Morgan Lewis

alert

investment management lawflash

www.morganlewis.com

SEC Adopts Exemptions for Certain Private Fund Advisers and Other Dodd-Frank Implementing Rules

Certain fund advisers that fit narrow definitions are exempt from registration requirements imposed by the Dodd-Frank Act, but are still required to comply with recordkeeping and reporting obligations.

June 29, 2011

On June 22, the U.S. Securities and Exchange Commission (SEC) adopted several rules implementing changes to the Investment Advisers Act of 1940 (Advisers Act) made by Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The new rules were adopted under a pair of companion releases: the first implemented changes for "mid-size" advisers and outlined reporting requirements of "exempt reporting advisers" (Implementing Release)[1] and the second promulgated exemptions from SEC registration for venture capital fund advisers, private fund advisers, and foreign private advisers (Exemptions Release).[2]

As a result of the new rules, many previously unregistered advisers, such as advisers to private funds, will have to register with the SEC or one or more state regulators absent an exemption from registration. As set forth in the Exemptions and Implementing Releases, Form ADV will now serve as both a registration and reporting form for registered advisers and a reporting form for exempt reporting advisers. Advisers newly registering with the SEC or reporting as exempt reporting advisers must file Form ADV by March 30, 2012. In this LawFlash, we will discuss the following:

- The exemption from SEC registration for private fund advisers
- The reporting requirements for private fund advisers as "exempt reporting advisers"
- The exemption from registration for foreign private advisers
- The treatment of subadvisory relationships and advisory affiliates under the exemptions
- Practical considerations for advisers impacted by the new rules
- Sources for additional information

---

1. *See* Rules Implementing Amendments to the Investment Advisers Act of 1940, Advisers Act Rel. No. 3221 (June 22, 2011), *available at* http://www.sec.gov/rules/final/2011/ia-3221.pdf. For the proposing release, *see* Rules Implementing Amendments to the Investment Advisers Act of 1940, Advisers Act Rel. No. 3110 (Nov. 19, 2010), *available at* http://www.sec.gov/rules/proposed/2010/ia-3110.pdf.

2. *See* Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers with Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, Advisers Act Rel. No. 3222 (June 22, 2011), *available at* http://www.sec.gov/rules/final/2011/ia-3222.pdf. For the proposing release, *see* Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers with Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, Advisers Act Rel. No. 3111 (Nov. 19, 2010), *available at* http://www.sec.gov/rules/proposed/2010/ia-3111.pdf.

SECTION 203(m) AND RULE 203(m)-1: EXEMPTION FOR "PRIVATE FUND ADVISERS"

As amended by the Dodd-Frank Act, Section 203(m) of the Advisers Act requires the SEC to provide an exemption from registration to any investment adviser that acts solely as an adviser to private funds and that has assets under management in the United States of less than $150 million. In the Exemptions Release, the SEC adopted Rule 203(m)-1, which brings this private fund adviser exemption into effect.

Section 202(a)(29) of the Advisers Act, as amended by the Dodd-Frank Act, defines a "private fund" as an issuer that would be an investment company under Section 3 of the Investment Company Act of 1940 (1940 Act) but for the exclusions from the definition of "investment company" under Section 3(c)(1) or 3(c)(7) of the 1940 Act. This definition of "private fund" would also include a private fund that invests in other private funds. The SEC explained in the Exemptions Release that a fund organized under the laws of the United States or a state is a "private fund" if it is excluded from the definition of "investment company" pursuant to Section 3(c)(1) or 3(c)(7) of the 1940 Act, and that a non-U.S. fund that offers its securities in the United States and relies on Section 3(c)(1) or 3(c)(7) of the 1940 Act would be a "private fund" under Section 202(a)(29) of the Advisers Act. Thus, a non-U.S. fund may conduct a private offering of its securities in the United States without first obtaining an order permitting registration under Section 7(d) of the 1940 Act if the fund can rely on either Section 3(c)(1) or 3(c)(7) with respect to its U.S. investors.[3] The Exemptions Release also clarified that a private fund that also qualifies for another exclusion from the definition of "investment company" in addition to Section 3(c)(1) or 3(c)(7)—such as certain real estate funds under Section 3(c)(5)—may still be treated as a "private fund" for the purposes of the exemption, so long as the adviser treats such fund as a "private fund" for all other purposes (e.g., Form ADV reporting).

