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What you need to know about the changes to the U.S. Investment Advisers Act after Dodd-Frank: How to become a U.S. registered adviser or confirm an available exemption

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Non-U.S. advisers to private investment funds with U.S. investors and/or to U.S. clients, may be required to register with the U.S. Securities and Exchange Commission (the "SEC") under the U.S. Investment Advisers Act of 1940 (the "Advisers Act"), in light of the U.S. Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), unless they qualify for an exemption. Prior to Dodd-Frank, an exemption from registration was readily available for non-U.S. advisers with fewer than 15 U.S. "clients," without the need to count as clients any U.S. investors in their private fund. A more detailed description of the new rules can be found here.

Focusing on the important questions

Dodd-Frank eliminated the prior exemption and replaced it with two more narrowly defined exemptions potentially available to non-U.S. advisers. This means all non-U.S. advisers with a direct or indirect link to U.S. clients and investors need to know the answers to a number of important questions:

- Does the adviser qualify for a full or partial exemption from SEC registration?
- What would the adviser need to do to register under the Advisers Act?
- What are the adviser's ongoing compliance requirements?

Underlying each of these questions is the need to understand the potential regulatory consequences, the resources and costs required, and to what extent the outcome will impact the adviser's business.

Clarifying a non-U.S. adviser's position under the Advisers Act

Each non- U.S. adviser with a nexus to the United States by virtue of having one or more U.S. clients, or through U.S. investors in one or more private funds advised by such non-U.S. adviser, will necessarily fall into one of three categories with respect to the Advisers Act:

- Those qualifying for the new “Foreign Private Adviser” exemption that are exempt entirely from any SEC registration, reporting and oversight

- Those qualifying for the new “Private Fund Adviser” partial exemption that are exempt from SEC registration but are subject to limited SEC ongoing reporting requirements and SEC oversight

- Those not qualifying for either exemption that are required to be registered at the U.S. federal level under the Advisers Act and comply with ongoing reporting requirements and SEC oversight

If a non-U.S. adviser does not currently know which category it falls under, an analysis of its status, organization structure and client base should be undertaken immediately with counsel to ensure compliance with the Advisers Act. Each non-U.S. adviser should determine whether it qualifies for the Foreign Private Adviser exemption or the Private Fund Adviser partial exemption, or is required to register with the SEC under the Advisers Act.

How do you qualify for the Foreign Private Adviser exemption?

In order to qualify for the Foreign Private Adviser exemption, a non-U.S. adviser must meet each of the following requirements: • It has no place of business in the United States

- It has a total of fewer than 15 clients and private fund investors in the United States

- It has assets under management attributable to such clients and private fund investors of less than $25 million

- It does not hold itself out generally to the U.S public as an investment adviser

If a non-U.S. adviser qualifies for the Foreign Private Adviser exemption, then it is able to conduct its business without registering under the Advisers Act or subjecting itself to ongoing reporting and other compliance requirements. The adviser will still be responsible, however, for complying with the anti-fraud provisions of the U.S. federal securities laws.

How do you qualify for the Private Fund Adviser partial exemption?

To qualify, an adviser must ensure that each of its U.S. clients is a “qualifying private fund” and that the adviser has less than $150 million in assets under management. A number of rules apply as to how to count investors and clients, but generally the rules follow existing interpretations under the U.S. Investment Company Act of 1940.

Unlike the Foreign Private Adviser exemption, non-U.S. advisers that qualify for the Private Fund Adviser exemption must still meet certain ongoing reporting requirements and are subject to

SEC oversight, although registration is not required. The size, number and nature of a non-U.S. adviser's clients, assets or other business activities outside the United States will not affect the availability of the exemption. In addition, the methodology for calculating the amount of U.S. assets under management is based upon a number of SEC interpretations.

In general, any non-U.S. adviser with a place of business in the United States must only count the assets of the private funds it manages at such place of business for purposes of determining whether it has less than $150 million in assets under management in order to rely on the Private Fund Adviser exemption. On the other hand, a non-U.S. adviser without a place of business in the United States may rely on the Private Fund Adviser exemption without consideration of the size of its investments managed from outside the United States.

