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A Client Alert from Paul Hastings

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SEC Finalizes Rules to Implement Dodd-Frank Act Regulation of Private Investment Funds and Their Managers

BY THE INVESTMENT MANAGEMENT PRACTICE

On June 22, 2011, the Securities and Exchange Commission (the "SEC") adopted rules and rule amendments[1] (the "Final Rules") designed to implement a number of significant changes applicable to private investment funds and their managers imposed by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[2]

The SEC adopted a number of the rules substantially in the form originally proposed on November 19, 2010.[3] Notable changes are as follows:

- Compliance Deadline: The Final Rules extend the deadline for private fund advisers not eligible for any exemption to register with the SEC to March 30, 2012.
- Eligibility for SEC Registration: The Final Rules clarify that advisers with assets under management in excess of $25 million and who have their principal office and place of business in New York, Minnesota or Wyoming are required to register with the SEC (unless an exemption is available).
- Venture Capital Fund Exemption: The Final Rules made several changes to this exemption. Most notable is the revised definition of venture capital fund to include funds which invest up to 20% in "non-qualifying investments" rather than 100% in qualifying investments as proposed.
- Private Fund Adviser Exemption: The Final Rules require an adviser seeking to rely on the private fund adviser exemption to calculate and report its assets under management on an annual basis rather than quarterly as proposed.
- Foreign Private Adviser Exemption: The Final Rules do not require non-U.S. advisers to count investors who are "knowledgeable persons" toward the 14 investor limit as originally proposed and expand on the definition of "place of business" for purposes of the requirement that the non-U.S. adviser have no "place of business" in the United States.

This Alert summarizes the aspects of the Final Rules that are most significant to private investment funds and their managers.[4]

I. EXTENDED COMPLIANCE DATE

The Dodd-Frank Act eliminated the current "private adviser" exemption from registration for any U.S. resident adviser that has fewer than 15 clients and does not "hold itself out as an investment adviser" to the U.S. public. The Dodd-Frank Act provided that this change would be effective on July 21, 2011. The Final Rules officially postpone the compliance date. An investment adviser that becomes subject to registration under the Investment Advisers Act of 1940 (the "Advisers Act") due to the elimination of the "private adviser" exemption will not need to register with the SEC (or report information if an "exempt reporting adviser") until March 30, 2012.

Investment advisers required to register with the SEC should plan to file their completed Form ADV (Parts 1 and 2) no later than February 14, 2012 to ensure compliance by the deadline. Other new transition deadlines and compliance dates are listed below under "Section VI. Significant Dates."

II. ELIGIBILITY FOR SEC REGISTRATION

A. General Rules

Under prior law, an investment adviser generally could not register with the SEC unless it had at least $25 million of assets under management ("AUM"). Effective July 21, 2011, the Dodd-Frank Act raised this threshold to $100 million and created a new category of "mid-sized advisers" (those with AUM between $25 million and $100 million) subject to state regulation. Accordingly, as of July 21, 2011, the minimum AUM for SEC registration for most U.S. advisers (that do not manage registered investment companies or business development companies) is:

- $100 million generally except as follows:
- $25 million for advisers that either (i) are not subject to registration and examination in the state in which they maintain their principal office and place of business or (ii) otherwise would be required to register with 15 or more states.

At present, advisers are not "subject to examination" in Wyoming (which has no investment adviser statute), New York and Minnesota. Accordingly, advisers with at least $25 million AUM and who have their principal place of business in Minnesota, New York or Wyoming are required to register with the SEC (unless otherwise exempt).

B. Exceptions from Prohibition on SEC Registration

In addition, Rule 203A-2 under the Advisers Act sets forth exemptions from the general prohibition on SEC registration for advisers that do not meet the AUM threshold for SEC registration. The Final Rules amend these exemptions and extend them to mid-sized advisers.[5] The amendments provide that (i) nationally recognized statistical rating organizations would no longer be covered by these exemptions; (ii) pension consultants continue to qualify for this exemption, however the minimum value of plan assets necessary in order to qualify has been increased from $50 million to $200 million; and (iii) the multistate exemption has been amended to permit SEC registration for an investment adviser required to register with 15 (rather than 30) or more states. As a result of these amendments, pension consultant advisers advising plan assets of less than $200 million may be required to withdraw from SEC registration.

C. Registration Buffer

The Final Rules include a registration buffer which provides that (i) advisers with greater than $100 million in AUM but less than $110 million are permitted, but not required, to register with the SEC and (ii) advisers that are registered with the SEC and have at least $90 million in AUM need not withdraw their SEC registrations.