Assets Under Management

Under the new rules, a private fund adviser may advise an unlimited number of private funds and still qualify for the exemption from registration under Rule 203(m)-1, provided that the adviser's U.S. assets under management are less than $150 million. Any uncalled capital commitments, proprietary assets, and assets managed with or without compensation will be counted toward this $150 million threshold. Unlike the proposed rule, which would have required quarterly calculations, the new rule requires a private fund adviser to determine its assets under management annually within 90 days of filing its Form ADV annual updating amendment (as further discussed below), which must be filed within 90 days of its fiscal year-end. This requirement effectively results in a private fund adviser annually calculating and reporting its fiscal-year-end assets under management, but seems to permit an adviser the flexibility of selecting any date within 90 days after its fiscal year-end. Calculations must be on a gross basis using market value or, if market value is unavailable, fair value.[4]

If an adviser exceeds the $150 million threshold in its annual calculation and has otherwise complied with all applicable reporting requirements (as discussed further below), the adviser must apply for SEC registration within 90 days after reporting its assets under management and may continue to act as a private fund adviser until it is registered. A private fund adviser that exceeds the $150 million threshold and has not complied with all applicable reporting requirements will not be given this 90-day grace period and should plan to register prior to reporting its assets under management, thus becoming ineligible for the private fund adviser exemption.

3. Section 7(d) of the 1940 Act prohibits a non-U.S. fund from using U.S. jurisdictional means to make a public offering, absent an order from the SEC permitting registration.

4. Rule 203(m)-1 does not require private fund advisers to determine fair value in accordance with U.S. generally accepted accounting principles (GAAP). *See* Implementing Release at n.98.

Due to the exemption, an adviser solely to private funds that would otherwise need to register with the SEC once it had reached $100 million of assets under management[5] will not need to register with the SEC until it acquires an additional $50 million of U.S. assets under management or takes on a client that is not a qualifying private fund. Advisers to private funds with less than $150 million of U.S. assets under management will still need to comply with applicable state investment adviser registration requirements.

U.S. and Non-U.S. Advisers

The exemption counts U.S. assets under management differently for advisers with a principal office and place of business in the United States (U.S. advisers) versus advisers with a principal office and place of business outside the United States (non-U.S. advisers).[6] For U.S. advisers, all of the private fund assets managed by an adviser would be counted toward its U.S. assets under management, even if the adviser has offices outside the United States. Non-U.S. advisers would only need to count those assets managed at a place of business within the United States toward the $150 million threshold. In either case, all U.S. assets under management must be attributable to private funds in order for an adviser to fit the private fund adviser exemption.

A non-U.S. adviser may rely on the exemption if all of its clients that are U.S. persons are "qualifying private funds,"[7] regardless of the type or number of the adviser's non-U.S. clients. "U.S. persons" is defined by reference to Rule 902(k) of Regulation S under the Securities Act of 1933, which treats legal partnerships and corporations that are organized or incorporated in the United States as U.S. persons and treats trusts with U.S. resident trustees and discretionary accounts with U.S. fiduciaries as U.S. persons. In other words, non-U.S. advisers may advise clients that are not "qualifying private funds" so long as those clients are not U.S. persons. In addition, a non-U.S. adviser may rely on the exemption from registration if it advises U.S. funds so long as all of the funds are "qualifying private funds." Any assets managed by a non-U.S. adviser outside the United States (whether investment funds or managed accounts) do not count toward the $150 million limit. However, if the non-U.S. adviser manages any assets from a U.S. place of business for clients that are not qualifying private funds, the non-U.S. adviser is disqualified from the exemption.

