DechertOnPoint

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A legal update from Dechert's Financial Services Group

SEC Adopts Final Rules Regarding Investment Adviser Registration and Amends Form ADV

The Securities and Exchange Commission ("SEC") on June 22, 2011 adopted new rules and rule and form amendments under the Investment Advisers Act of 1940, as amended ("Advisers Act"), that are designed to implement and give effect to the provisions of Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").[1] Among other changes, the final rules adopted by the SEC ("Final Rules"): (i) establish new exemptions from Advisers Act registration and reporting requirements for certain advisers; (ii) extend the compliance date for registration of certain previously unregistered advisers until March 30, 2012; (iii) amend Form ADV; and (iv) reallocate regulatory responsibility for advisers between the SEC and the states.

Background

Effective July 21, 2011, the Dodd-Frank Act repeals the "private adviser exemption" currently set forth in Section 203(b)(3) of the Advisers Act, which many advisers to private funds and certain other clients have relied on in order to avoid registration with the SEC under the Advisers Act. The private adviser exemption has allowed an investment adviser to avoid SEC registration if, among other requirements, the adviser did not hold itself out to the public as an investment adviser and had fewer than 15 clients during the preceding 12 months. A private fund typically qualified as a single client for purposes of the private adviser exemption. Thus, advisers to private funds avoided registration under the Advisers Act by limiting themselves to advising a maximum of 14 private funds and other client accounts.[2] With the elimination of the private adviser exemption, these advisers generally will be required to register with the SEC, unless they can rely on another exemption.

The Dodd-Frank Act offers three new exemptions that are available to certain advisers that previously relied on the private adviser

1 The Final Rules were presented in two releases: *Rules Implementing Amendments to the Investment Advisers Act of 1940*, Release No. IA-3221 (June 22, 2011) ("Implementing Release"), *available at* www.sec.gov/rules/final/2011/ia-3221.pdf and *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 (June 22, 2011) ("Exemptions Release"), *available at* www.sec.gov/rules/final/2011/ia-3222.pdf. At the same time, the SEC adopted rules implementing the "Family Office Exception" provided by the Dodd-Frank Act: *Family Offices*, Release No. IA-3220 (June 22, 2011), available at http://www.sec.gov/rules/final/2011/ia-3220.pdf. The family office rule will be discussed in a separate *DechertOnPoint*.

2 *See also* Rule 203(b)(3)-1 (which was repealed by the Final Rules). In 2004, the SEC adopted rules that required advisers to "look through" certain funds to their investors in order to count the number of clients for purposes of the private adviser exemption in an attempt to subject many private fund advisers to SEC registration under the Advisers Act. However, in *Goldstein et al. vs. Securities and Exchange Commission*, Slip Op. No. 04-1434 (D.C. Cir. June 23, 2006), the Court of Appeals for the District of Columbia vacated those rules on the basis that the SEC had exceeded its authority to promulgate interpretive rules under the Advisers Act.

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exemption.[3] The following discussion reviews those exemptions and the table in Appendix A highlights the differing substantive obligations and reporting requirements under the Advisers Act for advisers relying on any of these exemptions.

Venture Capital Fund Exemption

Terms of Exemption

One exemption created by the Dodd-Frank Act is available to advisers that solely advise venture capital funds ("Venture Capital Fund Exemption"). The Final Rules define a "venture capital fund" as a private fund that:

- represents to investors that it pursues a venture capital strategy;
- holds, at the time of acquisition of any asset other than "qualifying investments" and short-term holdings, no more than 20% of the amount of the fund's aggregate capital contributions and uncalled committed capital ("Total Capital") in assets (other than short-term holdings) that are not "qualifying investments" ("Miscellaneous Assets");
- does not borrow, incur indebtedness, provide guarantees or otherwise incur leverage in excess of 15% of the fund's Total Capital, and any such borrowing, indebtedness, guarantee or leverage is for a non-renewable term of no longer than 120 calendar days;[4]
- does not offer its investors redemption or other similar liquidity rights except in extraordinary circumstances; and
- is not registered under the Investment Company Act of 1940, as amended ("1940 Act") and has not elected to be treated as a business development company.

Comments Shaped Final Rules

The proposed rules relating to the Venture Capital Fund Exemption drew significant comments suggesting that the proposal was too rigid and likely would prevent advisers to legitimate venture capital funds from relying on the Venture Capital Fund Exemption. To address these concerns, the Final Rules depart from the proposed rules in a number of important respects. Among the key features of the Final Rules are:

- **Introduction of a 20% Bucket for Miscellaneous Assets.** A number of comments to the proposed rules related to limitations on investments and the definition of a "portfolio company". By seeking to reflect a balance between (i) commenters' concerns that the rigidity of the proposed rules could result in inadvertent violations by venture capital funds, unnecessary limits on the investment discretion of advisers to venture capital funds or interfere with existing or evolving business practices and (ii) the SEC's concerns that "the cumulative effect of revising the rule to reflect all of the modifications supported by commenters could . . . expand the exemption beyond what we believe was the intent of Congress", the Final Rules allow a venture capital fund to make limited investments beyond qualifying venture capital investments and still be deemed a "venture capital fund" under the Final Rules. Thus, under the Final Rules, a venture capital fund may hold Miscellaneous Assets, provided that, immediately after the acquisition of any Miscellaneous Asset, a fund's Miscellaneous Assets (other than short-term holdings) represent no more than 20% of the venture capital fund's Total Capital. A venture capital fund may choose whether to calculate this 20% limit on Miscellaneous Assets based on the cost or fair value of its assets. But, once a method is chosen by a fund, it must be consistently applied to the fund's assets. Importantly, because the measurement of the 20% limit is made at the time of acquisition of a Miscellaneous Asset, a venture capital fund would not be required to dispose of a Miscellaneous Asset as a result of an increase in the value of that asset after acquisition. However, if the fund has chosen to base the measurement of its 20% limit on fair value rather than cost, increases in

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3 New Rule 203-1(e) provides transition relief allowing an adviser, in effect, to continue to rely on the private adviser exemption until March 30, 2012, provided that the adviser complies with the terms of that exemption (*i.e.*, has not had 15 or more clients during the prior 12 month period, does not hold itself out to the public as an investment adviser, and does not advise a registered investment company or business development company). Advisers whose business or marketing activities change before March 30, 2012, will need to consider whether they can continue to rely on the transition guidance.

Earlier registration may be required in order to accept additional clients or engage in broader marketing efforts. Additionally, the SEC noted that these new exemptions are not mandatory and, therefore, an adviser may register with the SEC if it meets the other registration criteria, even if such adviser may rely on an exemption.