D. Assets Under Management

In general, the amount of AUM will determine whether an adviser must register with the SEC or the states. The Final Rules provide that the SEC will use a uniform method for calculating AUM for purposes of (i) determining eligibility for SEC registration, (ii) reporting AUM on Form ADV, and (iii) the new exemptions from SEC registration (see Section III *"Exemption from SEC Registration"* below). Under the Final Rules, in order to calculate this uniform AUM or "Regulatory AUM" an adviser must:

- include the value of any securities portfolios (i.e., at least 50% of the total value of the account consists of securities) or any private fund for which it provides continuous and regular supervisory or management services, regardless of the nature of the assets held by the portfolio and/or the fund (e.g., proprietary assets, assets managed without receiving compensation, or assets of foreign clients);
- include the amount of any uncalled capital commitments made to a fund;
- not subtract any outstanding indebtedness and other accrued but unpaid liabilities that remain in a client's account and are managed by the adviser; and
- use market value, or fair value when market value is unavailable, in determining Regulatory AUM.

Advisers are required to assess their eligibility for registration on an annual basis. If an adviser is no longer eligible for SEC registration at the end of its fiscal year, the Final Rules provide a 180-day grace period from the adviser's fiscal year end to allow it to switch to state registration.

E. Transition to State Registration for Mid-Sized Advisers

Under the Final Rules, most mid-sized advisers currently registered with the SEC will be required to withdraw their registration with the SEC and register with one or more state securities authorities (unless their home state is Minnesota, New York or Wyoming). Although the Dodd-Frank Act amendments are in effect as of July 21, 2011 to provide for the general transition of mid-sized advisers to state registration, the SEC has extended the deadline for mid-sized advisers to withdraw their SEC registrations to June 28, 2012 as follows:

- *mid-sized advisers registered with the SEC as of July 21, 2011:* must remain registered with the SEC (unless an exemption from registration is available) until January 1, 2012. They may withdraw their registrations at any time after January 1, 2012 but not later than June 28, 2012.
- *mid-sized advisers applying for registration prior to July 21, 2011:* may register with either the SEC or the appropriate state securities authority, but those who register with the SEC will be required to withdraw their registrations by June 28, 2012.

- *mid-sized advisers applying for registration after July 21, 2011:* must register with the appropriate state securities authority (unless located in New York, Minnesota or Wyoming or an adviser to a registered investment company or business development company or eligible to use a Rule 203A-2 exemption).

See Section IV.A. below, "*Required Filing of Amendment to Form ADV*" for a description of the process for the withdrawal of mid-sized adviser SEC registrations.

III. EXEMPTION FROM SEC REGISTRATION

A. General Rules

The Dodd-Frank Act eliminated the current "private adviser" exemption. In lieu of the private adviser exemption, the Dodd-Frank Act created three new exemptions from SEC registration: (i) an exemption for advisers solely for venture capital funds (the "VC Fund Exemption"); (ii) an exemption from registration for advisers that solely advise private funds with aggregate AUM in the United States of less than $150 million (the "Private Fund Adviser Exemption"), and (iii) an exemption from registration for advisers located outside of the United States that have limited AUM and clients in the United States (the "Foreign Private Adviser or FPA Exemption"). The Final Rules implement and define each of these exemptions, as set forth below.

Note that the FPA Exemption is a complete exemption that imposes no ongoing compliance obligations, whereas the VC Fund Exemption and the Private Fund Adviser Exemption are conditional exemptions that subject advisers to the Exempt Reporting Adviser compliance regime (see Section IV.C "*Exempt Reporting Advisers*" below).

Note that these new exemptions are not mandatory. An adviser that qualifies for any of the exemptions could choose to register (or remain registered) with the SEC, provided it has at least $100 million in AUM.

In addition, although exempt from SEC registration, advisers relying on any of these exemptions are still subject to applicable state registration provisions.

B. Private Fund and Place of Business Definitions

The terms "private fund" and "place of business" are essential components of the exemptions.

As defined in the Dodd-Frank Act, a "private fund" is a fund that would be regulated as an "investment company" but for Section 3(c)(1) (funds with not more than 100 owners) or Section 3(c)(7) (funds owned by qualified purchasers only) of the U.S. Investment Company Act of 1940, as amended (the "Investment Company Act"). The Final Rules make clear that any fund qualifying for exclusion under Section 3(c)(1) or Section 3(c)(7) may be treated as a private fund **even if** it also qualifies for exclusion from the definition of "investment company" pursuant to another provision of the Investment Company Act, such as Section 3(c)(5)(C) (funds primarily engaged in acquiring interests in real estate). The adviser must, however, treat the fund as a private fund for all purposes under the Advisers Act, including for purposes of reporting on Form ADV.