---

5. The Dodd-Frank Act amended Section 203A(a)(2) of the Advisers Act to increase the assets-under-management threshold for mandatory registration with the SEC from $25 million to $100 million. Rule 203A-1(a) under the Advisers Act permits an adviser with between $25 million and $30 million in assets under management to not register with the SEC if the state in which the adviser maintains its principal office and place of business has enacted an investment adviser statute. Rule 203A-1(a) also includes a $5 million "buffer" that does not require a registered adviser to de-register with the SEC until its assets under management, as annually reported, fall below $25 million. In the Implementing Release, the SEC amended Rule 203A-1 to create a similar voluntary range between $100 million and $110 million and also specified that an adviser need not de-register until its assets under management have dropped below $90 million.

6. The SEC noted that, similar to the approach taken under Rules 203A-3(c) and 222-1 under the Advisers Act, an adviser's principal office and place of business would be the location where the adviser controls, or has ultimate responsibility for, the management of private fund assets and the location where it directs, controls, and coordinates its advisory activities, even if day-to-day management of certain assets or some of the advisory activities occur elsewhere. *See* Exemptions Release at n.385 and accompanying text.

7. Rule 203(m)-1(e)(5) defines "qualifying private fund" as any private fund that is not registered under Section 8 of the 1940 Act and has not elected to be treated as a business development company under Section 54 of the 1940 Act. The adopted rule clarifies that a fund that qualifies for exclusion from the definition of "investment company" under the provisions of Section 3 of the 1940 Act, other than Sections 3(c)(1) and 3(c)(7), may still be treated as a "qualifying private fund."

Because Rule 203(m)-1 deems all assets managed by a U.S. adviser to be managed in the United States, a U.S. adviser may rely on the exemption only if all of its clients are qualifying private funds. If a U.S. adviser has any client that is not a qualifying private fund, it cannot rely on the exemption, even if the client is a non-U.S. person.

Offshore Discretionary Accounts

Rule 203(m)-1 also requires that an adviser's discretionary or other fiduciary account be treated as a U.S. person if it is held for the benefit of a U.S. person by a non-U.S. fiduciary that is a related person of the adviser. That is, an adviser will not qualify for the exemption if it establishes offshore accounts for the benefit of U.S. clients held by an offshore affiliate of the adviser and the offshore affiliate then delegates the management of the account back to the adviser, unless the aggregate amount of assets under management by the adviser in such accounts and other accounts of U.S. persons is less than $150 million and all such accounts and other accounts are qualifying private funds. This aspect of Rule 203(m)-1 is aimed at curtailing attempts by non-U.S. advisers to circumvent the exemption. This treatment would not affect U.S. advisers because all assets managed by a U.S. adviser, regardless of client location, would already be counted toward the adviser's $150 million threshold.

Clients That Become U.S. Persons

The adopted version of Rule 203(m)-1 added a note to the definition of "U.S. person" to clarify that a person's status is determined at the time such person becomes a client of the adviser. In other words, a foreign client that later moves to, organizes in, or incorporates in the United States will not later be deemed a "U.S. person."

NEW REPORTING REQUIREMENTS FOR PRIVATE FUND ADVISERS AS "EXEMPT REPORTING ADVISERS"

Section 203(m)(2) of the Advisers Act, as amended by the Dodd-Frank Act, mandates that the SEC require private fund advisers that are exempted from registration to nonetheless maintain records and provide the SEC with reports as the SEC determines necessary or appropriate in the public interest, or for the protection of investors. In the Implementing Release, the SEC adopted Rule 204-4 under the Advisers Act, requiring private fund advisers (which, along with venture capital fund advisers, are referred to as "exempt reporting advisers") to complete and electronically file reports using the Investment Adviser Registration Depository (IARD) system on certain amended items set forth in Form ADV, which will be made publicly available on the SEC's website.[8]

New Reporting Requirements

The items in Form ADV on which exempt advisers must report within 60 days of relying on either exemption from registration are the following:

- **Item 1 – Identifying Information.** An exempt reporting adviser must disclose information such as its principal place of business, website address, name and contact information of its chief compliance officer, registration status with any foreign financial regulatory authority, and status as a public reporting company under the Securities Exchange Act of 1934 (1934 Act).

