June 23, 2011

SEC Adopts Rules to Implement the Private Fund Investment Advisers Registration Act

On June 22, 2011, the Securities and Exchange Commission ("SEC") adopted rules to implement certain provisions under the *Private Fund Investment Advisers Registration Act of 2010* (the "Registration Act"), which was signed into law as part of the *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010* ("Dodd-Frank Act"). These new rules effect significant changes to the existing registration and reporting regime applicable to both registered and unregistered advisers under the *Investment Advisers Act of 1940* (the "Advisers Act"). Among other things, the rules:

1. Extend the date by which advisers relying on the "private adviser exemption" must register with the SEC to March 30, 2012;

2. Clarify the scope of new exemptions from registration for certain advisers, including exemptions for advisers solely to venture capital funds, advisers solely to private funds managing less than $150 million in assets in the United States, and foreign private advisers;

3. Clarify eligibility requirements for registration as an investment adviser with the SEC for advisers with less than $100 million in assets under management (certain of these clarifications would also affect advisers with greater than $100 million in assets under management);

4. Set forth reporting requirements for certain advisers exempt from registering with the SEC;

5. Expand the information required to be provided by registered investment advisers on Form ADV, including by establishing substantial new reporting requirements with respect to each private fund advised by a registered adviser; and

6. Amend the political contribution rules adopted by the SEC in 2010.

A summary of the final rules and other amendments implementing the Registration Act appears below. The SEC's rules implementing the Registration Act may be found here and here.

1. Extension of Compliance Date for Registration

The Registration Act eliminated the so-called "private adviser exemption" under Section 203(b)(3) of the Advisers Act, which exempted any investment adviser from registration if the adviser did not hold itself out to the public as an investment adviser, had fewer than 15 clients (with each private fund counting as a single client for this purpose), and was not an adviser to a registered investment company. The Registration Act provided that this change would be effective on July 21, 2011. The rules adopted by the SEC provide that advisers that were relying on, and were entitled to rely on, the "private adviser exemption" on July 20, 2011, may delay registration with the SEC until March 30, 2012. Initial applications for registration can take up to

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45 days to be approved. Consequently, in the adopting release for the rules, the SEC staff stated that such advisers should file a complete application on Form ADV no later than February 14, 2012.

2. Exemptions from the Advisers Act Registration Requirements

In lieu of the private adviser exemption, the Registration Act created three new exemptions from registration under the Advisers Act: (i) an exemption for advisers solely to venture capital funds (the "venture capital fund exemption"); (ii) an exemption for advisers solely to private funds with less than $150 million in assets under management in the United States, without regard to the number or type of private funds (the "private fund adviser exemption"); and (iii) an exemption for certain non-U.S. advisers with no place of business in the United States and minimal assets under management attributable to U.S. clients and investors (the "foreign private adviser exemption").

Exempt advisers relying on the venture capital fund exemption or the private fund adviser exemption are categorized by the SEC as "exempt reporting advisers." As further discussed below under "*Reporting Requirements for Exempt Reporting Advisers*," although exempt reporting advisers are not required to register as investment advisers with the SEC, they remain subject to certain reporting requirements, which will require exempt reporting advisers to file Part 1A of Form ADV with the SEC, and to examination by the SEC. The final rules implement each of the three exemptions, which are summarized below.

(a) *Venture Capital Fund Exemption*

Rule 203(l)-1 defines a venture capital fund as a private fund that: (i) holds no more than 20 percent of its aggregate capital commitments (other than short-term holdings) in non-qualifying investments; (ii) does not borrow, provide guarantees or otherwise incur leverage, other than by engaging in limited short-term borrowings or providing limited guarantees of the obligations of qualifying portfolio companies; (iii) does not offer its investors redemption rights or other similar liquidity rights except in extraordinary circumstances; (iv) represents itself as pursuing a venture capital strategy; and (v) is not registered under the *Investment Company Act of 1940* (the "Investment Company Act"), and has not elected to be treated as a business development company. The rule also includes a grandfathering provision for certain existing funds that would not meet all of the conditions set forth above but have held themselves out historically as pursuing a venture capital strategy.

