance in exchange for the fund's investment; and (iii) may not be an investment company, a private fund, an issuer that would be an investment company but for the exemption provided by Rule 3a-7 under the Investment Company Act (relating to certain issuers of asset-backed securities), or a commodity pool.

Holding Out. The Exemptions Adopting Release makes clear that the holding out requirement of the Venture Capital Exemption goes to the investment strategy that the investment adviser represents to potential investors, as opposed to the particular name of a fund.

Grandfathering Provision. Under a grandfathering provision, final Rule 203(l)-1 provides that an investment adviser may treat any existing private fund as a venture capital fund for purposes of Section 203(l) of the Advisers Act if the fund meets the following elements of the grandfathering provision: (i) represented to investors and potential investors at the time the fund offered its securities that it pursues a venture capital strategy (rather than representing that it is a venture capital fund, as provided for in the proposed rule); (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.

Application to Non-U.S. Advisers. A non-U.S. adviser may rely on the Venture Capital Exemption if all of its clients, whether U.S. or non-U.S., are venture capital funds. Rule 203(l)-1 contains a note indicating that an adviser may treat as a private fund (and therefore, a venture capital fund, if it meets the rule's other criteria) any non-U.S. fund that is not offered through the use of U.S. jurisdictional means but that would be a private fund if the issuer were to conduct a private offering in the United States.

Effective Date. Rule 203(l)-1 is effective July 21, 2011.

C. Reporting Obligations

Part IA of Form ADV. Under new Rule 204-4, Exempt Reporting Advisers will be required to file, and periodically update, a subset of items on Part IA of Form ADV (renamed as the "Uniform Application for Investment Adviser Registration and Report By Exempt Reporting Advisers"),[9] including:

- basic identification details about the Exempt Reporting Adviser such as name, address, contact information, form of organization, the identity of its owners and affiliates and the exemption(s) that it is relying on to report, rather than register, with the SEC (Items 1 (Identifying Information), 2B (SEC Reporting by Exempt Reporting Advisers), 3 (Form of Organization) and 10 (Control Persons) and corresponding sections of Schedules A, B and C);

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9 Exempt Reporting Advisers will not be required to complete the remaining items of Part IA or prepare a client brochure on Form ADV Part 2.

- details about the private funds the investment adviser manages and about other business activities that the investment adviser and its affiliates are engaged in that present conflicts of interest that may suggest significant risk to clients (Items 6 (Other Business Activities) and 7 (Financial Industry Affiliations and Private Fund Reporting) and corresponding sections of Schedule D); and

- the disciplinary history of the investment adviser and its employees that may reflect on their integrity (Item 11 (Disclosure Information)).

Because Exempt Reporting Advisers manage private funds, they will be required to complete the expanded information required by Item 7B and Section 7B of Schedule D for each private fund they advise, as more fully discussed below.

An Exempt Reporting Adviser will be required to file its initial report with the SEC on Form ADV between January 1 and March 30, 2012. An Exempt Reporting Adviser must also amend its report: (i) at least annually, within 90 days of the end of the adviser's fiscal year; and (ii) promptly, if the information in Items 1 (Identification Information), 3 (Form of Organization), or 11 (Disciplinary Information) becomes inaccurate in any way, and Item 10 (Control Persons) if it becomes materially inaccurate. The Implementing Adopting Release indicates that reports by Exempt Reporting Advisers will be made publicly available on the SEC's website.

Effective Date. Rule 204-4 will be effective September 17, 2011.