4 As discussed below, certain guarantees are not subject to the 120 calendar day limit.

the fair value of existing Miscellaneous Assets could have the effect of filling the 20% Miscellaneous Asset bucket, thereby restricting the fund from acquiring new Miscellaneous Assets until existing Miscellaneous Assets are sold or depreciate in value.[5]

- **Qualifying Portfolio Companies.** Under the Final Rules, a "qualifying portfolio company" is any company that: (i) at the time of any investment by the venture capital fund, is not reporting or foreign-traded[6] and does not control, is not controlled by, or is not under common control with another company, directly or indirectly, that is reporting or foreign-traded; (ii) does not borrow or issue debt obligations in connection with the fund's investment in such company and does not distribute to the venture capital fund the proceeds of such borrowing or issuance in exchange for the venture capital fund's investment; and (iii) is not an investment company, a private fund, an issuer that would be an investment company but for the exemption provided by Rule 3a-7 under the 1940 Act, or a commodity pool.[7] The last prong of this definition is meant to ensure that qualifying portfolio companies are operating companies as opposed to investment companies.[8] While other types of entities excepted from the definition of an investment company under Section 3 of the 1940 Act could be qualifying portfolio companies, the Exemptions Release suggests that a fund whose strategy involves investment in the types of issuers that are excepted from the definition of an "investment company" (other than through Section 3(c)(1) or Section 3(c)(7) of, or Rule 3a-7 under, the 1940 Act) may bar its adviser from relying on the Venture Capital Fund Exemption.[9]

- **Qualifying Investments.** As under the proposed rules, not all investments in a qualifying portfolio company are qualifying investments.[10] Instead, qualifying investments must be equity securities[11] issued by: (i) a qualifying portfolio company

5 Because the 20% will be applied to current investments of the venture capital fund, liquidated Miscellaneous Assets are excluded from the calculation.

6 For these purposes, a reporting or foreign-traded company is any company that is subject to the reporting requirements under Sections 13 or 15(d) of the Securities Exchange Act of 1934, as amended ("Exchange Act"), or that has any security listed or traded on any exchange or organized market in a foreign jurisdiction, except in certain limited circumstances as discussed below.

7 This definition was adopted substantially as proposed, except that the Final Rules modify the qualifying portfolio company leverage criterion to define a qualifying portfolio company as any company that does not both (i) borrow (or issue debt) in connection with the venture capital fund's investment in the portfolio company and (ii) distribute the proceeds of such borrowing or issuance to the venture capital fund in exchange for the fund's investment. In effect, this allows a venture capital fund to provide financing, or a portfolio company to incur leverage, to be used for operational purposes such as financing inventory or equipment or meeting payroll. The SEC explained that the purpose of this change was to "adequately distinguish[ ] between venture capital funds and leveraged buyout funds and provide[ ] a simpler and clearer approach to determining whether or not a qualifying portfolio company satisfies the definition." *Exemptions Release* at 49.

Rather than make significant changes to the definition of qualifying portfolio company, the SEC indicated that holdings that do not fit within the definition may be held in the 20% Miscellaneous Assets bucket.

8 The requirement that a qualifying portfolio company must be an operating company is intentionally designed to exclude venture capital fund-of-funds from the definition of a venture capital fund. However, a venture capital fund may hold interests in other venture capital funds in the 20% Miscellaneous Assets bucket.

9 *See Exemptions Release* at n. 203 ("Under the holding out criterion . . . a fund that represents itself as pursuing a venture capital strategy to investors implies that the fund invests primarily in operating companies and not for example in entities that hold oil and gas leases.") Because companies that hold oil and gas leases may be excepted from the definition of an investment company under Section 3(c)(9) of the 1940 Act, the SEC's note could be read as requiring advisers to putative venture capital funds to more closely examine companies relying on Section 3(c)(9) or other exceptions from the 1940 Act to assure that the business in question is that of an operating company.

10 Rather than expand the types of securities or nature of transactions that could be a qualifying investment, the SEC indicated that the 20% Miscellaneous Assets bucket would be available for securities or transactions that did not fit within the qualifying investment definition. Thus, for example, debt securities or secondary market purchases of equity securities of a qualifying portfolio company could be held only as Miscellaneous Assets. The Exemptions Release also identified the following instruments that would be classified as Miscellaneous Assets: shares of other venture capital funds, non-convertible debt (including bridge loans of a portfolio company) and publicly traded securities.

11 For these purposes, the Final Rules adopt the definition of an "equity security" in Section 3(a)(11) of the Exchange Act *i.e.*, limited partnership interests, common stock, preferred stock, warrants and other securities convertible into any such equity security). The SEC describes this definition as "broad . . . providing venture capital funds with flexibility to determine which equity securities in the portfolio company capital structure are appropriate for the fund." Additionally, any security received as a divi-

and acquired directly from the qualifying portfolio company (a "directly acquired equity"); (ii) the qualifying portfolio company in exchange for a direct equity investment in that same qualifying portfolio company (an "exchanged equity investment"); or (iii) a company of which the qualifying portfolio company is a majority owned subsidiary or predecessor company, if acquired in exchange for directly acquired equity or an exchanged equity investment. [12] The inclusion of the latter two categories allows venture capital funds to participate in reorganizations of a portfolio company or mergers or acquisitions of a portfolio company. In the case of a merger or acquisition, the Final Rules enable a venture capital fund to hold as a "qualifying investment" securities of a reporting or foreign-traded company. However, following the merger or reorganization, any further purchases of interests of a reporting or foreign-traded company, as well as any secondary market purchases, would need to be held as Miscellaneous Assets.[13]

- **Short-Term Holdings: Inclusion of Money Market Fund Shares.** As under the proposed rules, the Final Rules allow a venture capital fund to invest in short-term holdings, generally for cash management purposes, and such short-term holdings will not be counted as part of the 20% bucket of Miscellaneous Assets. Short-term holdings, as proposed, would have included only cash, bank deposits, certificates of deposit, bankers acceptances and similar bank instruments, and U.S. Treasuries with remaining maturities of 60 days or less. Although the SEC generally was not receptive to commenters' requests to expand the types of instruments that would qualify as short-term holdings,[14] the SEC did expand the definition of short-term holdings to include shares of registered money market funds. All other instruments used for cash management purposes could be held by a venture capital fund, as long as they are included in the 20% bucket of Miscellaneous Assets.

- **''Holding Out''.** Whereas the proposed rules focused on whether the fund was held out as a "venture capital fund", the Final Rules instead require that the fund "represents to investors and potential investors that it pursues a venture capital strategy."[15] Among the concerns raised by commenters was that the proposed requirement would have focused too much on the fund's name, in conflict with the practice of many venture capital funds to "avoid[] referring to themselves as 'venture capital funds'." The Final Rules do not require that the fund include the term "venture capital" in its name or explicitly prohibit an adviser from including terms like "private equity" or "growth capital" in the fund name. Rather, the Exemptions Release clarifies that the determination of whether a fund represents itself as a venture capital fund focuses on "all of the statements (and omissions) made by the fund to its investors and prospective investors. While this includes the fund name, it is only part of the analysis." As a result, advisers to venture capital funds that desire to rely on the new Venture Capital Fund Exemption should carefully review the fund's marketing materials and disclosure documents in light of the SEC's expectation that "an investor's understanding of the fund and its investment strategy must be consistent with an adviser's reliance on the exemption."[16]

dend in respect of a qualifying investment would be a qualifying investment for purposes of the Venture Capital Fund Exemption. *Exemptions Release* at n. 97.