i. Holdings Requirements

Under the rule, a venture capital fund must hold, immediately after the acquisition of any asset (other than qualifying investments or short-term holdings), no more than 20 percent of its *bona fide* aggregate capital contributions and uncalled committed capital in assets that are not qualifying investments (other than short-term holdings) valued at cost or fair value, consistently applied. The ability of a venture capital fund to hold up to 20 percent of its investment assets in a "basket" of assets that are not qualifying investments (or short-term holdings) is a significant change to the venture capital fund definition in the rules proposed by the SEC last November.

(1) Qualifying Investments

A qualifying investment generally consists of (i) any equity security issued by a qualifying portfolio company that is directly acquired by the private fund, (ii) certain equity securities issued by a qualifying portfolio company in exchange for the directly acquired securities described in (i) above, and (iii) an equity security

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issued by a company of which a qualifying portfolio company is a majority owned subsidiary, that is acquired by the fund in exchange for an equity security described in (i) and (ii) above. A fund may purchase shares in secondary markets to the extent that it has room for such securities in its non-qualifying investment basket.

(2) Short-Term Holdings

"Short-term holdings" refers to cash and cash equivalents, U.S. Treasuries with remaining maturities of 60 days or less, and shares of registered money market funds.

(3) Qualifying Portfolio Company

Under the rule, a qualifying portfolio company is a company that:

- *Is not reporting or foreign traded (i.e., is not subject to the reporting requirements of Sections 13 or 15(d) of the Securities Exchange Act of 1934 and does not have any publicly traded securities) and does not have a control relationship with a reporting or foreign traded company.* The SEC clarified that a venture capital fund may continue to hold securities of a portfolio company that becomes reporting or foreign traded and treat such securities as a qualifying investment, but it cannot make a new investment in a publicly traded company or an affiliate of a reporting or foreign traded company and treat such investment as a qualifying investment.
- *Does not borrow or issue debt obligations in connection with an investment by a fund and distribute to the fund the proceeds of such borrowing or issuance in exchange for the fund's investment.* Under the rule, qualifying portfolio companies may borrow in the ordinary course of business; however, a company would be disqualified if it borrows (or issues debt) in connection with a fund's investment *and* distributes the proceeds of such borrowing or issuance to the fund in exchange for the fund's investment.
- *Is not a pooled investment vehicle.* In other words, a qualifying portfolio company must be an operating company. A fund-of-funds that invests in other private funds or investment companies could not qualify as a venture capital fund (subject to the 20 percent basket available to all venture capital funds for non-qualifying investments), even if the underlying portfolio funds were themselves venture capital funds.

ii. Limitations on Leverage

For purposes of the exemption, a venture capital fund cannot borrow, issue debt obligations, provide guarantees, or otherwise incur leverage in excess of 15 percent of the fund's aggregate capital contributions and uncalled committed capital. Any such borrowing, indebtedness, guarantee, or leverage must be for a non-renewable term of no longer than 120 calendar days, except that any guarantee of a qualifying portfolio company's obligations up to the value of the fund's investment in the qualifying portfolio company is not subject to the 120 calendar day limit.

iii. No Redemption or Similar Liquidity Rights

A venture capital fund cannot provide investors with redemption or withdrawal rights or the right to require the repurchase of securities, except in extraordinary circumstances.

iv. Represents Itself as Pursuing a Venture Capital Strategy and Is a Private Fund