The Final Rules define "place of business" to mean (i) any office where the investment adviser regularly provides advisory services, solicits, meets with, or otherwise communicates with clients, whether U.S. or non-U.S. and (ii) any other location held out to the public as a place where the adviser conducts any such activities. It also includes any location where an adviser conducts research

or other activities intrinsic to the provision of advisory services. It does not include an office where an adviser does not communicate with clients and solely performs administrative services and back-office activities, provided that such services and activities must not be intrinsic to providing investment advisory services.

Non-U.S. advisers with U.S. affiliates will not generally be presumed to have a place of business in the United States. A non-U.S. adviser might be deemed to have a place of business in the United States, however, if its personnel regularly conduct activities at an affiliate's place of business in the United States.

C. Venture Capital Fund Exemption

The Dodd-Frank Act amended the Advisers Act to exempt investment advisers that solely advise venture capital funds from registration, and directed the SEC to define the term "venture capital fund." As summarized below, the Final Rules make a number of changes to the earlier definition of a "venture capital fund" included in the proposed rules, and in particular relax the restrictions on portfolio investments.

The Final Rules define a venture capital fund (a "VC Fund") as follows:

A "private fund" (see definition above) that meets the following five requirements:

(1) holds no more than 20% of its aggregate capital commitments in non-qualifying investments (NQIs), other than short-term holdings of cash, cash equivalents and money market funds;

(2) does not borrow, provide guarantees or otherwise incur leverage in excess of 15% of its capital, and such borrowing, guarantee or indebtedness is for a non-renewable term of not more than 120 days (any guarantee by the fund of a "qualifying portfolio company's" obligations up to the amount of the value of the fund's investment in the company is not subject to the 120 day limit);

(3) does not permit investors to withdraw or redeem their interests except in extraordinary circumstances;

(4) represents itself as pursuing a venture capital strategy to its investors and prospective investors; and

(5) is not registered under the Investment Company Act and has not elected to be a "business development company."

As set forth in the above definition, a VC Fund may invest up to 20% of its aggregate capital commitments in NQIs. **This is a significant change from the original proposal.** The Final Rules provide that this 20% be measured based on aggregate capital commitments rather than on invested capital or contributed capital. Further, the NQIs are permitted be valued at their historical cost. VC Funds may also choose to have NQIs measured at fair value, but the cost or fair value methodology must be applied consistently throughout the term of the fund. The determination of the 20% basket calculation need only be made at the time of making an NQI, based on the NQIs held by the venture capital fund immediately after the NQI acquisition.

Except for the 20% basket described above and short-term investments, a VC Fund must only invest in "qualifying investments" which are defined as:

- an equity security issued by a "qualifying portfolio company" that has been acquired directly by the fund from the qualifying portfolio company,
- any equity security issued by a qualifying portfolio company in exchange for an equity security described above, or
- an equity security issued by a company of which a qualifying portfolio company is a majority-owned subsidiary, or a predecessor, and is acquired by the fund in exchange for an equity security described above.

A "qualifying portfolio company" is a private operating company that:

- is not an affiliate of a public company, and
- does not borrow in connection with the fund's investment and distribute to the fund the proceeds of such borrowing in exchange for the fund's investment.

As a result, a VC Fund may hold up to 20% of its committed capital in public companies, securities purchased in secondary transactions, debt instruments, and other NQIs.

An adviser would be eligible to rely on the VC Fund Exemption only if it solely advised VC Funds that met all of the elements of the above definition, or if the adviser were grandfathered. A non-U.S. adviser would be eligible to rely on the VC Fund Exemption only if all of its clients, whether U.S. or non-U.S., are VC Funds. An existing VC Fund may be grandfathered, even if it does not meet all of the criteria for the new exemption, so long as it:

- has represented to investors at the time of the offering of its securities that it pursued a venture capital strategy;
- has sold securities to one or more unrelated investors prior to December 31, 2010; and
- does not sell securities to or accept any new capital commitments from any person after July 21, 2011 (although it may call previously committed capital).

D. Small Private Fund Adviser Exemption

New Section 203(m) of the Advisers Act exempts from SEC registration investment advisers that advise only private funds and that have less that $150 million in AUM in the United States. The proposed rules addressed several interpretive questions raised by this new exemption and were adopted substantially as proposed.