12 Additionally, the SEC confirmed that "a fund may disregard a wholly owned intermediate holding company formed solely for tax, legal or regulatory reasons to hold the fund's investment in a qualifying portfolio company" for purposes of determining whether the holding is a qualifying portfolio company. *Exemptions Release* at 51.

13 The continued exclusion of securities acquired in secondary transactions from the category of qualifying investments ensures that a venture capital fund primarily deploys its capital for operating and business purposes.

14 In particular, the SEC refused to extend the definition of short-term holdings to allow venture capital funds to invest in U.S. Treasuries with more than 60 days to maturity, foreign sovereign debt, repurchase agreements and commercial paper.

15 An identical change was made to the grandfathering provision, which allows a private fund in existence and with third-party investors prior to December 31, 2010, that does not fully meet the definition of a venture capital fund under the Final Rules, to be treated as a venture capital fund provided that it conforms to the holding out requirement and does not sell interests, or accept any committed capital, after July 21, 2011 ("Grandfathered Funds").

16 While generally taking a facts and circumstances approach, the SEC emphasized that certain actions, such as "identify[ing] a fund as a 'hedge fund' or 'multi-strategy fund' [or including] the fund in a hedge fund database or hedge fund index", would be inconsistent with the adviser's ability to rely on the Venture Capital Fund Exemption. *Exemptions Release* at 65. Thus, while the SEC did not explicitly preclude fund names that refer to recognized, non-venture, investment strategies (*e.g.*, "multi-strategy funds"), the Exemptions Release suggests that advisers to so-named funds may have some difficulty in demonstrating compliance with the "holding out" requirement.

- **No Managerial Assistance Requirement.** The Final Rules do not, as the proposed rules would have, require the venture capital fund's adviser to "have a significant level of involvement in developing a fund's portfolio companies."

- **Exclusion of Certain Guarantees from Leverage Time Limits.** In response to commenters' concerns that the proposed rules' strict 120-day limitation on leverage could interfere with a venture capital fund's ability to guarantee certain obligations of portfolio companies (that often secure longer term borrowings for working capital), the Final Rules exclude such guarantees (up to the value of the venture capital fund's investment in the portfolio company). However, these guarantees remain subject to the 15% of Total Capital limitation on fund borrowings.[17]

- **Restrictions on Liquidity.** The Final Rules retain the proposed restrictions on providing liquidity. Thus, venture capital funds are limited, except in extraordinary circumstances, from providing liquidity (*i.e.*, withdrawal, redemption or repurchase rights) beyond *pro rata* distributions to investors. While stressing that whether "specific redemption or 'opt out' rights for certain categories of investors under certain circumstances should be treated as 'extraordinary' will depend on the particular facts and circumstances," the Exemptions Release provides some guidance as to the types of rights that do (or do not) raise concerns. In this regard, the SEC indicated that both (i) periodic withdrawal rights, even if subject to an initial lock-up or other restrictions, or (ii) "regularly identifying potential investors on behalf of fund investors seeking to transfer or redeem fund interests" would be inconsistent with this criterion. By contrast, consents to transfer "to accommodate an investor's internal corporate restructurings, bankruptcies or portfolio allocations rather than to provide investors with liquidity from the fund" as well as rights that are contingent on changes in law or fact that are foreseeable, but unexpected as to timing or scope (*e.g.*, tax law changes or regulatory or legal changes that prohibit an investor from participating in certain fund investments), generally would be permissible.

[17] Despite commenters' requests, the SEC determined not to otherwise expand a venture capital fund's ability to borrow or use leverage for other purposes (such as capital call lines of credit or borrowings to satisfy fee or expense obligations) or to generally increase the 15% or 120-day limitations. In particular, the SEC expressed concerns that advisers to leverage buyout funds should not be able to rely on the Venture Capital Fund Exemption.

Application to Non-U.S. Advisers

The Exemptions Release specifies that a "non-U.S. adviser" (*i.e.*, an adviser whose principal office and place of business[18] is outside the United States) may rely on the Venture Capital Fund Exemption, provided that it solely advises funds that are venture capital funds or Grandfathered Funds.[19] Accordingly, such an adviser may not rely on the Venture Capital Fund Exemption if it advises other client accounts, even if such clients are outside of the United States. The Final Rules clarify that an adviser may treat as a "private fund"[20] for purposes of the Venture Capital Fund Exemption any non-U.S. fund that is not offered in the United States but that would be a private fund if the issuer were to conduct a private offering in the United States. However, the adviser would be required to treat the fund as a private fund for all purposes under the Advisers Act.[21]

[18] An adviser's principal office and place of business is the location where the adviser controls, or has ultimate responsibility for, the management of assets. *Exemptions Release* at text accompanying n. 385. As discussed below, this will typically be the office at which investment decisions are formulated and implemented and not an office where the only investment-related functions relate to research or due diligence activities.

[19] By contrast, the Private Fund Adviser Exemption requires an adviser to consider only those funds or accounts that are managed (i) at a place of business in the United States or (ii) for U.S. persons. As a result, a non-U.S. venture capital fund adviser who provides additional services in its home jurisdiction may be able to rely on the Private Fund Adviser Exemption (assuming the conditions for that exemption, described below, are met) but not the Venture Capital Fund Exemption.

[20] The Dodd-Frank Act amended the Advisers Act to define a "private fund" as any issuer that would be an "investment company" under the 1940 Act but for Section 3(c)(1) or 3(c)(7) of the 1940 Act. This definition of a "private fund" appears to effectively exclude any non-U.S. fund that does not use U.S. jurisdictional means to offer its securities (*i.e.*, is not offered in the United States), but would otherwise be a "private fund" if it was privately offered in the United States.

[21] This would require the non-U.S. adviser to report such funds on the Amended Form ADV (as discussed below) and would subject disclosures made by the adviser to investors in such funds to Rule 206(4)-8 under the Advisers Act, which generally prohibits advisers to pooled investment vehicles from engaging in any fraudulent, deceptive or manipulative act with respect to any investor or prospective investor in a pooled investment vehicle.