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The rule further limits the definition of venture capital fund to a fund that represents itself to investors or potential investors as pursuing a venture capital strategy. To satisfy this requirement, a fund could describe its investment strategy as venture capital investing or as a fund that is managed in compliance with the elements of the venture capital fund exemption rule. In addition, a venture capital fund must be a private fund (*i.e.*, a fund relying on Section 3(c)(1) or 3(c)(7) of the Investment Company Act for its exemption from registration as an investment company under the Investment Company Act, or certain non-U.S. funds that have not offered securities in the U.S. or to U.S. persons in a manner inconsistent with being a private fund) and not a registered investment company or a regulated business development company.

v. Grandfathering Provision

Included in the definition of venture capital fund is any fund that: (i) represented to investors and potential investors that it was pursuing a venture capital strategy at the time such fund offered its securities; (ii) has sold securities to one or more investors that are not related persons prior to December 31, 2010; and (iii) does not sell securities to, or accept additional capital commitments from, any person after July 21, 2011. The grandfathering provision includes any fund that has accepted capital commitments by the specified dates even if none of the commitments have been called. Funds that meet these grandfathering conditions will not be required to satisfy the stricter definition of "venture capital fund" applicable to new funds.

(b) Private Fund Adviser Exemption

i. U.S. Advisers

Rule 203(m)-1 provides that a U.S. adviser (*i.e.*, an adviser with its principal office and place of business in the United States) solely to "private funds" is exempt from registration under the Advisers Act if the aggregate value of the adviser's assets under management in the United States is less than $150 million. A private fund for these purposes means any private fund (*i.e.*, a 3(c)(1) or 3(c)(7) fund) that is not registered under Section 8 of the Investment Company Act and has not elected to be treated as a business development company, as well as any fund that qualifies for an exclusion from the definition of investment company under the Investment Company Act, even if it is not a 3(c)(1) or 3(c)(7) fund, so long as the fund is treated as a private fund under the Advisers Act for all purposes (*e.g.*, reporting on Form ADV). Under the rule, a U.S. adviser can advise an unlimited number of private funds, provided that the value of the adviser's aggregate private fund assets under management is less than $150 million. However, in order to rely on the private fund adviser exemption, a U.S. adviser must aggregate the value of all assets of private funds it manages, regardless of where the funds are organized, to determine whether the adviser remains below the $150 million limitation.

The rules require an adviser to calculate its assets under management in accordance with the definition of "regulatory assets under management" set forth in amended Form ADV. See *"Eligibility for Registration with the SEC – Calculation of Assets Under Management"* below for more details on the calculation of assets under management for this purpose. Under the rule, an adviser must calculate its assets under management on an annual basis.

ii. Transition Rule

An adviser will have 90 days after it reports in its annual updating amendment to Form ADV that is has $150 million or more of private fund assets (and therefore becomes ineligible to rely on the private fund adviser

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exemption) to register as an investment adviser with the SEC. However, this 90 day grace period is only available to advisers that have complied with all applicable SEC reporting requirements. See *"Reporting Requirements for Exempt Reporting Advisers"* below for more information.

iii. Non-U.S. Advisers

Under Rule 203(m)-1, non-U.S. advisers (defined as those with their principal office and place of business outside of the United States) are exempt from registration if: (i) the adviser has no client that is a U.S. person, except for one or more private funds; and (ii) all assets managed by the adviser at a place of business in the United States are solely attributable to private fund assets, the total value of which is less than $150 million. The method for calculating assets under management, the definition of private fund and the transition rule described above apply equally to non-U.S. advisers.

As a result of this implementation of the Registration Act, non-U.S. advisers with no U.S. operations will not need to register under the Advisers Act, regardless of the amount of private fund assets under management attributable to U.S. investors, unless they have U.S. clients that are not private funds. Non-U.S. advisers with a U.S. affiliate or U.S. office will need to determine whether they are managing assets in the U.S. for purposes of Rule 203(m)-1. In its adopting release, the SEC reaffirmed its prior guidance concerning what it means for assets to be "managed by the adviser at a place of business in the United States." In general, an adviser will be regarded as managing assets at a U.S. place of business if it provides "continuous and regular supervisory or management services" from such location. The SEC clarified in the adopting release for the rule that providing research or conducting due diligence at a U.S. place of business would not be viewed as causing assets to be covered if a person outside of the United States makes independent investment decisions and implements those decisions.