1. Advises Only Private Funds

To meet this condition, advisers with a principal office and place of business in the United States may only have advisory clients that are "private funds" (see definition above). A single non-private fund client would render this exemption unavailable, but an adviser could advise an unlimited number of private funds, provided that the aggregate value of the adviser's private fund assets is less than $150 million. Advisers with **no** principal office and place of business in the United States (a "non-U.S. adviser") will qualify for this exemption so long as all of the adviser's clients that are United States

persons[6] are private funds. Under this approach, a non-U.S. adviser would not lose the Private Fund Adviser Exemption as a result of its business activities outside the United States. Single-investor funds used to avoid registering under the Advisers Act will not be considered private funds for purposes of this exemption.

2. Private Fund Assets

An adviser would have to aggregate the value of all assets of the private funds it manages in the United States to determine if the adviser remains below the $150 million threshold. Advisers must calculate the value of private fund assets annually (and not quarterly as originally proposed) in accordance with the definition of "regulatory assets under management" set forth in amended Form ADV. See Section II.D. "*Assets Under Management*" above for more details on the calculation of assets under management for this purpose. A sub-adviser would have to count only that portion of the private fund assets for which it has responsibility. **Advisers would be required to include any uncalled capital commitments in the calculation.**

3. Assets Managed in the United States

All of the private fund assets of an adviser with a principal office and "place of business" (see definition above) in the United States are considered to be "assets under management in the United States," even if the adviser has offices outside of the United States that participate in managing such assets. A non-U.S. adviser, however, must only count private fund assets it manages at a place of business in the United States toward the $150 million asset limit under the exemption. An adviser's principal office and place of business is the location where the adviser controls, or has ultimate responsibility for, the management of private fund assets, and this will be the place where all of the advisers' assets are deemed managed, even if day-to-day management of certain assets may also take place at another location.

If a non-U.S. adviser has a place of business in the United States, it may rely on this exemption only if all of the clients whose assets the adviser manages at the place of business are private funds and the assets managed at that place of business have a total value of less than $150 million. A non-U.S. adviser with no private funds or other clients who are U.S. persons, and no place of business in the United States, should be eligible for the Private Fund Adviser Exemption or otherwise not be subject to SEC registration – even if assets under management attributable to U.S. investors in the adviser's non-U.S. client private funds are over $25 million or $150 million. However, in the adopting release, the SEC stated that whether a non-U.S. adviser with no place of business in the United States and no U.S. clients would be subject to registration depends on whether there is sufficient use of U.S. jurisdictional means.

4. Annual Verification of Eligibility to Use Exemption

An adviser relying on the Private Fund Adviser Exemption must file *annually* a Form ADV update amendment to report its AUM. If an adviser reports in its annual updating amendment that it has greater than $150 million of private fund assets under management, it is no longer eligible for the Private Fund Adviser Exemption and will be required to register unless it qualifies for another exemption. If the adviser has complied with all reporting requirements applicable to Exempt Reporting Advisers (see Section IV.C. "*Exempt Reporting Advisers"* below), it has 90 days after filing the annual updating amendment to register with the SEC. This 90-day transition period is not available to advisers that have not complied with Exempt Reporting Adviser requirements or have accepted a

client that is not a private fund. **A private fund adviser relying on this exemption must register with the SEC before accepting a client that is not a private fund.**

E. Foreign Private Adviser Exemption

New Section 203(b)(3) of the Advisers Act exempts "foreign private advisers" ("FPA") from SEC registration. A FPA is any investment adviser that:

- has no "place of business" (see definition above) in the United States;
- has a total of fewer than 15 clients in the United States and investors in the United States in private funds (see definition above) advised by the adviser;
- has aggregate AUM attributable to clients in the United States and investors in the United States in private funds advised by such adviser of less than $25 million (or such higher amount specified by the SEC); and
- neither holds itself out generally to the public in the United States as an investment adviser nor acts as an investment adviser to any registered investment company or any business development company.

As originally proposed, the Final Rules clarify certain terms used in the FPA Exemption. The FPA Exemption is a complete exemption that imposes no ongoing compliance obligations.

1. Who Are a FPA's Clients?

A FPA may treat as a single client a natural person and: (i) that person's minor children (whether or not they share the natural person's principal residence); (ii) any relative, spouse, or relative of the spouse of the natural person who has the same principal residence; (iii) all accounts of which the natural person and/or the person's minor child or relative, spouse, or relative of the spouse who has the same principal residence are the only primary beneficiaries; and (iv) all trusts of which the natural person and/or the person's minor child or relative, spouse, or relative of the spouse who has the same principal residence are the only primary beneficiaries.