Private Fund Adviser Exemption

Terms of Exemption

A second exemption provided by the Dodd-Frank Act exempts from registration any adviser that acts solely as an adviser to certain private funds, provided such adviser's "Regulatory AUM" (as described further below) in the United States are less than $150 million ("Private Fund Adviser Exemption"). Consistent with the current rule for counting clients,[22] which requires U.S. advisers to count all clients worldwide while allowing non-U.S. advisers (*i.e.*, those advisers with a principal office and place of business outside the United States) to count only their U.S. clients for this purpose, the Final Rules require non-U.S. advisers to count only "qualifying private fund" assets that are managed from a place of business within the United States,[23] while requiring a U.S. adviser to consider all of its management activities worldwide. Specifically, under the Private Fund Adviser Exemption, a U.S. adviser: (i) would not be permitted to advise any client that is not a qualifying private fund; and (ii) could not exceed $150 million in total "Regulatory AUM", regardless of where the adviser's qualifying private funds are domiciled or where the management activity occurs. By contrast, a non-U.S. adviser: (i) would be permitted to manage an unlimited amount of qualifying private fund assets provided its principal office and place of business is outside the United States and it does not manage any assets for U.S. persons other than qualifying private funds and (ii) would count only those qualifying private fund assets that are managed at a place of business in the United States toward the $150 million "Regulatory AUM" limit. Thus, non-U.S. advisers that manage more than $25 million in assets for U.S. persons (the amount allowed under the Foreign Private Adviser Exemption (as discussed below)) will be required to register with the SEC if any of the advised accounts is not a qualifying private fund, even if the non-U.S. adviser does not have a place of business in the United States. Such an adviser will be unable to qualify for either the Private Fund Adviser Exemption or the Foreign Private Adviser Exemption.[24] Additionally, the SEC was equivocal in its views about whether a single-investor fund would be viewed as a qualifying private fund or a non-qualifying separately managed account by noting that any such determination will be based on the relevant facts and circumstances.

Regulatory AUM

Given the relevance of an adviser's assets under management ("AUM") with respect to certain of the new registration and exemption thresholds under the Dodd-Frank Act, the Final Rules require every adviser to calculate Regulatory AUM using a new uniform methodology.[25] An adviser's Regulatory AUM will be based on the value of the securities portfolios for which the adviser provides continuous and regular supervisory or management services, inclusive of proprietary assets,[26]

22 *See* Rules 203(b)(3)-1 and 203(b)(3)-2 under the Advisers Act, each of which was rescinded by the Final Rules.

23 A "qualifying private fund" is defined as any private fund that is not registered under the 1940 Act and has not elected to be treated as a business development company. Under the Final Rules, an adviser may also include as a "private fund" any fund that qualifies for an exclusion from the definition of an "investment company" in the 1940 Act (in addition to the exclusions in Sections 3(c)(1) and 3(c)(7)). *See* Final Rule 203(l)-1 and *Exemptions Release* at text accompanying n. 299. This expanded approach from the proposed rule, which limited "qualifying private funds" to private funds that rely on the exclusions provided by Sections 3(c)(1) or 3(c)(7), now assures that advisers to funds that could rely, for example, on Section 3(c)(5)(C) (certain real estate funds) or Section (3)(c)(9) (oil, gas, or mineral fund) of the 1940 Act or Rule 3a-7 (asset-backed issuers) under the 1940 Act will not be precluded from relying on the Private Fund Adviser Exemption. If an adviser elects to treat such a fund as a private fund for this purpose, however, the adviser must treat such fund as a private fund for all purposes under the Advisers Act.

24 Advisers seeking to rely on either the Private Fund Adviser Exemption or the Foreign Private Adviser Exemption must fully meet each element of the respective exemption. Advisers may not "mix-and-match" elements of the exemptions.

Please see Appendix B for a matrix detailing the circumstances in which advisers to private funds and separately managed accounts based in popular jurisdictions (*i.e.*, New York, Connecticut and London) would be required to register with the SEC or, if applicable, their home state in reliance on the Private Fund Adviser Exemption.

25 While the uniform calculation for Regulatory AUM is required for various purposes under the Advisers Act, registered advisers are able to use a different AUM calculation method for purposes of disclosure to clients in their narrative brochure required by Part 2 of Form ADV and for marketing or other purposes.

26 In response to comments criticizing the inclusion of proprietary capital (as well as assets not managed for compensation) in Regulatory AUM on the basis that the definition of "investment adviser" requires, among other things, that advice be provided "to others" and "for compensation", the SEC noted that "[a]lthough a person is not an 'investment adviser' for purposes of the Advisers Act unless it receives compensation for providing advice to

assets managed without receiving compensation, and assets of non-U.S. clients (if managed from the United States), each of which an adviser may currently exclude in calculating its AUM.[27] Regulatory AUM also includes: (i) the value of any private fund over which an adviser exercises continuous and regular supervisory or management services; (ii) the amount of any uncalled capital commitments of any private fund (a new concept intended to capture, among others, private equity fund managers); (iii) the fair value (as opposed to the cost basis) of private fund assets;[28] and (iv) the value of any assets managed for no compensation or for knowledgeable employees.

Practical Applicability of Exemption

A non-U.S. adviser would not be precluded from relying on the non-U.S. adviser aspects of the Private Fund Adviser Exemption by maintaining an office or place of business in the United States, provided that its principal place of business remains in a non-U.S. jurisdiction. However, given the global operations of many large advisers, advisers with a principal place of business outside the United States should be careful to limit any activities that occur within the United States such that no U.S. office is deemed to be (i) its principal office or (ii) a place of business at which assets above the permissible limit or clients other than private funds are managed. In this regard, a non-U.S adviser should (i) limit U.S. office advisory activities to conducting due diligence and research and (ii) formulate and implement investment decisions solely from a non-U.S. office.[29]

Advisers relying on the Private Fund Adviser Exemption are required to file certain information with the SEC and remain subject to limited substantive requirements under the Advisers Act as well as SEC examination authority. In this regard, the SEC's treatment of non-U.S. advisers is similar to the current "Regulation Lite"[30] approach, under which a non-U.S. adviser registered with the SEC has been able to avoid many of

others, once a person meets the definition (by receiving compensation from any client to which it provides advice), the person is an adviser, and the Act applies to the relationship between the adviser and any of its clients (whether or not the adviser receives compensation from them)." *Exemptions Release* at text accompanying n. 343. Thus, it would appear clear that gratis accounts are entitled to the full protections of the Advisers Act. Importantly, however, the Implementing Release does not indicate that proprietary accounts should be treated as "clients" for other purposes under the Advisers Act. Instead, the SEC justifies inclusion of proprietary assets on the basis that management of a significant amount of assets (whatever the source) "may suggest that the adviser's activities are of national concern or have implications regarding . . . systemic risk." *Implementing Release* at text accompanying at n. 75.

Consistent with this approach, the SEC staff recently granted no action assurance allowing a U.S. domiciled, wholly-owned subsidiary of a foreign insurance cooperative to advise certain private funds without registration under the Advisers Act where the funds consisted solely of the parent's assets, and the subsidiary did not advise other clients or hold itself out to the public as an investment adviser. The staff based its relief on the assertion that the subsidiary was not "engaged in the business of 'advising others'" and indicated that relief would not apply if the parent were, itself, a private fund. Moreover, the incoming letter indicated that "[n]o policy holder [of the parent] will be deemed a beneficial owner of a [f]und." *Zenkyoren Asset Management of America Inc.* (pub. avail. June 30, 2011).

27 Notably, accounts other than private funds are considered securities portfolios only if 50% or more of the total value of such account consist of securities. As a result, client accounts that hold more than 50% of their AUM in "non-securities", such as collectibles, commodities or real estate, can be excluded entirely from Regulatory AUM, whereas the entire value of a private fund must be attributed to an adviser's Regulatory AUM, even if such private fund similarly contains more than 50% of "non-securities". Further, Regulatory AUM requires that client assets be calculated on a "gross" basis. As described by the SEC, Regulatory AUM requires an adviser to include total assets under management and reflected on a client's balance sheet, without regard to any corresponding liabilities incurred to acquire or carry the assets. *See Implementing Release* at 22.