As noted above, non-U.S. advisers exempt from registration pursuant to the private fund adviser exemption will still be subject to reporting requirements and examination. See *"Reporting Requirements for Exempt Reporting Advisers"* below for more information.

iv. Single-Investor Funds

Advisers should be aware that whether funds established for a single investor qualify as a private fund for the purposes of the rule will depend upon the facts and circumstances. The SEC expressed its concern in an adopting release that advisers could convert client accounts to single-investor funds in order to avoid the registration requirement under the Advisers Act. As a result, single-investor funds that serve no purpose other than the circumvention of the Advisers Act will not be respected by the SEC as "private funds" for purposes of applying the private fund adviser exemption. However, the SEC acknowledged, without elaboration, that there are circumstances in which it may be appropriate for an adviser to treat a single-investor fund as a private fund for the purposes of Rule 203(m)-1.

(c) Foreign Private Adviser Exemption

The Registration Act provides for an exemption from registration for a "foreign private adviser," which is defined as an investment adviser that: (i) has no place of business in the United States; (ii) has fewer than 15 clients and investors in the United States in private funds advised by it; (iii) has less than $25 million in assets under management attributable to U.S. clients and investors in the United States in private funds advised by it; and (iv) neither holds itself out to U.S. investors as an investment adviser, nor acts as an investment

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adviser to any investment company registered under the Investment Company Act or any company that has elected to be a business development company.

Rule 202(a)(30)-1 defines certain terms for use by investment advisers seeking to avail themselves of the foreign private adviser exemption, highlights of which are discussed below:

- *Place of Business.* "Place of business" means any office where an 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 investment adviser conducts any such activities.
- *Clients.* A non-U.S. adviser is permitted to treat as a single client: (i) certain family members and related accounts; (ii) an entity to which the adviser provides investment advice based on the entity's investment objectives; and (iii) two or more entities that have identical shareholders, partners, limited partners, members, or beneficiaries. Further, any general partner, managing member, or other person acting as an investment adviser to a limited partnership or limited liability company must treat the limited partnership or the limited liability company as a client. If a client relationship involving multiple persons does not fall within this rule, the question of whether the relationship may appropriately be treated as a single client must be determined on the basis of the facts and circumstances involved. A non-U.S. adviser is not required to count a private fund as a client if the non-U.S. adviser is counting any investor (as discussed below) in that private fund as an investor in the United States in that private fund. Finally, a non-U.S. adviser is not required to count a person as an investor if the adviser counts such person as a client of the adviser. Therefore, a client who is also an investor in a private fund advised by the adviser would only be counted once.
- *Investors.* An "investor" is any person that would be included in determining the number of beneficial owners of the outstanding securities of a private fund under Section 3(c)(1) of the Investment Company Act, or whether the outstanding securities of a private fund are owned exclusively by qualified purchasers under Section 3(c)(7) of the Investment Company Act, except that beneficial owners of short-term paper issued by the private fund will also be included in determining the number of beneficial owners of outstanding securities of a private fund. These tests under Section 3(c)(1) and Section 3(c)(7) require "looking through" an entity to its underlying investors under certain circumstances. A non-U.S. adviser may treat as a single investor any person that is an investor in two or more private funds advised by the non-U.S. adviser.
- *Assets Under Management.* Assets under management are determined in the same manner as described under *"Eligibility for Registration with the SEC — Calculation of Assets Under Management"* below.
- *In the United States.* "In the United States" is generally defined consistently with Regulation S under the *Securities Act of 1933* (the "Securities Act") (which regulates non-U.S. offerings of securities).
- *Holding Out.* A non-U.S. adviser would not be deemed to be holding itself out to the public if it participates in a non-public offering in the United States of securities issued by a private fund.