A FPA may also treat as a single "client" (i) a corporation, general partnership, limited partnership, limited liability company, trust, or other legal organization to which the adviser provides investment advice based on the organization's investment objectives, and (ii) two or more legal organizations that have identical shareholders, partners, limited partners, members, or beneficiaries. All persons for whom the adviser provides investment advisory services without compensation must be counted as clients. In addition, the Final Rules avoid potential double-counting by providing that an investment adviser need not count (a) a private fund as a client if any investor in the private fund was counted as an investor for purposes of determining the availability of the FPA Exemption, or b) a person as an investor in a private fund if the person was also counted as a client.

2. Private Fund Investors

An "investor" in a private fund is any person who would be included in determining the number of beneficial owners of the outstanding securities of a private fund under Section 3(c)(1) of the Investment Company Act, or considered in determining if the outstanding securities of a private fund are owned exclusively by qualified purchasers under Investment Company Act Section 3(c)(7). Beneficial owners of short-term paper issued by the private fund will also be included in determining

the number of beneficial owners. In order to avoid double-counting, a FPA would be able to treat as a single investor any person who is an investor in two or more private funds advised by the FPA. In a master-feeder structure, for example, the investors in the feeder funds and not the feeder funds themselves, would be treated as investors in the master fund. Also, an adviser would need to count as an investor any holder of an instrument, such as a total return swap, that effectively transfers the risk of investing in the private fund from the record owner of the private fund's securities. The Final Rules, unlike the proposal, do not treat as investors beneficial owners who are "knowledgeable employees" with respect to a private fund.

3. In the United States

The definition of "foreign private adviser" employs the term "in the United States" in several contexts including: (i) limiting the number of, and assets under management attributable to, an adviser's "clients" "in the United States" and "investors" "in the United States" in private funds advised by the adviser; (ii) exempting only those advisers without a place of business "in the United States;" and (iii) exempting only those advisers that do not hold themselves out to the public "in the United States" as an investment adviser. As originally proposed, the Final Rules define "in the United States" generally by incorporating the definition of a "U.S. person" and "United States" under Regulation S.

An exception exists for any discretionary account or similar account that is held for the benefit of a person "in the United States" by a non-U.S. dealer or other professional fiduciary. Such account is deemed "in the United States" if the dealer or professional fiduciary is a related person of the investment adviser relying on the exemption. In addition, the Final Rules clarify that if a client or investor was not "in the United States" when it became a client of the investment adviser or acquired its interest in the investment adviser's private fund (as applicable), the client or investor may continue to be treated as such even after relocating to the United States.

4. Assets Under Management

"Assets under management" is defined by reference to the calculation of "regulatory assets under management" for Item 5 of Form ADV. See Section II.D. "*Assets Under Management"* above.

5. Annual Verification of Eligibility to Use Exemption

Advisers relying on the FPA Exemption are not considered Exempt Reporting Advisers and therefore are not required to file an annual updating amendment to the Form ADV. The Final Rules do not address the time period by which a non-U.S. adviser relying on the Foreign Private Adviser Exemption must register with the SEC after becoming ineligible to rely on this exemption due to an increase in the value of private assets attributable to U.S. clients and investors in the United States.

6. Affiliated Advisers and Unibanco

In the Final Rules, the SEC reaffirmed the validity of the *Unibanco* line of no-action letters; thus a non-U.S. adviser affiliated with an SEC registered adviser will not be required to register with the SEC if it follows the guidance provided by the SEC in those letters. The SEC also indicated that it expected the SEC staff, where appropriate, to provide guidance to the application of these letters in the context of the new exemptions.

IV. ADDITIONAL REPORTING REQUIREMENTS

A. Required Filing of Amendment to Form ADV

The Final Rules amend Form ADV to require each adviser registered with the SEC (and each applicant for registration) to identify whether it is eligible to register with the SEC because it:

- is a large adviser (having $100 million or more of AUM or $90 million or more if the adviser is already SEC registered and is filing its annual updating amendment);
- is a mid-sized adviser that does not meet the criteria for state registration and examination (i.e., is located in Minnesota or New York);
- has its principal office and place of business in Wyoming or outside the United States;
- meets the requirements for one of the Section 203A exemptions;
- is an adviser (or sub-adviser) to a registered investment company;
- is an adviser to a business development company and has at least $25 million of AUM; or
- has some other basis for registering with the SEC.