28 The fair value of a private fund's assets may be calculated in accordance with generally accepted accounting principles ("GAAP"), another international accounting standard or some other fair valuation standard, including any such procedure identified in the private fund's governing documents.

29 *See Exemptions Release* at text accompanying n. 401.

30 *See ABA Subcommittee on Private Investment Companies* (pub. avail. Aug. 19, 2006). Regulation Lite requires non-U.S. advisers to maintain records (and upon request provide such records to the SEC) with respect to non-U.S. funds and clients and subjects a non-U.S. adviser's non-U.S. client activities to inspection, without subjecting such non-U.S. client activities to other provisions of the Advisers Act. Although the SEC did not withdraw Regulation Lite, its usefulness is now limited given that most advisers that previously relied upon Regulation Lite will be able to rely on the Private Fund Adviser Exemption or Foreign Private Adviser Exemption. Additionally, the Private Fund Adviser Exemption allows a non-U.S. adviser to advise U.S.-domiciled private funds, which is not possible under Regulation Lite.

the substantive provisions of the Advisers Act with respect to its management of non-U.S. client accounts. Under the Final Rules, a non-U.S. adviser can rely on the Private Fund Adviser Exemption, while managing any number of U.S.-domiciled qualifying private funds (but not other U.S. clients) together with any number and kind of clients that are not U.S. persons, provided that: (i) *without regard to where management activities take place*, every client that is a U.S. person is a qualifying private fund; and (ii) *with respect to assets managed from within the United States*, all such assets are attributable to qualifying private funds and the total value of such assets does not exceed $150 million. As a result, this exemption may be available to non-U.S. advisers that do not service U.S. clients other than private funds, but are unable to meet the more restrictive Foreign Private Adviser Exemption (discussed below) because, for example, the adviser has significant investments by U.S. persons in an offshore fund.

Foreign Private Adviser Exemption

Terms of Exemption

The third new exemption from registration provided by the Dodd-Frank Act is an exemption for foreign private advisers ("Foreign Private Adviser Exemption").[31] The Dodd-Frank Act defines a "foreign private adviser" as any investment adviser that, among other requirements:

- has *no place of business* in the United States;
- has, in total, *fewer than 15 clients and investors in the United States in private funds* advised by the adviser;
- has aggregate [Regulatory AUM] of *less than $25 million* attributable to clients in the United States (including U.S.-domiciled private funds) and U.S. investors in private funds advised by the adviser;
- *does not hold itself out* generally to the public in the United States as an investment adviser; and
- does not advise *registered investment companies* or *registered business development companies*.

The Final Rules define certain key terms used by Congress in the Dodd-Frank Act by generally using familiar rules and concepts already in use under the federal securities laws. For instance, the manner in which an adviser must count "clients" and "investors" refers to concepts already familiar to private fund advisers, such as how an adviser would count the number of beneficial owners for purposes of the 100 person limit in Section 3(c)(1) of the 1940 Act or limiting investors to "qualified purchasers" for purposes of Section 3(c)(7) of the 1940 Act.[32]

Because the concept of being "in the United States" is integral to the Foreign Private Adviser Exemption, the Final Rules codify the existing interpretation that a person is only considered "in the United States" if such person is deemed to be in the United States at the time the person becomes a client of an adviser or, in the case of an investor in a private fund, each time the investor acquires securities of the fund.[33] Advisers may treat an investor as being not "in the United States" if the adviser has a reasonable belief that an investor was not in the United States at the relevant measurement

31 Because the Foreign Private Adviser Exemption is codified in Section 203(b) of the Advisers Act, advisers relying on the exemption will be exempt from all registration, reporting and recordkeeping requirements of the Advisers Act. However, advisers relying on the Foreign Private Adviser Exemption are subject to the anti-fraud provisions of Section 206 of the Advisers Act and Rules 206(4)-5 ("Pay-to-Play Rule") and 206(4)-8 (which prohibits an adviser from making false or misleading statements to investors in a pooled vehicle) under the Advisers Act.

32 However, unlike the counting regime under Section 3(c)(1) of the 1940 Act, a beneficial owner of short-term paper issued by a private fund is an "investor" and must be counted for purposes of the 15 client and investor limit. In addition, the Final Rules permit advisers not to count "knowledgeable employees" (as defined in Rule 3c-5 under the 1940 Act) as investors for this purpose. *See Exemptions Release* at n. 451. Nonetheless, the assets of "knowledgeable employees" must be included for purposes of calculating "Regulatory AUM". In addition, and contrary to previous practice, the Final Rules require an adviser to count as a client any person who receives investment advice regardless of whether the adviser receives compensation for such service. As a result, advisory services provided gratis and/or to knowledgeable employees may have the effect of altering an adviser's registration status under the Advisers Act. See the discussion of "Regulatory AUM" above for more details.

33 The Exemptions Release identifies a specific exemption for Canadian retirement accounts (consistent with Rule 7d-2 under the 1940 Act) to the general rule that a person must be considered "in the United States", and therefore count towards the 15 client and investor limit and $25 million Regulatory AUM limit, if the initial investment in a non-U.S. fund was made while the investor was outside of the United States but subsequent investments were made after the investor moved to the United States.

points (*i.e.*, at the time the investor becomes a client or, in the case of a fund, each time an investor makes an investment).

Additionally, the Exemptions Release sets forth circumstances where an adviser must "look-through" certain structures and count as clients and investors for purposes of the 15-person threshold: (i) each beneficial owner of an investor that is a nominee account; (ii) each U.S. investor in a feeder fund, if the feeder fund is formed or operated for the purpose of investing in the master fund; and (iii) each holder of a total return swap or other instrument that effectively transfers the risk of investing in the private fund to the holder.

In response to similar guidance in the proposing release, a number of commenters expressed concerns that these "look-through" requirements could be difficult to apply or impose unfair consequences on an adviser where, for example, the adviser had no knowledge of persons having an indirect interest in a fund or that a structured product had been created. In response to these comments, the Exemptions Release indicates that an adviser is required to "look-through" only those structures that the adviser knows, or should have known, introduce additional indirect beneficial owners to a fund.[34] Thus, an adviser is required to treat as an investor only those persons the adviser reasonably believes (based upon the exercise of reasonable due diligence) are investors, and the adviser's reliance on the Foreign Private Adviser Exemption would not be jeopardized as a result of the unknown actions of third-party investors.[35]

Foreign Private Adviser Exemption Likely to be of Limited Use

While attractive due to the limited requirements imposed on advisers relying on the exemption, the Foreign Private Adviser Exemption is quite narrow and likely will be unavailable to most foreign advisers that generally accept U.S. persons as clients or investors in private funds.[36] Each of the strict conditions of the Foreign Private Adviser Exemption must be met in order for an adviser to rely on the exemption.[37] As a result, a foreign private adviser must monitor and limit both (i) the number of clients and investors in the United States and (ii) the amount of assets attributable to such clients and investors.[38]

The limit on assets attributable to clients or investors in the United States may present particular difficulty for a foreign private adviser because the $25 million limit does not distinguish between a client's or investor's initial commitment of capital to the adviser's management and subsequent increases in such capital resulting from, among other things, an adviser's successful asset management. While Congress provided the SEC with the option of increasing the $25 million AUM threshold to "such higher amount as the [SEC] may, by rule, deem appropriate," the SEC did not increase the threshold so that the Foreign Private Adviser Exemption may be of greater use. Therefore, it is likely that the Foreign Private Adviser Exemption will be of most use not to advisers that seek U.S. business, but instead to advisers who service U.S. clients or investors only as an accommodation.