Unlike a non-U.S. adviser relying on the private adviser exemption, non-U.S. advisers relying on the exemption for foreign private advisers (i) are not given any time in which to register with the SEC after becoming ineligible to rely on this exemption due to an increase in the value of private assets attributable to U.S. clients and investors in the United States, and (ii) do not need to comply with the reporting and examination requirements discussed in *"Reporting Requirements for Exempt Reporting Advisers"* below.

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(d) *Note on Affiliated Advisers and Unibanco*

In the adopting release for the rules, the SEC staff noted generally that it will 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. However, the SEC also confirmed that nothing in its new rules is intended to withdraw any prior statement of the SEC or its staff expressed in the *Unibanco* line of no action letters, and specifically noted that the staff has said that it will not recommend enforcement action if a non-U.S. advisory affiliate of a registered adviser shares personnel with, and provides certain services through, the registered affiliate without such non-U.S. advisory affiliate registering under the Advisers Act.

3. Eligibility for Registration with the SEC

Section 203A of the Advisers Act (i) generally prohibits an adviser regulated by the state in which it maintains its principal office and place of business from registering with the SEC (unless the adviser has at least $25 million in assets under management) and (ii) preempts certain state laws that would otherwise regulate advisers registered with the SEC. Section 410 of the Dodd-Frank Act raises the threshold for SEC registration to $100 million by creating a new category of advisers called "mid-sized advisers" that have assets under management between $25 million and $100 million (although the SEC adopted a "buffer" for the $100 million threshold, described in more detail below). The SEC has amended several of its current rules and forms to implement the new registration rules applicable to mid-sized advisers. **Certain of the changes described below affect all federally registered advisers, including those with assets under management of more than $100 million.**

(a) *Registration Buffer*

The SEC also adopted a registration buffer which provides that (i) advisers with greater than $100 million in assets under management but less than $110 million are permitted, but not required, to register with the SEC and (ii) advisers that are registered with the SEC and have at least $90 million in assets under management need not withdraw their SEC registrations (in either case unless they are an investment adviser to an investment company registered under the Investment Company Act or to a business development company pursuant to Section 54 of the Investment Company Act).

(b) *Determining Eligibility for Registration —Form ADV*

Rule 203A-5 will require *each* adviser registered with the SEC as of January 1, 2012, including those with assets under management of more than $100 million, to file an amendment to its Form ADV no later than March 30, 2012 (which would serve as the annual updating amendment for advisers with a December 31 fiscal year-end). Each investment adviser must report (in that amendment and in its annual updating amendment thereafter) whether it is eligible to remain registered. Revisions to Item 2 of Part 1A of Form ADV reflect the new $100 million statutory threshold for registration with the SEC and will require each adviser registered with the SEC (and each applicant for registration) to identify whether, under Section 203A of the Advisers Act, as amended, it is eligible to register with the SEC because it: (i) is a large adviser (having $100 million or more of regulatory assets under management, or $90 million or more if the adviser is already registered with the SEC); (ii) is a mid-sized adviser that does not meet the criteria for state registration and examination; (iii) has its principal office and place of business in Minnesota, New York or Wyoming (which either do not regulate advisers or do not perform examinations on state-registered mid-sized advisers) or outside the United States; (iv) meets one or more of the exemptions from prohibition on registration set

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forth in the rules under Section 203A of the Advisers Act; (v) is an adviser (or subadviser) to a registered investment company; (vi) is an adviser to a business development company and has at least $25 million in assets under management; or (vii) received an order permitting the adviser to register. The prohibition on mid-size investment advisers registering with the SEC does not go into effect until January 1, 2012. Moreover, mid-sized advisers registered with the SEC as of July 21, 2011 that are prohibited from remaining registered with the SEC must withdraw their registrations by filing Form ADV-W no later than June 28, 2012.