Each investment adviser registered with the SEC on January 1, 2012 (regardless of size) must file an amendment to its Form ADV no later than March 30, 2012. Each investment adviser must report in this amendment (and in its annual updating amendments thereafter): (i) the market value of AUM and (ii) the basis for registration with the SEC as set forth above. For the year 2012, if an adviser is not eligible for SEC registration, the adviser will have an additional 90 days (until June 28, 2012) in which to withdraw its SEC registration and, to the extent required by state law, register with one or more states.

In future years, if an adviser is no longer eligible for SEC registration at the end of its fiscal year, the adviser has 180 days from its fiscal year end to withdraw from SEC registration and switch to state registration. Because advisers are required to assess their eligibility for registration on an annual basis, advisers will not need to switch frequently between state and SEC registration as a result of midyear changes in the value of an adviser's regulatory AUM.

The SEC may cancel the registration of investment advisers that fail to file an amendment or withdraw their registrations in accordance with the Final Rules.

B. Additional Form ADV Disclosures

The Final Rules amend Form ADV to require advisers to provide additional information about (i) the private funds they advise, (ii) their advisory business (including data about the types of clients they have, their employees, and their advisory activities), as well as business practices that may present significant conflicts of interest (such as the use of affiliated brokers, soft dollar arrangements, and compensation for client referrals), (iii) non-advisory activities and their financial industry affiliations, and (iv) other information intended to improve the SEC's ability to assess compliance risks and to identify advisers that are subject to the Dodd-Frank Act's requirements concerning certain incentive-based compensation arrangements.

1. Private Fund Reporting

The Final Rules expand the information advisers must provide about the private funds they advise. **All information will be made publicly available**. Both registered advisers and Exempt Reporting Advisers must furnish this information. Certain information requirements will only apply to private funds that the adviser (and not a related person) advises. To avoid multiple reporting for each private fund, a sub-adviser may exclude private funds for which an adviser is reporting on another Form ADV Schedule D and an adviser sponsoring a master-feeder arrangement may submit a single Schedule D for the master fund and all of the feeder funds that would otherwise be submitting substantially identical data. Finally, an adviser with a principal office and place of business outside the United States may omit a Schedule D for a private fund that is not organized in the United States and that is not offered to, or owned by, "United States persons."

New Section 7.B.1 of Schedule D requires the following additional identifying information: (i) the name of the private fund[7], (ii) the state or country where the private fund is organized, (iii) the name of the private fund's general partner, directors, trustees or persons occupying similar positions, (iv) information about the organization of the fund, including whether it is a master or a feeder fund, and information about the regulatory status of the fund and its adviser, including the exclusion from the Investment Company Act on which it relies, whether the adviser is subject to a foreign regulatory authority, and whether the fund relies on an exemption from registration of its securities under the Securities Act of 1933, (v) whether the adviser is a sub-adviser to the private fund, (vi) the name and SEC file number of any other advisers to the fund, (vii) the fund's gross assets, (viii) the type of investment strategy employed by the adviser[8] within seven broad categories, (ix) the number and the types of investors in the fund, (x) the minimum amounts required to be invested by fund investors, (xi) whether clients of the adviser are solicited to invest in the fund and what percentage of the other clients has invested in the fund, and (xii) information concerning five types of service providers (i.e., auditors, prime brokers, custodians, administrators and marketers). Advisers are required to name these service providers, and provide certain information concerning, among other things, the services they provide, and whether they are affiliated with the adviser. The SEC decided to not require disclosure of each private fund's net assets or a breakdown of private fund assets and liabilities.

2. Advisory Business Information

The Amended Form ADV requires registered advisers to provide additional information about (i) the adviser's employees, (ii) the number and types of clients the adviser services, (iii) the approximate amount of the adviser's regulatory assets under management attributable to each client type, (iv) the percentage of the adviser's clients that are not United States persons and (v) the types of advisory activities the adviser performs. The SEC had proposed that registered advisers disclose the types of investments with respect to which the adviser provided advice during the fiscal year for which it is reporting. In lieu of such reporting, the revised Form ADV will require advisers to indicate whether they report on their Part 2A Brochure that they provide investment advice only with respect to limited types of investments.

3. Other Business Activities and Financial Industry Affiliations

Items 6 and 7 of Form ADV Part 1A require advisers, including Exempt Reporting Advisers, to report those financial services the adviser or a related person is actively engaged in providing by reference to lists of financial services set forth in the items. The Final Rules expand the lists to include business as a trust company, registered municipal advisor, registered security-based swap dealer, and major security-based swap participant, accountants and lawyers.