D. SEC Examination and Oversight

Although the SEC has the authority under Section 204(a) of the Advisers Act to examine Exempt Reporting Advisers, the Implementing Adopting Release, as well as statements made by SEC Chairman Mary Schapiro, indicate that the SEC does not intend to conduct compliance examinations of Exempt Reporting Advisers on a regular basis, but may do so where there are indications of wrongdoing. Chairman Schapiro also indicated that the SEC will reconsider the types of information it has collected from Exempt Reporting Advisers one year after the first reporting date to determine whether the types of information being collected is appropriate. Finally, the Implementing Adopting Release indicates that the recordkeeping requirements for Exempt Reporting Advisers will be addressed in a future release.[10]

III. Foreign Private Adviser Exemption

The Dodd-Frank Act, through amended Section 203(b)(3) of the Advisers Act, provides a new exemption from SEC 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;

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[10] The Dodd-Frank Act provides that the SEC shall require Exempt Reporting Advisers to maintain such records as the SEC determines necessary or appropriate in the public interest of for the protection of investors.

- has, in total, fewer than 15 clients and investors in the United States in private funds[11] advised by the investment adviser;
- has aggregate assets under management attributable to clients in the United States and investors in the United States in private funds advised by such investment 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.

Importantly, investment advisers who are eligible to claim the Foreign Private Adviser Exemption will not be subject to the reporting and recordkeeping requirements that are applicable to Exempt Reporting Advisers.

Final Rule 202(a)(30)-1 clarifies certain terms used in the Foreign Private Adviser Exemption.

Place of business. The final Rule provides that a "place of business" is any office where the investment adviser regularly provides advisory services, solicits, meets with, or otherwise communicates with clients, and any location held out to the public as a place where the adviser conducts any such activities. The Exemptions Adopting Release clarifies that a place of business includes any office from which an adviser regularly communicates with its clients, whether U.S. or non-U.S., and an office or other location where an adviser regularly conducts research because research is intrinsic to the provision of investment advisory services.[12] However, a place of business would not include an office where an investment adviser performs solely administrative services and back-office activities if they are not intrinsic to the provision of investment advisory services and do not involve communicating with clients.

The Exemptions Adopting Release also clarifies that there is no presumption that a non-U.S. adviser has a place of business in the United States solely because it is affiliated with a U.S. adviser.[13] A non-U.S. adviser might, however, be deemed to have a place of business in the United States if such non-U.S. adviser's personnel regularly conduct activities at an affiliate's place of business in the United States. Any determination of whether an office or location is a place of business for purposes of the Foreign Private Adviser Exemption involves an analysis of all relevant facts and circumstances.

Clients. As originally proposed, the final Rule includes "safe harbors" for counting clients similar to those currently in effect under the repealed "private adviser exemption;"[14] however,

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11 See *supra* note 5.

12 Therefore, an office that conducts client-service or marketing operations may be deemed to be a "place of business," because it is involved in regular communications with clients.

13 The Exemptions Adopting Release notes the analysis provided in *Richard Ellis, Inc.* in determining whether the advisory businesses of two separately formed affiliates may be required to be integrated.

14 Final Rule 203(b)(3)-1 allows an investment adviser to treat as a single client a natural person and certain members of its family, as well as 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 final Rule also permits an investment adviser to treat as a single client (*i.e.*, the adviser would not

the Foreign Private Adviser Exemption requires an investment adviser to count clients from which the investment adviser receives no compensation. As clarified by the final Rule, only clients in the United States should be counted. The final Rule avoids potential double-counting by providing that an investment 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. As originally proposed, the definition of "investors" incorporates 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 (i) the number of beneficial owners of the private fund's outstanding securities under Section 3(c)(1), or (ii) whether the private fund's outstanding securities are owned exclusively by qualified purchasers under Section 3(c)(7).

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. Beneficial owners of short-term paper issued by the private fund would also count as investors, even though these persons are not counted as beneficial owners for purposes of Section 3(c)(1) of the Investment Company Act.

Unlike the proposed rule, however, the final Rule does not include knowledgeable employees and certain other persons related to such employees within the definition of "investor," in light of prior Congressional and SEC determinations that such employees do not need the protection of the Investment Company Act. Accordingly, a non-U.S. adviser with senior managers based in the United States who qualify as knowledgeable employees does not need to count such managers as investors.