Participating Affiliates

The Exemptions Release reiterates the SEC's position that it would treat as a single adviser two or more affiliated advisers that are separately organized but

34 *See Exemptions Release* at n. 443.

35 *See Exemptions Release* at text accompanying n. 447.

36 Foreign private advisers are exempt from registration and reporting requirements but remain within the Advisers Act's definition of an "investment adviser". As a result, foreign private advisers are subject to the anti-fraud provisions of the Advisers Act, including principally Section 206, and Rules 206(4)-5 and 206(4)-8, thereunder. However, such advisers would not be subject to other anti-fraud rules, such as those governing advertising and custody by investment advisers, adopted under Section 206 nor to the SEC's general examination authority.

37 The Foreign Private Adviser Exemption is unavailable if: (i) an adviser has 15 or more clients/investors in the United States (even if the assets attributable to those clients/investors is below $25 million); and (ii) an adviser has $25 million or more in assets attributable to clients/investors in the United States.

38 The Exemptions Release is silent as to whether the $25 million threshold for assets attributable to a U.S. person should be monitored on a continuous basis or whether it should be measured annually. Based on the guidance provided for the annual threshold measurement for the Private Fund Adviser Exemption and the instructions in the Amended Form ADV relating to the annual measurement of Regulatory AUM, it may be reasonable for an adviser relying on the Foreign Private Adviser Exemption to only measure its AUM on an annual basis for purposes of complying with the exemption. *See Exemptions Release* at text accompanying n. 372 and Part 1A Instruction 5.b.(4) of Amended Form ADV. The number of clients and investors threshold, however, appears to be continuous.

operationally integrated, which could require one or more of such advisers to register with the SEC. The determination of whether affiliates should be integrated, even if such affiliates are established as legally separate entities, is based on the facts and circumstances surrounding the operational relationship between the affiliates as described in the SEC's previous no-action guidance in *Richard Ellis, Inc*.[39] While the SEC did not provide further guidance on the *Richard Ellis* factors, which are largely considered outdated and impractical for most advisers given their rigidity, the SEC confirmed the applicability of the established alternative to the *Richard Ellis* factors—known as the participating affiliate doctrine—under which the SEC would not recommend enforcement action against the non-U.S. unregistered affiliate of a registered adviser even if the affiliates share personnel and resources and provide certain services through the non-U.S. unregistered affiliate.[40] The non-U.S. unregistered affiliate, often called a "participating affiliate", would not be subject to the substantive provisions of the Advisers Act with respect to its relationships with its non-U.S. clients, provided the limitations in the Participating Affiliate Letters are observed. The Exemptions Release also states, however, that reliance on a "participating affiliate" arrangement prevents the participating affiliate from having any U.S. clients other than through the registered affiliate.[41]

The SEC expressed a willingness in the Exemptions Release to further elaborate on the participating affiliate doctrine in the context of the new Foreign Private Adviser Exemption and the Private Fund Adviser Exemption via the no-action letter process.[42]

Amended Form ADV

The Final Rules also adopt amendments to Form ADV, Part 1 ("Amended Form ADV") that significantly revise the Form in a manner that affects all registered advisers (both existing registrations and new ones), as well as Exempt Reporting Advisers (as defined below). The Amended Form ADV greatly expands the reporting information required of registered advisers by requiring public disclosure of information regarding: (i) the private funds they advise; (ii) their advisory businesses and related conflicts of interests; and (iii) their non-advisory activities and financial industry affiliations.[43]

With respect to each private fund an adviser manages, the Amended Form ADV will require basic organizational, operational and investment information about the private funds, such as information regarding: (i) the gross asset value of the fund; (ii) the type of investment strategy employed by the fund (to be identified from a list of available options);[44] (iii) the number of beneficial

39 *Richard Ellis, Inc*. (pub. avail. Sept. 17, 1981). Under *Richard Ellis*, an advisory entity would avoid integration with its parent company where, the subsidiary: (1) is adequately capitalized; (2) has a board or similar governance buffer the majority of the members of which are independent of the parent; (3) has advisory personnel who are not engaged in the parent's advisory business; (4) makes investment decisions independently from the parent and does not rely solely on information provided by the parent; and (5) keeps its investment advice confidential until communicated with the client. It would appear that advisers meeting these factors would be considered separate. However, the Exemptions Release does not indicate that the failure to meet any particular factor precludes a separateness determination.

40 *See e.g., Royal Bank of Canada* (pub. avail. June 3, 1998), *ABN AMRO Bank, N.V.* (pub. avail. Jul. 7, 1997); *Murray Johnstone Holdings Limited* (pub. avail. Oct. 7, 1994); *Kleinwort Benson Investment Management Limited* (pub. avail. Dec. 15, 1993); *Mercury Asset Management plc* (pub. avail. Apr. 16, 1993) and *Uniao de Bancos de Brasileiros S.A.* (pub. avail. Jul. 28, 1992) (collectively, the "Participating Affiliate Letters").

41 *See Exemptions Release* at n. 516. However, in these circumstances the non-U.S. participating affiliates could continue to receive investments from U.S. investors in non-U.S. private funds in reliance upon the Private Fund Adviser Exemption discussed above.

42 In addition, the Exemptions Release did not withdraw prior no-action guidance that allowed a special purpose vehicle to serve as the general partner or managing member of a private fund in certain circumstances in order to avoid registration where the affiliated investment adviser was so registered. *See ABA Subcommittee on Private Investment Entities* (pub. avail. Dec. 8, 2005).

43 The new disclosure requirements in the Amended Form ADV are separate from the recently proposed Form PF, which would require registered advisers (but not Exempt Reporting Advisers) that advise one or more private funds to periodically file information with the SEC. The Form PF was proposed by the SEC on January 25, 2011, and its final form is still under consideration.

