WHITE PAPERS PUBLISHED: JANUARY 18, 2011

Implementing Dodd-Frank: SEC Proposes Rules for "the Switch"

The Securities and Exchange Commission (SEC) recently proposed a number of new rules and rule amendments to implement changes to the Investment Advisers Act of 1940 (Advisers Act) contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). The new and amended rules focus primarily on registration thresholds and reporting requirements, including when advisers with less than $100 million in assets under management (AUM) must switch their registration between the SEC and one or more states; how advisers calculate their AUM; and what information advisers (both those who do and do not meet the new venture and private fund manager exemptions from registration under the Advisers Act) must publicly file concerning the private and venture funds they manage. Additionally, a newly proposed rule requires all SEC-registered advisers to amend their Form ADV to update their AUM in August 2011. Lastly, the SEC also proposed amendments to its “pay to play” rule that expand its reach and clarify who may be paid for certain client referrals.

Registration and Transition Requirements

Persons meeting the definition of “investment adviser” must register under the Advisers Act unless they are exempt or prohibited from registration. Dodd-Frank significantly modified the registration exemptions and prohibitions, some of which are outlined in our previous updates (SEC Proposes Dodd-Frank Say-on-Pay Rules, SEC Issues Proposed Investment Adviser Registration Exemptions).

The modifications to the Advisers Act contained in Dodd-Frank are intended to shift greater responsibility for monitoring small advisers to the states in order to allow the SEC to focus its oversight resources on large advisers that are more likely to engage in behavior that could pose a systemic risk to financial markets. Effective July 21, 2011, Dodd-Frank will add to the Advisers

Act registration prohibition of §203A advisers that (1) are required to register in the state in which their primary office is located, (2) if registered, are subject to examination by the state, and (3) have AUM between $25 - $100 million (unless the adviser would have to register in 15 or more states or manages a registered investment company or a business development company).

The proposed rules and amendments introduced by the SEC to implement the Dodd-Frank mandates contain several significant changes. First, all advisers, regardless of existing registration, must file an amended Form ADV and report the updated market value of their AUM by August 20, 2011 using the new AUM calculation method found in the form's revised instructions. Second, the new AUM calculation method requires an adviser to include *all* securities portfolios for which the adviser provides continuous and regular supervisory or management services, regardless of whether the assets are proprietary, managed without compensation or managed for a foreign client. Further, the SEC proposal will no longer allow advisers to subtract debt and other accrued but unpaid liabilities in client accounts from their AUM. These revisions eliminate an adviser's ability to manipulate AUM to avoid federal registration.

The proposed rule amendments eliminate the AUM buffer between $25 and $30 million in light of the increased federal registration threshold from $25 to $100 million contained in Dodd-Frank. Further, the proposed amendments provide that state-registered advisers who become SEC-eligible must switch to SEC registration within 90 days of filing their Form ADV update. The amendments also eliminate the safe harbor that currently protects advisers from enforcement actions if they have failed to register with the SEC based solely on their reasonable belief that they manage less than $30 million in assets. Finally, the proposed rules narrow the scope of existing exemptions from the federal registration prohibition for certain enumerated organizations that fail to satisfy the threshold.

Reporting Requirements

As we have noted previously, the SEC proposed new rules to require advisers of private and venture funds who are exempt from the Advisers Act registration to file Form ADV with the SEC on the IARD by August 20, 2011 and at least annually thereafter. The filing will include less information than registered advisers are required to submit, but advisers will incur a fee for the filing.

In an effort to better understand the risk profiles of its registered advisers (and therefore improve the allocation of its examination resources), the proposed SEC amendments expand the scope of information that registered advisers must report on Form ADV. The required disclosures are broad and comprehensive, and span topics from the structure and ownership of private funds managed by the adviser to more detailed information about the adviser's affiliations and business practices. These enhanced private fund reporting requirements are intended to provide a level of transparency to help the SEC identify practices that may harm investors and would deter advisers' fraud and facilitate earlier discovery of potential misconduct.

Pay to Play

Rule 206(4)-5, which was only recently adopted by the SEC under the Advisers Act, prohibits advisers from (a) advising government entities within two years after contributing to the campaign of an official associated with the entity, (b) paying persons other than “regulated persons” or advisory personnel to solicit advisory services from government entities, and (c) coordinating political contributions to government entity officials for which the adviser provides or seeks to provide services.

The SEC proposal expands the rule to also cover advisers to private and venture funds who are exempt from Advisers Act registration and foreign private advisers; to permit only payments to Municipal Securities Rulemaking Board-registered solicitors (instead of registered brokers or advisers); and to clarify the meaning of the term “covered associate.”

What This Means to You

Investment advisers, particularly those managing less than $100 million in assets and private funds, will face a different regulatory environment in 2011 as the SEC implements the changes to the Advisers Act contained in Dodd-Frank.

For an in-depth review and analysis of the Dodd-Frank changes and the SEC's proposed implementation rules including FAQ's and a reference matrix that compares existing requirements to the proposed new rules and amendments please see our **white paper**.

Contact Info

For additional information, please contact your Husch Blackwell attorney.