8. Part 1A of Form ADV, including Schedules A, B, C, and D, as amended by the Implementing Release, is filed as Appendix D of the Implementing Release, *available at* http://www.sec.gov/rules/final/2011/ia-3221-appd.pdf.

- **Item 2B – Identification of Exemption.** An exempt reporting adviser must identify the exemption that it is relying on to report to, rather than register with, the SEC.
- **Item 3 – Form of Organization.** An exempt reporting adviser must disclose its corporate form (e.g., limited liability company), the state under which the adviser is organized, and the month in which its fiscal year ends.
- **Item 6 – Other Business Activities.** An exempt reporting adviser must disclose other businesses in which it is actively engaged (e.g., broker-dealer, commodity pool operator, futures commission merchant, major security-based swap participant) and whether the adviser sells products or provides services other than investment advice to its advisory clients.
- **Item 7A and Section 7A of Schedule D – Related Persons.** An exempt reporting adviser must provide information about whether its related persons, including foreign affiliates, are financial industry participants (e.g., broker-dealer, other investment adviser, futures commission merchant). In the Implementing Release, the SEC removed "investment company" from the list of affiliates and added "registered municipal advisor," "registered security-based swap dealer," "major security-based swap participant," "trust company," and "sponsor, general partner, managing member (or equivalent) of pooled investment vehicles." The SEC also clarified that an adviser must report affiliates that are (i) either registered ***or exempt*** commodity pool operators or commodity trading advisors, or (ii) either registered ***or unregistered*** broker-dealers, municipal securities dealers, or government securities brokers or dealers. For each such related person, an exempt reporting adviser must also provide additional information, including any control relationships between the related person and the exempt reporting adviser, under Section 7A of Schedule D to Form ADV. This expansion of the categories of related affiliates, coupled with the addition of reporting requirements for foreign affiliates, represents a substantial increase in the scope of information reported to the SEC. In the Implementing Release, the SEC noted that the information provided in response to Item 7A will provide the SEC "with details regarding other business activities in which the adviser and its affiliates are engaged, which would permit [the SEC] to identify conflicts that the adviser may have with its clients that may suggest significant risks to those clients."[9]
- **Item 7B and Section 7B of Schedule D – Private Funds.** The Implementing Release adopted a revised Item 7B, which requires both registered and exempt reporting advisers to state whether they advise private funds. Advisers to private funds must then make a Section 7B of Schedule D filing for each such private fund, which requires disclosure of substantial information about the fund, including, among other things, its jurisdiction of organization, general partners, managers, trustees or directors, beneficial ownership, service providers, reliance on Regulation D offerings, and current gross asset value.

  Advisers that use a numerical or alphabetical code on their books and records to preserve the anonymity of private fund clients may report the same code on Schedule D in place of the private funds' names. The amendments to Form ADV set forth in the Implementing Release also put in place certain procedures to avoid dual reporting where a private fund may use subadvisers or is part of a master-feeder structure. In addition, a non-U.S. adviser (i.e., an adviser with a principal office and place of business outside the United States) is not required to complete Schedule D for any private fund that, during the adviser's last fiscal year, was not a U.S. person, beneficially owned by a U.S. person, or offered in the United States. This new regime represents a substantial increase in the reporting requirements of private fund advisers—a fact that led two of the five SEC Commissioners to vote against its adoption.

9. Implementing Release at 46.

- **Item 10 – Control Persons.** An exempt reporting adviser must disclose the identity of every person who directly or indirectly controls the adviser or its management policies. Form ADV defines "control" as the power, directly or indirectly, to direct the management or policies of a person, whether through ownership of securities, by contract or otherwise, and presumes control upon ownership of 25% of the adviser's voting interests.
- **Item 11 – Disclosure Information.** An exempt reporting adviser must disclose its disciplinary history as well as that of its employees.

