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# Private Equity and Hedge Fund Advisers Facing Registration under Dodd-Frank. What about Venture Capital Fund Advisers?

**By Cory White[1]**

Slowly but surely times are changing. As part of the regulatory upswing under the Dodd-Frank Wall Street Reform and Consumer Protection Act, advisers to certain private funds will have to register with and report to the SEC. This means that certain private equity, hedge, and venture capital fund advisers who could have once escaped SEC registration will no longer be so lucky. Although there are still exemptions built into the Dodd-Frank provisions, they are much more restrictive, in terms of who can use them. With the SEC set to announce new rules concerning registration and reporting, it's time to brush up on the basics and look to the future. As is often the case, time and regulatory law-making waits for no man or woman or, in this case, adviser.

## Investment Adviser Registration – The Basics

Under the Investment Advisers Act of 1940 (Advisers Act) if a person (1) for compensation (2) as part of his/its business (3) provides advice, makes recommendations, issues reports, or furnishes analyses on securities to other persons, either directly or through publications, such person is considered an investment adviser under the Advisers Act.[2] This determination requires the person to register with the SEC and any number of state agencies.[3] Registration with the SEC means the registrant is open to periodic reporting requirements and examinations.[4]

## Exemption from Registration Prior to Dodd-Frank – Everything Old is Old Again

Prior to the passage of Dodd-Frank, which amends the Advisers Act, investment advisers who operated in one state or who managed the assets of small "private funds" could have escaped registration by relying on certain exemptions. Under the old intrastate exemption, if the (1) adviser only advised clients in the state in which the adviser maintained his/its principal place of business and (2) did not furnish advice or issue analysis or reports on securities listed (or traded) on any national securities exchange, the adviser did not have to register with the SEC.[5] Under the old private funds exemption, if the adviser (1) had fewer than fifteen clients, (2) did not hold himself/itself out generally to the public as an adviser, and (3) did not act as an adviser to a registered investment company under the Investment Company Act, such adviser did not have to register with the SEC.[6] This latter exemption primarily kept advisers to smaller hedge funds,

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[2] 15 U.S.C. 80b-2(a)(11). For more detail on the specifics of each of these factors see "General Information on the Regulation of Investment Adviser," available on the SEC website at http://www.sec.gov/divisions/investment/iaregulation/memoia.htm#req.
[3] 15 U.S.C. § 80b-3(a).
[4] 15 U.S.C. § 80b-4.
[5] 15 U.S.C. § 80b-3(b)(1).
[6] 15 U.S.C. § 80b-3(b)(3).

private equity funds, and venture capital funds from having to register with the SEC. Congress, through painstaking compromise, has filled in the space in what it has deemed to be a gap in regulation through amendments to the Advisers Act noted below. Congress has characteristically left the SEC (and in some cases the CFTC) with rule making responsibilities necessary to flesh out the specifics of the new legislation.

Dodd-Frank Changes – SEC Rule Making is Upon Us

Under Dodd-Frank both the intrastate exemption and the old private funds exemption have been limited. In doing so, Dodd-Frank specifically defines a "private fund" as an issuer that would be an investment company but for Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act.[7]

As to the intrastate exemption, the exemption no longer applies to advisers who advise private funds, as such funds are defined by Dodd-Frank.[8] As to the old private funds exemption, the exemption is no longer based on whether or not the adviser has fifteen or fewer clients.[9] Now, a private fund adviser is exempt from registration only if such adviser acts solely as an adviser to private funds and has less than $150,000,000 assets under management,[10] i.e. the securities portfolios with respect to which the investment adviser provides continuous and regular supervisory and/or management services.[11] Dodd-Frank also specifically exempts certain foreign private fund advisers from registration.[12] Even with the exemption from registration, private fund advisers will still have to report to the SEC and be open to inspection, as specified by SEC rule making.[13]

The SEC has been charged with rule-making in order to further clarify and explain these new exemptions as well as create specific registration and examination procedures for advisers to "mid-sized" funds, to the extent necessary to mitigate any systemic risks while balancing the burden placed on these advisers.[14] In a recent letter from Mr. Robert E. Plaze, associate director of the Division of Investment Management, to Mr. David Massey, President of the North American Securities Administrators Association, Mr. Plaze noted that the SEC will issue final rules on these matters in advance of July 21, 2011.[15] Mr. Plaze did note that advisers will have until the first quarter of the 2012 to come into compliance with all the new registration requirements.[16]

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[7] Dodd Frank Wall Street Reform and Consumer Protection Act of 2010 § 402(a). For further clarification see Section 3 of the Investment Company Act of 1940.
[8] Dodd-Frank, § 403.
[9] Dodd-Frank, § 403.
[10] Dodd-Frank, § 408.
[11] See 15 U.S.C. § 80b-3a for the definition of "assets under management."
[12] Dodd-Frank, § 403(2).
[13] Dodd-Frank, § 408.
[14] Dodd-Frank, § 408.
[15] Letter from Robert Plaze to David Massey, Concerning Dodd –From Rule Making (US Securities and Exchange Commission, April 8, 2011).
[16] Letter from Robert Plaze to David Massey, Concerning Dodd –From Rule Making (US Securities and Exchange Commission, April 8, 2011).

Effect on Venture Capital Fund Advisers – The Importance of Definitions

Dodd-Frank has specifically carved out an exemption from the registration (but not the reporting and examination) requirement for "venture capital" fund advisers. Under Dodd-Frank, advisers who provide advice solely to one or more venture capital funds do not have to register under the Advisers Act.[17] The SEC, by July 21, 2011 must decide how to define "venture capital fund."[18] As with most regulatory issues, how things are defined are of the utmost importance. K. Susan Grafton, Of Counsel at Gibson, Dunn, & Crutcher LLP and writing for Insights: The Corporate and Securities Law Advisor, poses an interesting question.[19] Will the definition be broad enough to include funds that have commonly labeled themselves as private equity or real estate funds?[20] Only time will tell, but that time is fast approaching.

What This All Means – Or Doesn't Mean

As of the date of this article's publication nothing said above carries any dramatic weight, because the laws and accompanying rules and regulations have not gone into effect. But come summer of 2011, all advisers to private funds, such as hedge funds, venture capital funds, and private equity funds, need to carefully go over what is required of them, both on a federal and state level. Counsel to any of the aforementioned should begin to decipher what will be required under Dodd-Frank and then revisit the issue when the new SEC rules are released in July. Counsel should get familiar with the forms that she needs to use, how she needs to file, exactly when she needs to file, where she needs to file, and what she needs to file. Advance preparation generally means less perspiration.

[17] Dodd Frank, § 407.
[18] Dodd Frank, § 407.
[19] K. Susan Grafton, "Private Fund Investment Advisers Registration," Insights: The Corporate and Securities Law Advisor, Vol. 24 No. 9, September 2010 (Aspen Publishers) at 40.
[20] K. Susan Grafton, "Private Fund Investment Advisers Registration," at 40.