44 The Exemptions Release clarified the definitions included in the Instructions to the Amended Form ADV. Notably, the SEC has narrowed the definition of "hedge fund" (which was defined as any private fund that calculates a performance fee based on unrealized gains, uses leverage to a specified extent, or sells securities short) in the following ways: (i) clarified that a "securitized asset fund" will not be categorized as a hedge fund simply because it issues debt; (ii) narrowed the performance fee element to exclude those funds that do not allow for the payment of

owners of the fund and the percentage of the fund beneficially owned by the adviser and its related persons, funds-of-funds and non-U.S. persons; (iv) the minimum investment requirements of the fund; (v) whether clients are solicited to invest in the fund and what percentage of the adviser's other clients are invested in the fund; and (vi) the identity, location, and other information regarding certain "gatekeeper" service providers of the fund (*i.e.*, auditors, prime brokers, custodians, administrators, and marketers).[45] These reporting requirements would apply to non-U.S. advisers required to file an Amended Form ADV, but the reporting requirements with respect to such advisers would apply only to private funds that are organized in the United States or are offered to, or owned by, U.S. persons.

The advisory business information required by the Amended Form ADV will specifically require an adviser to disclose: (i) the approximate number of clients;[46] (ii) the types of clients it advises and the approximate amount of its Regulatory AUM attributable to each type of client; (iii) the percentage of clients that are not U.S. persons; (iv) the specific number of investment personnel and their advisory activities; (v) the types of advisory services it provides; and (vi) its business practices that may present conflicts of interest, such as the use of affiliated brokers, soft dollar arrangements, and compensation for client referrals.

Reporting Requirements for Certain Exempt Advisers

The Final Rules require advisers relying on the Venture Capital Fund Exemption or the Private Fund Adviser Exemption ("Exempt Reporting Advisers") to submit, and update at least annually, certain reports on Part 1 of Amended Form ADV to the SEC disclosing organizational and operational information, including:

- basic identifying information, such as name, address, contact information, form of organization, and who controls the adviser;[47]
- other business activities engaged in by the adviser and its affiliates, and information about potential conflicts of interests, as well as the detailed private fund reporting described above;[48] and
- the disciplinary history of the adviser and certain of its related persons and personnel.[49]

In connection with these requirements, the Amended Form ADV will serve as a registration form for registered advisers and a reporting form for Exempt Reporting Advisers. The information reported by Exempt Reporting Advisers will be (i) publicly available and (ii) used by the SEC to determine whether the activities of an Exempt Reporting Adviser warrant further SEC attention, as these advisers would be subject to examination by the SEC (although the SEC

performance fees on unrealized gains but do require such amounts to be accrued, such that the final definition includes only funds that have paid a performance fee based on unrealized gains; (iii) narrowed the performance fee element to exclude such funds that pay a fee which was calculated by taking into account unrealized gains solely for the purpose of reducing such fee to reflect net unrealized losses; (iv) clarified that a private fund will not be considered a hedge fund simply because it uses short positions to hedge foreign exchange risk or to manage the duration of interest rate exposure.

45 The following requirements, which were included in the proposal for the Amended Form ADV, were ultimately eliminated from the Final Rules because the SEC was persuaded by commenters concerns that the benefit of publicly disclosing such information did not outweigh the potential competitive harm: (i) disclosure of each private fund's net assets; (ii) disclosure of a private fund's assets and liabilities by class and categorization in the fair value hierarchy established under GAAP; and (iii) disclosure of the specific percentage of each fund owned by particular types of beneficial owners. The SEC notes, however, that while such information will not be reported under the publicly-filed Amended Form ADV, it may still be required to be disclosed to the SEC in the Form PF.

46 For purposes of this item in Amended Form ADV, the Exemptions Release clarifies that investors in private funds should not be included as clients unless the adviser has a separate advisory relationship with those investors. *See Exemptions Release* at n. 286.

47 *See* Item 1 (Identifying Information), Item 2.B. (SEC Reporting by Exempt Reporting Advisers), Item 3 (Form of Organization), and Item 10 (Control Person) of Amended Form ADV.

48 *See* Item 6 (Other Business Activities) and Item 7 (Financial Industry Affiliations and Private Fund Reporting) of Amended Form ADV. While an Exempt Reporting Adviser must fill out Item 7 and the corresponding Schedule D for the private funds it advises (as discussed in detail above), an Exempt Reporting Adviser would not be required to report on non-U.S. private funds that do not have any U.S. investors.

49 *See* Item 11 (Disclosure Information) of Amended Form ADV.

has indicated that it does not expect to subject Exempt Reporting Advisers to routine examinations).

Exempt Reporting Advisers will file the Amended Form ADV with the SEC and be subject to the SEC's nominal filing fees. Exempt Reporting Advisers will not be required to complete the entire Amended Form ADV (as described above), but will be required to file an annual updating amendment generally within 90 days of the end of the adviser's fiscal year.[50] Exempt Reporting Advisers must file their initial reports on the Amended Form ADV by March 30, 2012.

Exempt Reporting Advisers also will be subject to certain recordkeeping rules to be determined by the SEC. The SEC has indicated that it will propose such recordkeeping rules in a separate release. Importantly, Exempt Reporting Advisers will be subject to the anti-fraud provisions of the Advisers Act and certain (but not all) of the rules thereunder and will be subject to examination by the SEC.

New Registration Threshold and Timing of Registration

The Advisers Act prohibits an adviser from registering with the SEC unless the adviser meets certain criteria, one of which is the amount of assets the adviser has under management.[51] While the Dodd-Frank Act raises the threshold of AUM used to determine whether an adviser may register with the SEC from $25 million to $100 million, it does not affect the other criteria used by advisers to determine whether they are eligible to register with the SEC.

While small advisers (*i.e.*, those that have less than $25 million of Regulatory AUM and do not meet any other registration criteria) are still prohibited from registering with the SEC, a new category of "mid-sized advisers" created by the Dodd-Frank Act (*i.e.*, those with Regulatory AUM between $25 million and $100 million)[52] will be (i) required to register with the SEC if the adviser is not required to be registered as an adviser in its home state or is registered in its home state, but not subject to examination;[53] (ii) prohibited from registering with the SEC if the adviser is required to be registered in its home state and is subject to examination in its home state; and (ii) permitted to register with the SEC if it is required to register in 15 or more states.

The Final Rules require that each adviser that is registered with the SEC as of January 1, 2012, file an Amended Form ADV no later than March 30, 2012.[54]

An adviser no longer eligible for SEC registration must withdraw its SEC registration and register with the appropriate state(s) no later than June 28, 2012.[55] An adviser registered with the SEC as of July 21, 2011, must remain registered until January 1, 2012, unless

50 Exempt Reporting Advisers would not be obligated to prepare, file or deliver to clients the narrative brochure required of registered advisers by Part 2 of the Form ADV.

51 Other criteria used to determine eligibility for SEC registration include acting as an adviser to a registered investment company or registered business development company, or qualifying for an exemption adopted by the SEC. The Final Rules alter certain of these exemptions, including increasing the threshold of plan assets that a pension consultant advises to $200 million when determining a pension consultant's eligibility to register with the SEC. While pension consultants do not technically "manage" pension plan assets, the SEC has required certain pension consultants to register because their activities have a direct effect on the management of pension plan assets.

52 The Final Rules eliminate the current $5 million buffer to the previous statutory registration threshold of $25 million and replace it with a similar buffer for "mid-sized advisers" to achieve the same purpose of avoiding frequent switching between state and SEC registration. A mid-sized adviser must register with the SEC if it has $110 million Regulatory AUM, but, once registered, an adviser need not withdraw its registration until it has less than $90 million Regulatory AUM.

