Massachusetts Securities Division Adopts New Investment Adviser Regulations

THE FOLEY ADVISER - FEBRUARY 17, 2012

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The Massachusetts Securities Division (the “Division”) has adopted new regulations related to the registration of investment advisers. The new regulations are effective as of February 3, 2012, but will not be enforced by the Division until August 3, 2012.

The regulations, which were adopted in response to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) passed by Congress in July 2010, include the following key provisions: (i) substantial changes to the definition of “institutional buyer”; (ii) the establishment of a private fund adviser exemption from registration; and (iii) amendments to the requirements for advisers with discretion over, or custody of, client funds.

Change to the Definition of Institutional Buyer

Under the new regulations, the exemption relied on by most investment advisers to private funds is effectively removed. Previously, an adviser whose only clients were “institutional buyers”, which was defined to include a pooled investment vehicle in which all investors were accredited investors, and each of whom invested a minimum of $50,000, was excluded from the definition of an investment adviser under Massachusetts law. The new regulation now specifies that this definition applies only to funds which were not only in existence prior to February 3, 2012, but also ceased to accept any new beneficial owners as of such date. This grandfathering provision therefore permits existing funds to continue to operate in reliance on the exemption, but only if they do not accept any new investors. Additional investments into the fund from existing investors are permitted.

Private Fund Advisers Exemption

Similar to the federal exemptions put in place under the Dodd-Frank Act, Massachusetts has adopted a private fund adviser exemption from registration for advisers whose only clients are 3(c)(1) and 3(c)(7) funds, as defined under the Investment Company Act of 1940 (the

“Investment Company Act”) and who are not otherwise subject to certain disciplinary disqualifications. Private fund advisers who satisfy the requirements set out in the regulations will be exempt from registration, but will be required to: (i) file with the state the same reports and amendments as are required by the U.S. Securities and Exchange Commission (the “SEC”) of exempt reporting advisers, and (ii) pay the state a $300 reporting fee.

Under the Investment Company Act, all investors in a 3(c)(7) fund must be “qualified purchasers”, which is generally defined to include individuals with at least $5 million in investments and entities with at least $25 million in investments.

Advisers to 3(c)(1) funds (other than venture capital funds) must, in addition to the above reporting and fee obligations, satisfy the following conditions in order rely on the exemption for private fund advisers: (i) all investors in the fund must be “qualified clients”; (ii) at the time of an investor’s subscription, the adviser must disclose in writing the services and duties provided or owed (or a lack thereof) as well as any other material information affecting the rights and responsibilities of the investors; and (iii) the adviser must obtain and deliver audited financial statements to each investor on an annual basis.

“Qualified client” is defined by reference to Rule 205-3 of the Investment Advisers Act of 1940 (the “Advisers Act”) and generally means an investor with $2 million in net worth (excluding the value of the investor’s primary residence absent certain circumstances) or $1 million under management of the adviser.

“Venture capital fund” is defined also by reference to Rule 203(1)-1 of the Advisers Act.

Similar to the grandfathering provision for advisers to institutional buyers, the private fund adviser exemption is available for a 3(c)(1) fund that was in existence prior to February 3, 2012 provided that such fund ceased to accept any non-qualified clients as new beneficial owners as of such date, and the adviser complies with the disclosure and audited financial statements requirements for 3(c)(1) funds referenced above.

Custody and Discretion Requirements

Under the new regulations, any Massachusetts investment advisers with discretionary authority over client funds or securities must comply with Rule 206 of the Advisers Act. Under Rule 206, which is commonly known as the “SEC custody rule,” an adviser must comply with certain

requirements relating to independent verification of account assets. However, in adopting the SEC custody rule, the Massachusetts regulations add that an adviser is exempt from the independent verification requirement if the following requirements are met: (i) the adviser has written authorization from the client to deduct advisory fees from the account held with the qualified custodian; and (ii) the adviser sends the qualified custodian and client an invoice or statement of the amount of the fee to be deducted each time a fee is directly deducted.