(c) Mid-Sized Advisers ($25 - 100 Million in Assets Under Management)

Section 203A(a)(2) of the Advisers Act prohibits mid-sized advisers (*i.e.*, advisers with $25 million to $100 million in assets under management that do not fall within the registration buffer described above) from registering with the SEC if: (i) the adviser is required to be registered as an investment adviser with the securities commissioner (or any agency or office performing like functions) of the state in which it maintains its principal office and place of business; and (ii) if registered, the adviser would be subject to examination as an investment adviser by such commissioner, agency, or office. The SEC has incorporated into Form ADV an explanation of how to determine whether a mid-sized adviser is "required to be registered" or is "subject to examination" by a particular state securities authority.

- *Required to be Registered.* Under Section 203A(a)(1) of the Advisers Act, a mid-sized adviser that is not regulated or required to be regulated as an investment adviser in the state in which it has its principal office and place of business must register with the SEC regardless of the amount of assets it has under management, unless an exemption from registration is otherwise available. A mid-sized adviser filing with the SEC must affirm, upon application and annually thereafter, that (i) it is not required to be registered as an adviser with the state securities authority in the state where it maintains its principal office and place of business or (ii) is not subject to examination as an adviser by that state.
- *Subject to State Examination.* A mid-sized adviser must register with the SEC if the adviser is not subject to examination as an investment adviser by the state in which the adviser has its principal office and place of business. The SEC has corresponded with each state securities commissioner (or official with similar authority) and requested that each state securities commissioner (or official with similar authority) advise the SEC as to whether a mid-sized adviser registered in the state would be subject to examination as an investment adviser by that state's securities commissioner. Each state responded, and only New York, Minnesota and Wyoming will be treated as a state where state-registered mid-sized advisers would not be subject to examination.

(d) Calculation of Assets Under Management

In most cases, the amount of assets an adviser has under management will determine whether the adviser must be registered with the SEC or the states. Form ADV requires an adviser to report the market value of its assets under management, as determined within 90 days of the filing.

The SEC will use a uniform method of calculating assets under management for purposes of determining eligibility for SEC registration, reporting assets under management on Form ADV, and the new exemptions from registration under the Advisers Act. (See *"Exemptions from the Advisers Act Registration Requirements"* above for more information). Under the rules, in calculating regulatory assets under management, an adviser will:

- include the value of any securities portfolios (i.e., any portfolio at least 50% of the total value of which consists of securities) or any private fund for which it provides continuous and regular supervisory or management services, regardless of the nature of the assets held by the portfolio and/or the fund (e.g., proprietary assets, assets managed without receiving compensation, or assets of foreign clients);
- include the amount of any uncalled capital commitments made to a fund;
- not subtract any outstanding indebtedness and other accrued but unpaid liabilities that remain in a client's account and are managed by the adviser; and
- use market value, or fair value when market value is unavailable, in determining assets under management.

Because advisers are required to assess their eligibility for registration on an annual basis, advisers will not need to switch frequently between state and SEC registration as a result of mid-year changes in the value of an adviser's regulatory assets under management. As is the case under the previous rules, if an adviser is no longer eligible for SEC registration at the end of its fiscal year, the rule provides a 180-day grace period from the adviser's fiscal year end to allow it to switch to state registration.

(e) Exemptions from the Prohibition on Registration with the SEC

Section 203A(c) of the Advisers Act provides the SEC with the authority to permit advisers to register with the SEC even though they would be prohibited from doing so otherwise. Under this authority, the SEC adopted six exemptions in Rule 203A-2 from the prohibition on registration. The SEC has adopted amendments to three of the exemptions to reflect developments since their adoption: (i) the exemption for nationally recognized statistical rating organizations is eliminated; (ii) the exemption for pension consultants is amended to increase the minimum value of plan assets from $50 million to $200 million; and (iii) the multistate exemption is amended to permit SEC registration for an investment adviser required to register with 15 or more states.