4. Participation in Client Transactions

Item 8 currently requires an adviser to indicate if it has discretionary authority to determine the brokers or dealers for client transactions and if it recommends brokers or dealers to clients. New Item 8 will also (i) ask whether any of the brokers or dealers are related persons of the adviser, (ii) ask an adviser that indicates that it receives "soft dollar benefits" to report whether all those benefits qualify for the safe harbor under section 28(e) of the Securities Exchange Act of 1934 (the "Exchange Act") for eligible research or brokerage services, and (iii) ask whether the adviser or a related person receives direct or indirect compensation for client referrals to complement the existing question concerning whether the adviser compensates any person for client referrals.

5. Reporting $1 Billion in Assets

Each adviser must indicate in Item 1 whether or not the adviser had $1 billion or more in assets as of the last day of the adviser's most recent fiscal year. The amount of assets must be the adviser's total assets determined in the same manner as the amount of "total assets" is determined on the adviser's balance sheet for its most recent fiscal year end. This information will enable the SEC to identify those investment advisers that would be subject to a proposed future rule addressing certain excessive incentive-based compensation arrangements.

6. Other Amendments to Form ADV

The proposed amendments also include a number of additional changes unrelated to the Dodd-Frank Act that are intended to improve the SEC's ability to assess compliance risks, such as: (i) requiring an adviser to provide contact information for its chief compliance officer (not applicable to Exempt Reporting Advisers which are discussed below), (ii) whether the adviser or any of its control persons is a public reporting company under the Exchange Act, (iii) the total number of persons that act as qualified custodians for the adviser's clients in connection with advisory services the adviser provides to its clients, and (iv) three technical changes with respect to the reporting of disciplinary events.

C. Exempt Reporting Advisers

If an adviser is able to fall within the VC Fund or Private Fund Adviser Exemption, it will not need to register with the SEC as an investment adviser, but it will be subject to the lesser level of regulation under the Dodd-Frank Act as an "Exempt Reporting Adviser". Despite extensive industry commentary, the Final Rules differ only slightly from the proposals.

Exempt Reporting Advisers are required to file, and periodically update, Form ADV (renamed as the "Uniform Application for Investment Adviser Registration and Reporting Form By Exempt Reporting Advisers") on the SEC's adviser electronic filing system (the Investment Adviser Registration Depository), and these reports would be publicly available on the SEC's website. However, rather than completing all of the items on Part 1A of Form ADV, Exempt Reporting Advisers would fill out a limited subset of items, including:

- Basic identification details about an Exempt Reporting Adviser such as name, address, contact information, form of organization, the identity of its owners and affiliates and the exemption(s) that it is relying on to report, rather than register, with the SEC (Items 1 (Identifying Information), 2C (SEC Reporting by Exempt Reporting Advisers), 3 (Form of Organization) and 10 (Control Persons) and corresponding sections of Schedules A, B and C);

- Details about the private funds the investment adviser manages and about other business activities that the investment adviser and its affiliates are engaged in that present conflicts of interest that may suggest significant risk to clients (Items 6 (Other Business Activities) and 7 (Financial Industry Affiliations and Private Fund Reporting) and corresponding sections of Schedule D)—see Section IV.B.1 "*Private Fund Reporting*" above; and

- The disciplinary history of the investment adviser and its employees (Item 11 (Disclosure Information)).

Because Exempt Reporting Advisers manage private funds, they are required to complete the expanded information required by Item 7B and Section 7B of Schedule D for each private fund they advise, as discussed above.

The Final Rules do not require, as originally proposed, Exempt Reporting Advisers to disclose: (i) each private fund's net assets; (ii) the private fund's assets and liabilities separated by class and categorization in the fair value hierarchy established under GAAP; and (iii) the percentage of each fund owned by particular types of beneficial owners. The SEC did, however, reserve the right to require information requested in (ii) and (iii) above as part of its proposed Form PF.[9]

The first filing must be made between January 1 and March 30, 2012. In future years, each Exempt Reporting Adviser must file its initial report with the SEC on Form ADV no later than 60 days after relying on the venture capital or small private fund adviser exemption.

An Exempt Reporting Adviser, like a registered adviser, must amend its report on Form ADV: (i) at least annually, within 90 days of the end of the adviser's fiscal year; and (ii) more frequently, if required by the instructions to Form ADV. An Exempt Reporting Adviser must update Items 1 (Identification Information), 3 (Form of Organization), or 11 (Disciplinary Information) promptly if they become inaccurate in any way, and must update Item 10 (Control Persons) if it becomes materially inaccurate. An Exempt Reporting Adviser will also have to file an amendment to its Form ADV when it ceases to be an Exempt Reporting Adviser.