Other Considerations

- Exempt reporting advisers must file their initial Form ADV reports through IARD between January 1, 2012 and March 30, 2012.
- Under Rule 204-1, as amended by the Implementing Release, an exempt reporting adviser would be required to amend its Form ADV annually within 90 days of its fiscal year-end.
- Information in Items 1, 3, and 11 that becomes inaccurate in any way must be promptly updated. Information in Item 10 that becomes materially inaccurate must be promptly updated.
- Advisers no longer operating as exempt reporting advisers (due to voluntary registration, cessation of business, or failure to continue to qualify for the applicable exemption) must file a "final report" with the SEC, which will permit the SEC to distinguish between compliant and noncompliant exempt reporting advisers.
- An SEC-registered adviser that is deregistering in reliance on the private fund adviser exemption must file a Form ADV-W to withdraw its SEC registration prior to submitting its first exempt reporting adviser report.
- Non-U.S. advisers relying on the private fund adviser exemption from registration will be able to appoint the Secretary of the SEC as agent for service of process under Form ADV-NR.
- An exempt reporting adviser that is unable to electronically file Form ADV due to technical difficulties may request a seven-business-day temporary hardship exemption.
- An exempt reporting adviser will have to pay a filing fee, which is expected to range from $40 to $225 based on its assets under management.
- In the proposing release, the SEC noted that because private fund advisers are not "specifically exempt" from the registration requirement under Section 203(b) of the Advisers Act, their books and records will still be subject to SEC examination under Section 204(a). The books and records of foreign private advisers, on the other hand (as further discussed below), which are specifically exempt from registration under Section 203(b)(3), would not be subject to SEC examination. In the Implementing Release and in SEC Chairman Mary L. Schapiro's speech regarding the adoption of the Exemptions and Implementing Releases, it was noted that the SEC does not expect to conduct regular compliance examinations of exempt reporting advisers, although it retains the authority to do so.[10]

10. *See* Remarks by Chairman Schapiro: Opening Statement at SEC Open Meeting: Dodd-Frank Act Amendments to the Investment Advisers Act (June 22, 2011), *available at* http://www.sec.gov/news/speech/2011/spch062211mls-items-1-2.htm ("In addition, although the law enables the Commission to examine these 'exempt but reporting advisers,' we do not intend to conduct routine examinations of them. As many observers know, the Commission has scarce resources, and it is important therefore that we target those resources toward the advisers that are actually registered with us, where the investing public expects us to be focused. At the same time, if there are indications that we should conduct an on-site visit of an exempt but reporting investment adviser, we legitimately and appropriately will have the ability to do so.").

- Chairman Schapiro, in her remarks announcing the Exemptions and Implementing Releases, indicated that the SEC staff would revisit the exempt reporting adviser disclosure regime after receiving the first year's filings to determine whether any adjustments are necessary or if the staff is not receiving sufficient information.
- The Implementing Release noted that the SEC will address recordkeeping requirements for exempt advisers in a future release.[11]

SECTIONS 202(a)(30) AND 203(b)(3) AND RULE 202(a)(30)-1: EXEMPTION FOR "FOREIGN PRIVATE ADVISERS"

The Dodd-Frank Act amended Section 203(b)(3) of the Advisers Act to provide an exemption from registration for "foreign private advisers," as defined in Section 202(a)(30) of the Advisers Act. As a practical matter, this exemption applies only to foreign advisers that do not otherwise qualify for the private fund adviser exemption set forth in Section 203(m) of the Advisers Act and Rule 203(m)-1(b). An adviser with no place of business in the United States will nonetheless be required to register with the SEC if, among other things, (i) it holds itself out to the public in the United States as an investment adviser, or (ii) (a) it has 15 or more clients and private fund investors in the United States or (b) it has $25 million or more of assets under management from clients/investors in the United States regardless of the number of its clients/investors.[12] In the Exemptions Release, the SEC adopted Rule 202(a)(30)-1, which defines certain terms used in the definition of "foreign private adviser" set forth in Section 202(a)(30).

