Wilson Sonsini Goodrich & Rosati
PROFESSIONAL CORPORATION

WSGR ALERT

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SEC ADOPTS DODD-FRANK ACT AMENDMENTS TO THE INVESTMENT ADVISERS ACT RULES TO EXEMPT VENTURE CAPITAL FUNDS

Summary

On June 22, 2011, the Securities and Exchange Commission (SEC) adopted new rules to implement Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Title IV increases the supervision of the previously unregulated hedge fund industry, while largely leaving the status quo in place for venture capital funds.[1]

After a grace period, these new rules will require hedge funds to register with the SEC. Once registered, hedge funds will have to comply with certain restrictions and reporting requirements.[2]

Venture capital funds will not have to register, but beginning on July 21, 2011, they will have to file reports with the SEC detailing basic identifying information, conflicts of interest, and disciplinary history, if any.

These new rules operate by simultaneously repealing and issuing a set of exemptions to the federal securities laws. Private funds, which include hedge funds, venture capital funds, private equity funds, and other types of pooled investment vehicles, have historically been exempt from the laws that regulate investment vehicles, which include the Investment Company Act (ICA) and the Investment Advisers Act of 1940 (IAA). Title IV repeals the old exemptions, but simultaneously reinstates narrower exemptions for venture capital funds and certain other private funds.

Regulation of Private Funds under the Old Rules: The Investment Advisers Act and the Investment Company Act of 1940

Prior to the adoption of Title IV, the IAA and ICA imposed registering and reporting obligations and other broad restrictions on investment advisers but exempted private fund advisers (i.e., those with fewer than 15 clients that did not advertise their services to the general public) from these requirements. Advisers to mutual funds and other funds open to the general public had to register with the SEC, report certain information about their practices, and refrain from certain strategies. Advisers to hedge funds, venture capital funds, and other funds avoided the registration and other related requirements.

Regulation of Private Funds under the New Rules

Title IV repealed the "private adviser exemption" contained in the IAA, but instructed the SEC to provide new exemptions for:

- any adviser that acts solely as an adviser to one or more venture capital funds;
- any adviser that acts solely as an adviser to private funds with less than $150 million in assets under management in the United States; and
- certain foreign advisers without a place of business in the U.S.

Definition of a Venture Capital Fund

The SEC's new rules define a "venture capital fund" as a private fund that:

- holds no more than 20 percent of the fund's capital commitments in non-qualifying investments (other than short-term holdings) ("qualifying investments" consist of equity securities of "qualifying portfolio companies" that are directly acquired by the fund);
- does not borrow or otherwise incur leverage, other than limited short-term borrowing (excluding certain guarantees of qualifying portfolio company obligations by the fund);
- does not offer its investors redemption or other similar liquidity rights except in extraordinary circumstances;
- represents itself as pursuing a venture capital model strategy to its investors and prospective investors; and
- is not registered under the ICA and has not elected to be treated as a business development company.

This definition distinguishes venture capital funds from other types of private funds, mainly hedge funds and private equity funds.

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[1] *See* "Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers with Less than $150 Million in Assets Under Management and Foreign Private Advisers, Release No. IA-3222," available at http://www.sec.gov/rules/final/2011/ia-3222.pdf.
[2] *See* "Rules Implementing Amendments to the Investment Advisers Act of 1940, Release No. IA-3221," available at http://www.sec.gov/rules/final/2011/ia-3221.pdf.

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The new rules grandfather funds that began raising capital by the end of 2010 and represented themselves as pursuing a venture capital strategy into the definition of venture capital fund.

New Filing Requirements for Venture Capital Funds

While the new rules exempt venture capital funds from the majority of the requirements under the IAA, the rules do require venture capital fund managers to submit reports that are designed to provide the public with basic information about the advisers, and to inform the SEC if a particular adviser warrants further attention. Specifically, venture capital funds will need to report the following information to the SEC through its investment advisor electronic filing system (IARD):

- basic identifying information for the advisor, its owners, and affiliates;
- information regarding the private funds the advisor manages and other business activities that may create a conflict of interest or suggest significant risk to clients; and
- the disciplinary history (if any) of the advisor and its employees.

For any questions or more information on these or any related matters, please contact your regular Wilson Sonsini Goodrich & Rosati contact or any member of the firm's corporate and securities practice.

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