Non-U.S. advisers that qualify for the Private Fund Adviser exemption are subject to the recordkeeping and reporting requirements applicable to exempt reporting advisers, and remain subject to the anti-fraud provisions of the U.S. federal securities laws. This entails providing certain identifying information, other business activities, financial industry affiliations, information about private funds advised, and identities of all control persons and their disciplinary history.

What should you do if you need to register under the Advisers Act?

Non-U.S. advisers who don't meet the terms of the Foreign Private Adviser exemption or the Private Fund Adviser exemption will need to register and take the following steps to comply with the requirements imposed on registered investment advisers:

- ***Registration on Form ADV*** To register, an adviser must complete Form ADV, which requires substantial disclosures to the SEC and to the adviser's clients. Form ADV must be updated at least annually and, with respect to certain key information, at the time of certain changes in the reported information.

- ***Disclosures to adviser's clients*** "Part 2" of Form ADV, or the "brochure," calls for substantial narrative description of the adviser's business, products, management, material adverse financial or disciplinary matters, conflicts of interest, and policies designed to address conflicts of interest. Advisers are required to deliver their brochure to advisory clients annually. The brochure is often used as a means of conveying other required disclosures, such as privacy policies.

- ***Adoption of a comprehensive compliance programme*** Registered advisers must adopt written policies and procedures designed to prevent violation of the Advisers Act and its rules. Such written policies must be reviewed at least annually for adequacy and effective implementation, and a chief compliance officer must be appointed to oversee their administration.

- ***Adoption of an anti-insider trading policy*** Registered advisers must have a policy designed to ensure that material, non-public information is not misused in violation of the

Advisers Act or the other U.S. federal securities laws. This may entail (i) circulating a written policy to all employees, (ii) drafting employee training programs, (iii) creating physical and organizational information barriers, (iv) maintaining restricted lists, watch lists, and rumor lists, and/or (v) maintaining a procedure for monitoring client and personal trades.

- ***Adoption of code of ethics and personal trading policy for access persons*** These policies are considered critical to managing conflicts of interest and other regulatory and fiduciary objectives. Access persons must report their personal securities holdings and transactions. Some access persons must also obtain pre-clearance before participating in, and may be barred from investing in, initial public offerings and limited offerings.

- ***Subject to SEC examination authority*** The SEC conducts periodic examinations of registered advisers. Registrants will benefit from staying abreast of “hot topics” and periodic SEC staff statements about the focus of the SEC’s examination program.

- ***Recordkeeping obligations*** The Advisers Act imposes requirements with respect to adviser records substantiating the basis of performance claims and other records reflecting the relationship between the adviser and its clients. Certain private fund records must also be maintained. These records include assets under management, the use of leverage, counterparty credit risk exposure, trading and investment positions, valuation policies, side arrangements or side letters, trading practices, and any other subjects deemed necessary for the public interest, investor protection, or the assessment of systemic risk.

- ***Compliance with anti-fraud laws*** The Advisers Act generally prohibits a wide range of fraudulent, deceptive and manipulative conduct, and conduct that has fraudulent, deceptive or manipulative results, whether intentional or not. Rules under the Advisers Act extend these protections to investors in the adviser’s private funds. In addition to the anti-fraud provisions of the Advisers Act, advisers may be subject to the anti-fraud and manipulation provisions of the other federal securities laws, such as section 17(a) of the U.S. Securities Act of 1933, and Rule 10b-5 under the U.S. Securities Exchange Act of 1934. (Note that these obligations apply to registered and unregistered advisers alike.)

- ***The custody rule*** The Advisers Act imposes specific measures registered advisers must take to safeguard client assets over which the adviser has, or is deemed to have, custody. These steps include maintenance of client assets with a “qualified custodian” and submission to an annual surprise examination by an independent public accounting firm (or the issuance of annual audited financial statements by private funds advised by the adviser.)

How do you plan a cost-effective way forward in the post-Dodd-Frank environment?

Reed Smith has a team of lawyers dedicated to helping our non- U.S. adviser clients analyze and apply the new and complex set of registration exemptions Dodd-Frank has brought upon us. We are dedicated to making sure your costs are fixed, and that you know your compliance obligations. In the Nordic and Baltic Region, we are working with Magnusson's law firm to assist clients in understanding and fulfilling the regulations being adopted pursuant to Dodd-Frank. For assistance in analyzing the effect of these changes on your advisory business, please contact the authors of this *Client Alert* or your local Magnusson's attorney.