In the United States. As originally proposed, the final Rule defines "in the United States" generally by reference to the definitions of "U.S. person" and "United States" in Regulation S under the Securities Act.[15] 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, in the case of an investor in a private fund, at the time the investor acquires the securities issued by the fund. The SEC has, however, clarified that in order to

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need to "look-through" to count holders of the securities) (i) 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 (ii) 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.

[15] See *supra* note 6.

take advantage of this provision, an investor must be outside the United States *each time* he or she acquires private fund securities.

Assets Under Management. The Foreign Private Adviser Exemption requires such investment advisers to calculate assets under management by reference to Item 5F of Form ADV which provides a new, uniform method of calculating regulatory assets under management (as more fully discussed below) for regulatory purposes under the Advisers Act.

Effective Date. Rule 202(a)(30)-1 is effective July 21, 2011.

IV. Subadvisory Relationships and Advisory Affiliates

The Exemptions Adopting Release clarifies that although both a private fund and the fund's primary adviser may be viewed as clients of a subadviser, such subadviser is eligible to rely on the Private Fund Adviser Exemption if the advisory services that it provides to the primary adviser relate solely to private funds, and on the Venture Capital Exemption if its services to the primary adviser relate solely to venture capital funds, provided the other conditions of the relevant exemption are met.

In response to comments on whether any of the rules should provide that an adviser must take into account the activities of its advisory affiliates when determining eligibility for an exemption, the Exemptions Adopting Release states that generally a separately formed advisory entity that operates independently of an affiliate may be eligible for an exemption if it meets all of the criteria set forth in the relevant rule. The existence of separate legal entities, however, may not by itself be sufficient to avoid integration of the affiliated entities, and the determination of whether the advisory businesses of two separately formed affiliates may be required to be integrated is based on the facts and circumstances. Accordingly, the Exemptions Adopting Release states that the SEC would treat as a single adviser two or more affiliated advisers that are separately organized but operationally integrated, which could result in a requirement for one or both advisers to register.

The Exemptions Adopting Release does not specifically address whether special purpose vehicles, such as the general partner of a private fund, must separately register as an investment adviser. With respect to many private funds, it has been common practice to have a separate general partner entity organized for each private fund. As a result, a course of practice developed whereby a single investment adviser would register with the SEC which would supervise all advisory personnel, maintain all relevant compliance programs and keep all required books and records. This practice of registering a single investment adviser entity under one registration umbrella and making appropriate disclosures regarding affiliated entities has been confirmed by the SEC staff in a letter to the American Bar Association dated December 8, 2005. David Vaughan[16], an Attorney Fellow in the SEC's Division of Investment Management, recently indicated that the SEC's Chief Counsel's Office is considering expanding this relief further.

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[16] Mr. Vaughan made these statements during a panel he participated in on July 11, 2011 at the Practicing Law Institute's Twelfth Annual Private Equity Forum.

In addition, in the Exemptions Adopting Release, the SEC states that the *Unibanco* line of no-action letters are not being withdrawn. In these letters, the staff, subject to certain conditions,[17] has not recommended enforcement action against a non-U.S. nonregistered adviser that is affiliated with an SEC-registered adviser, despite sharing personnel and resources. These letters provide that the SEC staff will not recommend enforcement action to apply the substantive provisions of the Advisers Act to a non-U.S. adviser's relationships with its non-U.S. clients. The Exemptions Adopting Release also notes that the staff is prepared to provide guidance, as appropriate, based on facts that may be presented to the staff regarding the application of the *Unibanco* letters to the Foreign Private Adviser Exemption and the Private Fund Adviser Exemption.