Counting Investors

Rule 202(a)(30)-1 implements certain client counting rules, similar to those that currently appear in Rule 203(b)(3)-1 under the Advisers Act. Under Rule 202(a)(30)-1, a foreign private adviser may treat as a single person a natural person combined with any of the following: (1) the natural person's minor children (regardless of principal residence); (2) any relative, spouse, spousal equivalent, or relative of the spouse or spousal equivalent of the natural person (with the same principal residence); and (3) all accounts or trusts of which the natural person and/or the natural person's minor child, spouse, spousal equivalent, relative, or relative of the spouse or spousal equivalent are the only primary beneficiaries. Rule 202(a)(30)-1 also permits a foreign private adviser to count a corporation, general partnership, limited partnership, limited liability company, trust, or other legal organization as a single client. Two or more legal organizations with identical shareholders, partners, limited partners, members, or beneficiaries could also be treated as a single client under Rule 202(a)(30)-1.

Unlike Rule 203(b)(3)-1, Rule 202(a)(30)-1 requires a foreign private adviser to count clients that do not pay compensation to the foreign private adviser. In addition, Rule 202(a)(30)-1 specifies that a foreign private adviser need not count a private fund as a client if the foreign private adviser counted any investor in the private fund when determining whether it qualifies for the exemption and need not count

---

11. *See* Implementing Release at n.163. Section 204(b) of the Advisers Act, as amended by the Dodd-Frank Act, states that the SEC may require registered investment advisers to maintain records and file reports regarding the amount of assets under management, use of leverage (including off-balance-sheet leverage), counterparty credit risk exposure, trading and investment positions, trading practices, valuation policies and practices, types of assets held, and side arrangements.

12. A person that is "in the United States" would not be treated as such if the person was not in the United States at the time the person became a client of the foreign private adviser or, if the person is an investor in a private fund advised by the adviser and each time the person acquired securities issued by the private fund, the person was not in the United States. In other words, a foreign private fund investor that moves to the United States would not be treated as a U.S. person so long as such investor did not subsequently acquire securities of the private fund after moving to the United States.

a person as an investor in a private fund advised by the adviser if the adviser counts such person as a client in the United States.

Rule 202(a)(30)-1 also defines "investor" as any person who would be included in determining the number of beneficial owners of a private fund's outstanding securities under Section 3(c)(1) of the 1940 Act or any person who would be included in determining whether a private fund's outstanding securities are owned exclusively by qualified purchasers under Section 3(c)(7) of the 1940 Act. The rule permits a foreign private adviser to count an investor in two or more private funds advised by the foreign private adviser as a single investor. These definitions would prevent foreign private advisers from using nominee accounts to circumvent the registration requirement. Further, because Sections 3(c)(1) and 3(c)(7) of the 1940 Act refer to beneficial owners and owners, respectively, of "securities," holders of both equity and debt securities would be counted as "investors" under Proposed Rule 202(a)(30)-1.[13]

The SEC in the Exemptions Release also sets forth certain examples in which a foreign private adviser would have to "look through" nominal owners to count the number of investors.[14] A foreign private adviser to a master fund in a master-feeder fund structure would have to count holders of securities of any feeder fund as investors. If the record owner of private fund shares has transferred the risk of investment in the private fund to a third party (i.e., through a total return swap), then the third party would be counted as an investor. Beneficial owners of short-term paper issued by the private fund would also be counted as investors. In the aggregate, these inclusions of "investors" have the effect of significantly narrowing the foreign private adviser exemption from registration with the SEC. Unlike the proposed rule, the adopted rule does not treat beneficial owners who are knowledgeable employees of the fund as investors.[15]

It would appear from the Dodd-Frank Act and Rule 202(a)(30)-1 that a foreign adviser only has to look through the adviser's funds that constitute "private funds." Therefore, the adviser's funds that are not offered in the United States and do not need to rely on exemptions from the 1940 Act may continue to have U.S. investors (assuming the admission of the investors was otherwise in compliance with the 1940 Act), without those investors being counted against the adviser's 14-U.S.-investor limit or the adviser's \$25-million-in-U.S.-assets-under-management limit. In a fund-of-funds arrangement, a private fund that invests in another private fund and is managed by a non-U.S. adviser solely from an offshore location would not constitute a U.S. client of the private fund in which it invests, even if the underlying private fund had U.S. person investors. From a practical standpoint, however, it would be difficult for an adviser to have U.S. investors in such other products and still comply with the requirements that it have no U.S. place of business and not hold itself out as an investment adviser to the U.S. investing public.