4. Reporting Requirements for Exempt Reporting Advisers

As discussed above under *"Exemptions from the Advisers Act Registration Requirements,"* certain advisers are exempt from registering with the SEC as investment advisers. Nevertheless, Section 203(1) and Section 203(m) of the Advisers Act permit the SEC to require exempt reporting advisers (*i.e.*, advisers relying on the venture capital fund exemption or the private fund adviser exemption) to maintain certain records and submit reports to the SEC.

As adopted, Rule 204-4 requires exempt reporting advisers to file reports with the SEC on Form ADV through the Investment Adviser Registration Depository. However, exempt reporting advisers will only be required to complete certain items in Part 1A of Form ADV (as well as corresponding sections of the schedules to Part 1A), namely, basic identifying information and information regarding other business activities engaged in by the adviser, information identifying the registration exemption(s) relied upon, financial industry affiliations, private funds managed by the adviser (see "*Amendments to Form ADV"* below for more information), the adviser's control persons, and disciplinary history for the adviser and its employees. Exempt reporting advisers are not required to prepare a client brochure (Form ADV Part 2) under the rule; however, reports filed by exempt reporting advisers will be publicly available on the SEC's website. In addition, exempt reporting advisers are required to update the information provided on Form

ADV pursuant to the same timeframes applicable to registered investment advisers (*i.e.*, exempt reporting advisers will be required to update the information at least annually, and may be required to file interim updates in the event of certain changes to their businesses). In order to facilitate filings by exempt reporting advisers, the SEC adopted several corresponding amendments to Form ADV. Exempt reporting advisers are required to file an initial Form ADV with the SEC between January 1, 2012 and March 30, 2012. As such, exempt reporting advisers will need to solicit disciplinary history information from their personnel and controlled companies in advance of the March 30, 2012 filing deadline in order to be in a position to make a complete and accurate filing by such date. At the SEC open meeting where the SEC adopted these rules, Chairman Schapiro directed the SEC staff to reconsider the new requirements for exempt reporting advisers after receiving and assessing the first year's filings.

The SEC noted that because the venture capital fund exemption and the private fund adviser exemption are set forth in Section 203(l) and Section 203(m) of the Advisers Act, rather than Section 203(b) (as was the case with respect to the historic private adviser exemption), the SEC views exempt reporting advisers as subject to examination pursuant to Advisers Act Section 204(a). The SEC added, however, that it does not intend to perform routine examinations of exempt reporting advisers, but may perform examinations in circumstances under which it determines that such examinations are appropriate, including where it believes there are indications of wrongdoing.

The SEC noted recordkeeping requirements for exempt reporting advisers will be addressed in a future release, as required by Section 407 and 408 of the Dodd-Frank Act, which provide that the SEC shall require exempt advisers to maintain such records as the SEC determines necessary or appropriate in the public interest or for the protection of investors.

5. Amendments to Form ADV

The final rules amend Form ADV to generally require advisers to provide the SEC with additional information about three specific areas of their operations. First, the amendments expand the identifying information that an adviser is required to provide to the SEC with respect to each private fund it advises (the scope of the required information is described in further detail below). Second, the amendments expand and/or refine the information collected by the SEC with respect to an adviser's advisory business (including data about its clients, employees, and advisory activities), as well as business practices that may present significant conflicts of interest (including the use of affiliated brokers, soft dollar arrangements, and compensation for client referrals). Third, the amendments require an adviser to provide additional information about its non-advisory activities and financial industry affiliations.