V. Regulation of "Mid-Sized Advisers"

The Dodd-Frank Act amends Section 203A of the Advisers Act by creating a new category of investment advisers called "mid-sized adviser" which is defined as an investment adviser that: (i) has assets under management between $25 million and $100 million; (ii) is required to be registered in the state where it maintains its principal office and place of business; and (iii) if so required to register, would be subject to examination[18] by such state. A mid-sized adviser generally may not register with the SEC, unless such investment adviser would be required to register with 15 or more states or is an investment adviser to a registered investment company or a company which has elected to be a business development company. In addition, if a mid-sized adviser is exempt from registration with the applicable state or excluded from the definition of an investment adviser in that state, such an investment adviser must register with the SEC – unless another exemption from SEC registration is available, such as investment advisers relying on the Venture Capital Exemption or the Private Fund Adviser Exemption described above.

Buffer. Rule 203A-1(a), as amended, provides a buffer zone for mid-sized advisers to avoid frequent switching between SEC and state registration (due to, for example the volatility of market values of assets managed), as currently exists for advisers within the $25-$30 million threshold. Advisers with between $90 million and $110 million in assets under management may choose between SEC or state registration. The rule raises the threshold above which a mid-sized adviser *must* register with the SEC to $110 million. Once registered with the SEC, an adviser need not withdraw its registration until it has less than $90 million of assets under management.

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[17] Generally, the staff has provided assurances that it will not recommend enforcement action in situations in which the unregistered non-U.S. adviser, often termed a —"participating affiliate" in these letters, and its registered affiliate are separately organized; the registered affiliate is staffed with personnel (located in the U.S. or abroad) who are capable of providing investment advice; all personnel of the participating affiliate involved in U.S. advisory activities are deemed —"associated persons" of the registered affiliate; and the SEC has adequate access to trading and other records of the participating affiliate and to its personnel to the extent necessary to enable it to identify conduct that may harm U.S. clients or markets.

[18] The Implementing Adopting Release notes that Wyoming does not currently require the registration of investment advisers and that investment advisers registered in Minnesota and New York are not subject to examination.

Transition Rules. Under final Rule 203A-5, every investment adviser that is registered with the SEC on January 1, 2012 must file an amendment to its Form ADV no later than March 30, 2012 indicating whether the investment adviser is eligible to remain registered with the SEC and reporting the market value of its assets under management determined within 90 days of such filing. Mid-sized advisers that are no longer eligible for SEC registration must withdraw their registrations by filing Form ADV-W with the SEC and become registered in the appropriate state(s) no later than June 28, 2012. Mid-sized advisers registered with the SEC as of July 21, 2011 must remain registered with the SEC (unless an exemption from registration is available) until January 1, 2012. The SEC expects to cancel the registration of investment advisers that are no longer eligible to register with the SEC that fail to file an amendment to their Form ADV or withdraw their registrations.

Until July 21, 2011, investment advisers that qualify as mid-sized advisers and are not yet registered may register with either the SEC or the appropriate state securities administrator. Beginning July 21, all new mid-sized advisers must register with the appropriate states.

The SEC has amended Form ADV Part 1A Item 2A to implement the new prohibition on registration for mid-sized advisers and reflect the new statutory threshold for registration.

VI. Calculating Regulatory Assets Under Management

In the Implementing Adopting Release, the SEC adopts revisions to Part 1A of Form ADV in order to implement a uniform method for calculating "regulatory assets under management" that will apply in determining whether an investment adviser is eligible to register with the SEC, reporting regulatory assets under management on Form ADV and the availability of the new exemptions from SEC registration created by the Dodd-Frank Act. (In acknowledging the "regulatory" purposes of this reporting requirement, the SEC notes that the amount disclosed in Part 1A may be different than the amount of assets under management disclosed to advisory clients in Part 2 of Form ADV.) Under the revised instructions to Part 1A, investment advisers must include in their regulatory assets under management securities portfolios for which they provide continuous and regular supervisory or management services, regardless of whether these assets are family or proprietary assets, assets managed without receiving compensation or assets of foreign clients. In addition, an investment adviser must calculate its regulatory assets under management on a gross basis, without subtracting outstanding indebtedness and other accrued but unpaid liabilities, which remain in a client's account and are managed by the investment adviser.