53 Advisers with New York or Wyoming as their home state will be considered "not subject to examination" for purposes of the Final Rules. The Exemptions Release also identified Minnesota as a state that does not conduct examinations of advisers, but the SEC has since clarified that only New York and Wyoming will be treated as such. *See* Division of Investment Management: Frequently Asked Questions Regarding Mid-Sized Advisers, *available at* http://www.sec.gov/divisions/ investment/ midsizedadviserinfo.htm (as of the date of this publication, last modified June 28, 2011). Wyoming does not have an investment adviser statute and New York does not subject its advisers to examinations.

54 Advisers amending their Form ADV after January 1, 2012, must use the Amended Form ADV.

55 As part of the transitioning process, new applicants qualifying as mid-sized advisers have the option of registering with either the SEC or the appropriate state securities authority until July 21, 2011. After July 21, 2011, these applicants are prohibited from registering with the SEC and must register with the state securities authority.

an exemption from SEC registration is applicable. An unregistered adviser that, as of July 20, 2011, was relying on the private adviser exemption and must now register with the SEC, must do so by March 30, 2012.[56] Importantly for such advisers, it may take up to 45 days for the SEC to approve an initial application for registration. Therefore, such advisers should file a complete application for registration (Part 1 and Part 2 (the narrative brochure) of the Amended Form ADV) with the SEC no later than February 14, 2012. Exempt Reporting Advisers must file their first reports on the Amended Form ADV by March 30, 2012.

Pay-to-Play Rule

The Final Rules also amend the Pay-to-Play Rule, which prohibits advisers from engaging directly or indirectly in pay-to-play practices identified in the rule, to subject Exempt Reporting Advisers and advisers relying on the Foreign Private Adviser Exemption to the requirements of the Pay-to-Play Rule. Because most of such advisers were previously relying on the private adviser exemption, they were already subject to the Pay-to-Play Rule. Therefore, this amendment will not affect the operations of most advisers. In addition, the Final Rules amend the Pay-to-Play Rule to add registered municipal advisers to the categories of registered entities that are excepted from the Pay-to-Play Rule's prohibition on advisers paying third parties to solicit a government entity, provided such municipal advisers are registered with the SEC and subject to the Municipal Securities Rulemaking Board's ("MSRB") pay-to-play rule. As a result, the compliance date for the ban on the use of third-party solicitors has been extended to June 13, 2012 to allow MSRB and FINRA to issue pay-to-play rules.

Conclusion

The Final Rules will significantly impact many investment advisers, whether such advisers are currently registered with the SEC, facing SEC registration as a result of the elimination of the private adviser exemption, facing state registration or operating inside the United States and outside the United States or both. Advisers are encouraged to review the new exemptions and, if applicable, the requirements of the Amended Form ADV to evaluate if and how the changes in the regulatory landscape will affect their day-to-day operations and annual reporting requirements.

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56 The Final Rules also amend Rule 204-2 under the Advisers Act (the "books and records" rule) to clarify that unregistered advisers that will be required to register with the SEC as of July 21, 2011, are not obligated to maintain certain performance-related records for any period in which they were not registered with the SEC. However, the adviser must continue to preserve any such records it currently retains.

APPENDIX A

Applicability of Advisers Act to Different Types of Advisers

The Dodd-Frank Act's repeal of the private adviser exemption will require many advisers who were previously unregistered to either: (i) register with the SEC; (ii) qualify as an Exempt Reporting Adviser; or (iii) qualify for the Foreign Private Adviser Exemption. Regardless of which category an adviser falls into, it is important for such adviser to understand the applicable duties and obligations. The chart below identifies the requirements of the Advisers Act as applicable to the various categories of advisers created by the Dodd-Frank Act.

	Registered Advisers	Exempt Reporting Advisers	Foreign Private Advisers
Form ADV, Part 1	X	X (Limited)	
Rule 204-3 (Form ADV, Part 2)	X		
Form PF (as proposed)	X		
Subject to Examination	X	X (Limited)	
Rule 204-2 Books and Records Rule	X	X	
Anti-Fraud Provisions (Section 206)	X	X	X
Rule 206(4)-1 Advertising Rule	X		
Rule 206(4)-2 Custody Rule	X		
Rule 206(4)-3 Cash Solicitation Rule	X		
Rule 206(4)-5 Pay-to-Play Rule	X	X	X
Rule 206(4)-6 Proxy Voting	X		
Rule 206(4)-7 Compliance Procedures and Practices	X		
Rule 206(4)-8 Pooled Investment Vehicles	X	X	X

APPENDIX B

Registration Matrix for Private Fund Advisers

The following table highlights different circumstances in which private fund advisers based in certain popular jurisdictions (*i.e.*, New York, Connecticut and London) will be affected by the Final Rules and with which governing entity (if any) such an adviser will be required to register.

Location of Adviser	Nature of Business	Regulatory AUM and Leverage	Registration Status
Based in NY	Solely manages private funds ($80mm AUM)	$80mm AUM with no leverage = $80mm Regulatory AUM	Exempt from all registration
Based in NY	Manages private funds ($50mm AUM) and separately managed accounts ($30mm AUM)	$80mm AUM with no leverage = $80mm Regulatory AUM	Must register with SEC (Private Fund Adviser Exemption not available)
Based in CT	Solely manages private funds ($80mm AUM)	$80mm AUM with no leverage = $80mm Regulatory AUM	Must register with CT (SEC exemptions do not preempt state law)
Based in CT	Manages private funds ($50mm AUM) and separately managed accounts ($30mm AUM)	$80mm AUM with no leverage = $80mm Regulatory AUM	Must register with CT
Based in CT	Manages private funds ($80mm AUM) and separately managed accounts ($30mm AUM)	$110mm AUM with no leverage = $110mm Regulatory AUM	Must register with SEC (Private Fund Adviser Exemption not available)
Based in CT	Solely manages private funds ($80mm AUM)	$80mm AUM with 2x leverage = $160mm Regulatory AUM	Must register with SEC
Based in London, with no U.S. office	Solely manages private funds ($80mm AUM) with 15 or more U.S. investors	$80mm AUM with 2x leverage = $160mm Regulatory AUM	May rely on Private Fund Adviser Exemption
Based in London, with no U.S. office	Manages private funds ($80mm AUM) and separately managed accounts for U.S. persons ($30mm AUM)	$80mm private fund AUM with 2x leverage + $30mm separate account AUM with no leverage = $190mm Regulatory AUM	Must register with SEC (Private Fund Adviser Exemption not available)
Principal place of business in London; manages solely private funds in U.S.	Manages solely private funds ($160mm AUM), of which $90mm managed at a U.S. office	$160mm AUM, of which $90mm managed at U.S. office with no leverage = $90mm Regulatory AUM (only assets managed at a U.S. office are included in Regulatory AUM for this purpose)	May rely on Private Fund Adviser Exemption

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