TREATMENT OF SUBADVISORY RELATIONSHIPS AND ADVISORY AFFILIATES

In the Exemptions Release, the SEC noted that subadvisers to private funds that satisfy the requirements of Rule 203(m)-1 may rely on the exemption from registration, despite technically having contractual privity with the adviser and not with the private funds themselves (and thereby having a non–private fund client in the form of the adviser).

13. Citing Section 2(a)(36) of the 1940 Act, the SEC noted in the Exemptions Release that "securities" is broadly defined to include both debt and equity securities. *See* Exemptions Release at n.439 and accompanying text.

14. *See* Exemptions Release at 108–15.

15. Rule 3c-5 under the 1940 Act excludes from the determinations of Sections 3(c)(1) and 3(c)(7) securities beneficially owned by knowledgeable employees of a fund, funds owned exclusively by knowledgeable employees, and, in certain circumstances, holders of fund securities that were acquired from a knowledgeable employee.

The SEC also noted that the activities of advisory affiliates need not be considered in determining whether an adviser fits an exemption from registration, but that two or more affiliates that are "separately organized but operationally integrated" would be treated as a single adviser. This would disallow organizational structures designed to circumvent registration requirements (i.e., an adviser to $200 million of private fund assets splitting into two advisers, each with $100 million of private fund assets).

For non-U.S. advisory affiliates, however, the SEC noted that nothing in the Exemptions Release withdraws the prior statements of the SEC or its staff set forth in the *Unibanco* line of no-action letters.[16] The *Unibanco* line of no-action letters generally states that the SEC will not recommend enforcement action if (a) neither a foreign bank nor certain of its affiliates register under the Advisers Act if they share certain personnel with, and provide certain services to, a U.S.-registered adviser; or (b) a non-U.S. registered adviser provides investment advisory services to its clients who are not residents of the United States solely in accordance with the laws of its home jurisdiction (or other applicable foreign law) without also complying with the substantive provisions of the Advisers Act. The SEC noted that it expects the SEC staff to provide appropriate guidance as to the application of the *Unibanco* letters in the context of the new foreign private adviser and private fund adviser exemptions. Under this regime, a foreign adviser will not need to treat U.S. investors in the adviser's offshore funds as "clients in the U.S." because the fund is not a U.S. client (and the investors are not clients), but will have to treat standalone funds and feeder funds as U.S. clients if the funds are organized under U.S. law. This may create an incentive for organizing U.S.-targeted funds in offshore jurisdictions.

PRACTICAL CONSIDERATIONS

For U.S. Advisers to Private Funds

Hedge fund and private equity fund managers in the United States will now have to register with the SEC if they exceed the $150-million-in-U.S.-assets-under-management threshold, and thus will become subject to the Advisers Act—just as if they managed separate accounts of individuals or institutions. Managers in the United States that have less than $150 million in assets under management must register with their state regulators if such registration is so required. Many states, such as Florida and New York, have broad exceptions that will allow managers to operate without registering.

Private fund advisers will need to revisit their valuation and recordkeeping methodologies to ensure that they comply with the instructions on how to calculate an adviser's assets under management, as amended by the Implementing Release, set forth in Instruction 5(b) to Part 1A of Form ADV. Advisers must use the same methodologies for determining eligibility of the private fund advisers exemption, reporting account valuation information to private fund clients and reporting assets under management to the SEC on Form ADV.