In calculating regulatory assets under management with respect to private funds, an investment adviser must: (i) include the value of any private fund assets over which it exercises continuous and regular supervisory or management services, regardless of the nature of the assets held by the private fund; (ii) include the amount of any uncalled capital commitments made to the private fund; and (iii) use the market value of private fund assets, or the fair value of private fund assets where market value is unavailable. 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 regulatory assets under management, provided it has done so consistently and in good faith. However, if an investment adviser uses U.S. Generally Accepted Accounting Principles ("GAAP") or some other basis of accounting to calculate fair value for financial reporting purposes, then the SEC expects such an investment adviser to use the same basis for determining regulatory assets under management.

VII. Changes to Form ADV Disclosures

The Implementing Adopting Release amends Form ADV to require, among other things, all registered investment advisers to provide more detailed information about: (i) their advisory business (including data about the types of clients they have, their employees and their advisory activities); (ii) their business practices that may present significant conflicts of interest (such as the use of affiliated brokers, soft dollar arrangements and compensation for client referrals); and (iii) their non-advisory activities and their financial industry affiliations. We understand that the newly amended Form ADV will be operational on the SEC's website (via the Investment Adviser Registration Depository) by late 2011.

To enhance its ability to oversee investment advisers to private funds, the SEC is requiring investment advisers to provide additional information on Form ADV about each private fund they manage. Specifically, the SEC has amended Section 7B of Schedule D (which currently requires limited information about limited partnerships and limited liability companies advised by an investment adviser) to require investment advisers to private funds to provide expanded information about each private fund they advise, including:

- the name of the private fund;[19]
- the state or country where the private fund is organized;
- the name of the private fund's general partner, directors, trustees or persons occupying similar positions;
- the structure of the private fund, including whether it is a master or a feeder fund;
- the regulatory status of the private fund, including the exception from the Investment Company Act on which it relies;
- whether the fund relies on an exemption from registration of its securities under the Securities Act;
- whether the investment adviser is subject to regulation by a non-U.S. regulatory authority;
- whether the investment adviser is a subadviser to the private fund;
- the identity (by name and SEC file number) of any other investment advisers to the fund;

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[19] The SEC has added an instruction to this item to permit an investment adviser that seeks to preserve the anonymity of a private fund client by maintaining its identity in code in its records to identify the private fund in Schedule D using the same code.

- the gross asset value of the private fund;

- the type of investment strategy employed by the investment adviser (to be selected from seven broad categories[20] which the applicable instruction would define);

- the number and the types of investors in the private fund;

- the minimum amounts required to be invested by fund investors; and

- whether clients of the investment adviser are solicited to invest in the private fund.

The SEC did not adopt proposed amendments to Form ADV that would have required investment advisers to:

- disclose each private fund's net assets;

- provide a breakdown of the assets and liabilities held by each private fund by class and categorization in the fair value hierarchy established under GAAP; and

- specify the percentage of each private fund owned by particular types of beneficial owners.

The Implementing Adopting Release also amends Part B of this Section to require investment advisers to provide information regarding five categories of "gatekeepers" that perform critical roles for investment advisers and the private funds they manage, specifically, auditors, prime brokers, custodians, administrators and marketers. Such information includes: (i) the identity of each service provider; (ii) their location; (iii) whether they are related persons; (iv) specific information describing the services they provide; and (v) registration status (*e.g.*, for auditors, whether they are independent, registered with the Public Company Accounting Oversight Board and subject to its regular inspection, and whether audited statements are distributed to fund investors; for prime brokers, whether they are SEC-registered and whether they act as custodian for the private fund; for custodians, whether they are a related person of the investment adviser; for administrators, whether they prepare and send to investors account statements and what percentage of the private fund's assets are valued by the administrator or another person that is not a related person of the investment adviser; for marketers, whether they are related persons of the investment adviser, their SEC file number (if any), and the address of any website they use to market the private fund).