The amendments to Form ADV significantly increase the scope of information required to be provided on Section 7.B of Schedule D to Part 1A concerning the private funds advised by an adviser. They also modify the scope of the disclosure requirement by requiring completion of Section 7.B only for a private fund that the adviser (and not a related person) advises, and clarify the application of the disclosure requirements to sub-advised funds, master-feeder funds and non-U.S. funds. In response to numerous comments, the SEC eliminated the public reporting of certain sensitive information regarding private funds that had been included in the initial proposal. In particular, an adviser is required to provide, with respect to each such private fund that it advises, information regarding:

- The name of the fund (although an adviser is permitted to use a code name, rather than the actual name);

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- The organization of the fund (including the name of the general partner);
- The fund's regulatory status (i.e., exemptions from registration under the Investment Company Act and Securities Act);
- Information about any other advisers or sub-advisers to the fund;
- Gross assets;
- Type of investment strategy employed (choosing from one of seven broad categories established by the SEC, e.g., "hedge fund");[1]
- The number of beneficial owners, as well as minimum amounts required to be invested;
- Certain characteristics of the fund that may present the adviser with conflicts of interest; and
- Information concerning five types of service providers that the SEC has identified as providing important "gatekeeper" roles for private funds: auditors, prime brokers, custodians, administrators, and marketers. Advisers are required to name these service providers, and provide certain information concerning, among other things, the services they provide, and whether they are affiliated with the adviser.

In addition, a number of other technical changes were made to Form ADV, as well as changes requiring an adviser to disclose whether it had $1 billion in total assets on its balance sheet as of the last day of the most recent fiscal year (i.e., to identify advisers that could be subject to incentive-based compensation rules). Our prior alert about the proposed incentive-based compensation rules can be found here: SEC Proposes Incentive-Based Compensation Rules.

6. Amendments to Political Contribution Rules

On June 30, 2010, the SEC approved Rule 206(4)-5 under the Advisers Act, which addresses so-called "pay to play" practices in the selection of advisers to manage the assets of U.S. state and local government entities (*e.g.*, state pension funds, any state or local government controlled fund, or any investment program or plan sponsored or established by a state or local government, including participant directed plans such as 529 tuition plans and 403(b) and 457 retirement plans). The rule, which applies to both registered advisers and unregistered advisers, effectively prohibits investment advisers who advise or seek to advise government entities, as well as certain personnel of such advisers, from making, or causing to be made, greater than *de minimis* political contributions to government officials with authority or influence over the hiring of investment advisers. The rule currently also requires that any placement agent retained by an investment adviser to solicit a government entity be either a registered broker-dealer that is itself subject to "pay to play" regulations or a registered investment adviser. For more information about Rule 206(4)-5, please see SEC Adopts Advisers Act Rule Addressing "Pay to Play" Practices.

[1] The SEC proposed to use the same categories (defined in the same manner) for purposes of Form ADV and Form PF. Although the SEC did not receive any comments on those definitions in the Form ADV rulemaking, they did receive several comments on the same definitions in response to Form PF. In response to those comments, the SEC made several changes to the definitions in Form ADV and will consider those comments in the context of the adoption of Form PF.

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The SEC approved two amendments to the political contribution rules described above:

- In order to avoid unintended narrowing of the application of the rule as a result of the recent amendments to the Advisers Act, the SEC expanded the application of the rule to exempt reporting advisers and foreign private advisers.
- The rules now include "registered municipal advisors" within the list of entities referred to as "regulated persons" that registered advisers are permitted to pay to solicit government entities if such entities are subject to restrictions that the SEC has determined to be at least as stringent as the pay-to-play rule (previously, only registered investment advisers and registered broker-dealers could be retained for this purpose under the rule).

In addition, in order to give the Municipal Securities Rulemaking Board and the Financial Industry Regulatory Authority more time to adopt pay-to-play rules for registered municipal advisers and broker-dealers, respectively, and give third-party solicitors additional time to come into compliance with such rules, the SEC extended the date by which adviser must comply with the ban on solicitation of government entities by third parties other than "regulated persons" to June 13, 2012.

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If you would like to learn more about the issues raised in this alert, please contact the lawyers listed below or your usual Ropes & Gray adviser.

Jason E. Brown **Joel A. Wattenbarger**

ropesgray.com

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