Indiana Advisers to Private Funds – Importance of State Law Registration Requirement

May 15, 2011 by Mark Barnes

Managers of private investment funds in Indiana until 2008 were often – quite legally – unregistered under securities laws as "investment advisers". This was because both federal and Indiana securities laws until July 1, 2008 exempted investment advisers from registration if those advisers had fewer than a certain number of clients within their jurisdictional borders. Although a fund typically would have a number of investors that exceeded those minimums, the fund itself in most cases was "the client" and so counted as only one client.

In 2008, Indiana law was changed to eliminate the exemption for these so-called private advisers with the result that a manager with offices in Indiana that had even one fund under management was potentially required to register with the Indiana Securities Division, unless registered with the U.S. Securities and Exchange Commission as an investment adviser. In 2008, Indiana Securities Commissioner Naylor adopted a no-action policy statement that offered some relief against the potential for Indiana Securities Division enforcement – but no relief from potential private investor claims – for unregistered advisers to certain "venture capital" funds as narrowly defined by the no-action policy.

In 2010, the federal Dodd-Frank Wall Street Reform and Consumer Protection Act amended the federal Investment Advisers Act of 1940 to eliminate the minimum number of clients exemption, with the effect that advisers to most private funds (including hedge funds and private equity funds) would henceforth be required to register with the Securities and Exchange Commission under the federal law. The Dodd-Frank Act, however, also created certain narrow exemptions for fund managers, including exemptions for advisers that exclusively advise venture capital funds and for private fund advisers with less than $150 million in assets under management in the United States.

These Dodd-Frank amendments will take effect on July 21, 2011 but the SEC staff has advised (in an April 2011 letter linked at the end of this SEC explanation here) that the compliance date for registration of private fund advisers with the SEC will likely be extended until the first quarter of 2012.

Advisers to Indiana private funds with offices in Indiana, however, are potentially subject to registration requirements under Indiana's securities law at present, due to the 2008 change in Indiana law. Private fund advisers in Indiana that seek to register under Indiana law will also be required to comply with investment adviser representative licensing and associated examination requirements, and with Indiana's rule prohibiting performance fee payments to a registered adviser (unless exempted by a separate performance fee rule or by an order of the Commissioner).

If a registered Indiana adviser is ultimately required to register with the SEC under the federal law, then that adviser will be eligible to deregister under the Indiana law, because

federally-registered advisers (but not their individual representatives) are exempt from the Indiana registration requirements. The converse is not true, however – just because a private fund adviser may qualify for a federal exemption (for instance, by reason of the $150 million AUM limit), it is not for that reason also eligible to claim an exemption from Indiana's requirements.

Barnes Law Online expects to report further on hedge fund and other private fund compliance issues including the SEC rulemaking and compliance guidance as events occur. Indiana advisers to private funds should, however, consult with Indiana counsel now if they have not registered with the Indiana Securities Division on the belief that exemption under federal law would confer exemptive treatment under Indiana law or were unaware of the 2008 change in Indiana.