The SEC has also modified the scope of Item 7 by requiring completion of Section 7B for any "private fund" that the investment adviser advises.[21] As a result, investment advisers must report all pooled investment vehicles, not only those that are organized as limited partnerships or limited liability companies. In addition, investment advisers would no longer be required to

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20 The categories include: (i) hedge fund; (ii) liquidity fund; (iii) private equity fund; (iv) real estate fund; (v) securitized asset fund; (vi) venture capital fund; and (vii) other private fund.

21 Item 7 currently requires each investment adviser to complete Section 7B of Schedule D for any investment-related limited partnership or limited liability company that the investment adviser or a related person advises.

report funds that are advised by affiliates, which in many cases would now be reported by an affiliate that is either registered under the Advisers Act or is now an Exempt Reporting Adviser. To avoid multiple reporting for each private fund, the SEC is permitting a subadviser to exclude private funds for which an investment adviser is reporting on another Schedule D, and is permitting an investment adviser sponsoring a master-feeder arrangement to submit a single Schedule D for the master fund and all of the feeder funds that would otherwise be submitting substantially identical data. Finally, the SEC is permitting an investment adviser with its principal office and place of business outside of the United States to omit a Schedule D for a private fund that is not organized in the United States and that is not offered to, or owned by, a "United States person."[22] This approach is designed to limit the reporting burden imposed on non-U.S. advisers with respect to funds in which U.S. investors have no direct interest.

In addition, the Implementing Adopting Release amends Form ADV to enable the SEC to identify those investment advisers that would be subject to Section 956 of the Dodd-Frank Act, which requires the SEC, jointly with certain other federal regulators, to adopt rules or guidelines addressing certain excessive incentive-based compensation arrangements, including those of investment advisers with $1 billion or more in assets. Part IA of Form ADV requires an investment adviser to indicate whether or not the investment adviser had $1 billion or more in assets as of the last day of the investment adviser's most recent fiscal year. For these purposes, the amount of assets would be the investment adviser's total assets (*e.g.*, the total assets of the advisory firm rather than the total regulatory assets under management) determined in the same manner as the amount of "total assets" is determined on the investment adviser's balance sheet for its most recent fiscal year end.

VIII. Amendments to the SEC Pay-to-Play Rule

The SEC also approved an amendment to Rule 206(4)-5 of the Advisers Act, the investment adviser "pay-to-play" rule, in response to changes made by the Dodd-Frank Act. The pay-to-play rule generally prohibits registered and certain unregistered investment advisers from engaging directly or indirectly in pay-to-play practices identified in the rule.

Final Rule 206(4)-5 extends the scope of the pay-to-play rule to make it applicable to Exempt Reporting Advisers and investment advisers relying on the Foreign Private Adviser Exemption. In addition, the final Rule adds regulated municipal advisors to the list of "regulated persons" that advisers may pay to solicit government entities' advisory business. Under the current rule, an adviser may also retain a registered broker-dealer or registered investment adviser for such solicitations. To qualify as a municipal advisor (and therefore, a regulated person), a solicitor must be registered under Section 15B of the Exchange Act and subject to pay-to-play rules adopted by the Municipal Securities Rulemaking Board ("MSRB"). In this regard, the MSRB has issued a proposed draft of a "pay-to play" rule and requested comment.

The SEC has also extended the compliance date for the ban on third-party solicitation from September 13, 2011 to June 13, 2012 in order to allow for the Financial Industry Regulatory

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22 Defined by reference to Regulation S.

Authority and the MSRB to adopt "pay-to-play" rules and to allow for placement agents and third-party solicitors to come into compliance.

IX. Form PF

As a reminder, the SEC has also proposed requiring investment advisers registered with the SEC that advise one or more private funds to file a Form PF periodically with the SEC.[23] The proposed Form PF is still under consideration by the SEC, and we understand that a final form is expected to be adopted by the end of 2011.

* * *

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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23 See SEC Release No. IA-3145 entitled "Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF" (January 26, 2011) at http://www.sec.gov/rules/proposed/2011/ia-3145.pdf

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