An Exempt Reporting Adviser may also be subject to examination by the SEC. Nevertheless, the SEC has stated that it does not intend to conduct routine compliance examinations of Exempt Reporting Advisers. The SEC does, however, reserve its right to conduct "cause" examinations where there are indications of wrongdoing (i.e., prompted by tips, complaints or referrals).

The SEC will address recordkeeping requirements for Exempt Reporting Advisers in a future release.

V. AMENDMENTS TO "PAY TO PLAY" RULE

The Final Rules also amend Rule 206(4)-5 of the Advisers Act, the investment adviser "pay-to-play" rule, in response to changes made by the Dodd-Frank Act. The "pay to play" rule (which applies to both registered and unregistered advisers) generally prohibits investment advisers from engaging directly or indirectly in pay-to-play practices identified in the rule.

The Final Rules amend the scope of the pay-to-play rule to make it applicable to Exempt Reporting Advisers and Foreign Private Advisers. The Final Rules also add "registered municipal advisors" to the list of entities referred to as "regulated persons" that registered advisers are permitted to pay to solicit government entities if such municipal advisors are subject to the pay-to-play rules adopted by the

Municipal Securities Rulemaking Board that are at least as stringent as the Advisers Act pay-to-play rule.

VI. SIGNIFICANT DATES

July 20, 2011—All advisers relying on the "private adviser" exemption as of this date may delay registration with the SEC until March 30, 2012.

July 21, 2011

- an investment adviser that commences operations on or after this date will be required to register with the SEC unless it qualifies for an exemption
- advisers to venture capital funds that will not qualify for the VC Fund Exemption but seek to rely on the "grandfathering provision" must stop selling securities and accepting capital commitments

January 1, 2012

- Mid-sized SEC-registered investment advisers that must transition to state registration must remain SEC-registered until this date
- Exempt Reporting Advisers may begin filing Form ADV

February 14, 2012—All advisers relying on the "private adviser" exemption that are required to register should file Form ADV by this date

March 30, 2012

- All advisers newly required to register with the SEC as a result of the repeal of the "private adviser" exemption must be registered
- All currently SEC-registered investment advisers must file an amendment to Form ADV confirming SEC registration eligibility.
- Exempt Reporting Advisers must file first reports on Form ADV by this date

June 28, 2012—Mid-size advisers no longer eligible for SEC registration must withdraw their SEC registrations by this date

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[1] "Rules Implementing Amendments to the Investment Advisers Act of 1940," Investment Advisers Act Release No. 3221 (June 22, 2011); "Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers," Investment Advisers Act Release No. 3222 (June 22, 2011).

[2] Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. 111-203, H.R. 4173) (111th Cong. 2010).

[3] See our previous alert, "*SEC Proposes Rules to Implement Dodd-Frank Act Regulation of Private Investment Funds and Their Managers*" available at http://www.paulhastings.com/assets/publications/1774.pdf?wt.mc_ID=1774.pdf.

[4] Although not addressed in this alert, the SEC also issued a release addressing the exclusion from the definition of "investment adviser" for "family offices" ("Family Offices," Investment Advisers Act Release No. 3220 (June 22, 2011)).

[5] Rule 203A-2 permits the following types of advisers to register with the SEC: (i) certain pension consultants, (ii) advisers affiliated with other SEC-registered advisers, (iii) advisers expecting to be eligible for SEC registration in 120 days, (iv) certain multi-state advisers and (v) certain internet advisers.

[6] With one exception, the Final Rules use generally the definition of U.S. Person found in Regulation S under the Securities Act of 1933 ("Regulation S"). For example, an adviser must treat a discretionary or other fiduciary account maintained outside the United States as a United States person if the account is held for the benefit of a United States person by a non-U.S. fiduciary who is a related person of the adviser. An adviser could not rely on the exemption if it established discretionary accounts for the benefit of U.S. clients with an offshore affiliate that would then delegate the actual management of the account back to the adviser.

[7] The Proposed Rules will permit an adviser that seeks to preserve the anonymity of a private fund client by maintaining its identity in code in its records to identify the private fund in Schedule D using the same code.

[8] There categories include: (i) hedge fund; (ii) liquidity fund; (iii) private equity fund; (iv) real estate fund; (v) securitized asset fund; (vi) venture capital fund; and (vii) other private fund.

[9] As proposed earlier this year, Form PF would provide additional information from private fund advisers that would be reported on a non-public basis pursuant to the Dodd-Frank Act. The information would be used to inform the SEC and the Financial Stability Oversight Council about the systemic risk profile of private fund advisers and the private funds they manage.