

## Status of New Fund Manager Regulations

For those of you who are or may be making offerings in California, this is an update on the latest regarding the new California regulations regarding investment advisers. This is important because the California Department of Corporations (DOC) is taking the position that managers of investment funds may be investment advisers. The same issue has or will be arising in other states as well, as they begin adopting the recommendations of the NASAA (North American Securities Administrators Association) regarding investment advisers.

I participated in a meeting with the DOC and the California Mortgage Association (CMA) on October 10 regarding the California's new investment adviser regulations. In particular, the DOC's statement of reasoning that was issued with the new regulations indicated that the regulations applied to managers of funds that invest in promissory notes. (Traditionally it's been held that fund managers are advising the fund itself on investment decisions even if they aren't advising investors.) The new regulations limit fund managers to accredited investors only (regardless of the type of offering), require expensive annual audits of a specified type, and require that a substantial annual report be filed.

The meeting began a bit contentiously as the DOC was firmly maintaining that it would not alter the new regulations. Perhaps two-thirds of the way through the DOC stunned everyone by stating that the new investment adviser regulations apply only to those who are paid for giving investment advice – and that management fees do not count. (No individualized investment advice can be given to any of the investors, either, of course.) One of the CMA members said that if the DOC put that in writing, then there are no issues.

The DOC was cautious and said it wanted some documentation within the next two weeks. It said it wanted the CMA to submit a letter regarding how funds that invest in deeds of trust are different from hedge funds, which are apparently what the DOC is trying to regulate better. Of course, hedge funds invest in all sorts of exotic investments, which even today include things like derivatives. The DOC also said that it is willing to delay implementation of the new regulations until this can be worked out.

While there won't be any certainty until the DOC issues something in writing and the language can be reviewed, I am cautiously optimistic. It is a vast improvement over what I and many others had feared when we saw the DOC's new regulations and statement of reasons.

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