It is also unclear whether the general partners of private funds will also need to register with the SEC or state regulators when they meet the definition of "adviser" because they provide limited advice to the private funds and are affiliated with the registered adviser to the funds. We presume that the SEC staff will continue to view them as "persons associated with an investment adviser" under Section 202(a)(17) of the Advisers Act, which would obviate their need to register separately as advisers.

For Foreign/Non-U.S. Advisers to Private Funds

16. *Uniao de Banco de Brasileiros S.A.*, SEC No-Action Letter, 1992 SEC No-Act. LEXIS 817 (July 29, 1992).

Foreign investment advisers gain substantially from the adoption of the rules set forth in the Exemptions Release because they have two chances to qualify for exempt status. Foreign advisers that cannot meet the narrow requirements of the foreign private adviser exemption from registration under Section 203(b)(3) may still be able to meet the non-U.S. private fund adviser exemption under Section 203(m) and Rule 203(m)-1(b) thereunder. It would be preferable for a foreign adviser to qualify as a foreign private adviser because foreign private advisers are not subject to any reporting requirements or SEC examination. Foreign private advisers also would not be subject to any recordkeeping rules that the SEC has indicated it will propose for exempt reporting advisers. Nonetheless, the restrictions of the foreign private adviser exemption—a limit on U.S. subscriptions to fewer than 15 investors and less than $25 million in assets under management—are tightly drawn and many foreign advisers will not be able to both fit the foreign private adviser exemption and participate in the U.S. market. In sum, to participate in the U.S. market beyond $25 million in assets, a foreign adviser will be subject to at least SEC reporting requirements as an exempt reporting adviser, and to participate beyond $150 million in assets, a foreign adviser will likely also be subject to SEC registration requirements.

Additional Information

If you have any questions or would like more information on the issues discussed in this LawFlash, please contact the authors, **Ethan W. Johnson** (305.415.3394; ejohnson@morganlewis.com), **Monica L. Parry** (202.739.5692; mparry@morganlewis.com), **Trina C. Winkelmann** (202.739.5254; twinkelmann@morganlewis.com), and **John J. O'Brien** (215.963.4969; jobrien@morganlewis.com), or any of the following Morgan Lewis attorneys:

New York		
Louis H. Singer	212.309.6603	lsinger@morganlewis.com
Jedd H. Wider	212.309.6605	jwider@morganlewis.com
Philadelphia		
Timothy W. Levin	215.963.5037	tlevin@morganlewis.com
San Francisco		
Paul C. McCoy	415.442.1385	pmccoy@morganlewis.com
Peter M. Phleger	415.442.1096	pphleger@morganlewis.com
Washington, D.C.		
Thomas S. Harman	202.739.5662	tharman@morganlewis.com
Steven W. Stone	202.739.5453	sstone@morganlewis.com

In addition, Morgan Lewis's multidisciplinary Financial Regulatory Reform resource team is available to assist with a wide range of issues and areas of concern related to the reform effort. You can access a complete collection of the firm's updates and alerts on the subject on our website's Financial Regulatory Reform page.

About Morgan, Lewis & Bockius LLP

With 22 offices in the United States, Europe, and Asia, Morgan Lewis provides comprehensive transactional, litigation, labor and employment, regulatory, and intellectual property legal services to clients of all sizes—from global Fortune 100 companies to just-conceived startups—across all major industries. Our international team of attorneys, patent agents, employee benefits advisors, regulatory scientists, and other specialists—nearly 3,000 professionals total—serves clients from locations in Beijing, Boston, Brussels, Chicago, Dallas, Frankfurt, Harrisburg, Houston, Irvine, London, Los

Angeles, Miami, New York, Palo Alto, Paris, Philadelphia, Pittsburgh, Princeton, San Francisco, Tokyo, Washington, D.C., and Wilmington. For more information about Morgan Lewis or its practices, please visit us online at www.morganlewis.com.

IRS Circular 230 Disclosure
To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing, or recommending to another party any transaction or matter addressed herein. For information about why we are required to include this legend, please see http://www.morganlewis.com/circular230.