HUSCH BLACKWELL

THOUGHT LEADERSHIP

LEGAL UPDATES

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SEC Issues Proposed Investment Adviser Registration Exemptions

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The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) repealed the exemption from registration under the Investment Advisers Act of 1940 (Advisers Act) that was frequently utilized by advisers to private equity funds, hedge funds and venture capital funds: the so-called "15 client" exemption. The Dodd-Frank Act also provided a much narrower registration exemption under the Advisers Act for such advisers and authorized the Securities and Exchange Commission (the Commission) to prepare implementing regulations for the new limited exemptions. Recently proposed regulations reflect the Commission's effort to further define the exemptions applicable to: (i) advisers solely to venture capital funds, without regard to the number of such funds advised by the advisor or the size of such funds; (ii) advisers solely to "private funds" with less than $150 million in assets under management in the United States, without regard to the number or type of private funds advised; and (iii) non-U.S. advisers with less than $25 million in aggregate assets under management from U.S. clients and private fund investors and fewer than fifteen such clients and investors.

Venture Capital Fund Advisers

Proposed regulation 203(1)-(1) defines the terms "venture capital fund" and "pre-existing venture capital fund." A venture capital fund is a "private fund" that:

invests in equity securities of private companies in order to provide operating and business expansion capital and at least 80 percent of each such company's securities owned by the fund must be acquired directly from the company;

directly, or through its investment advisers, offers or provides significant managerial assistance to, or controls, each portfolio company;

does not borrow or otherwise incur leverage;

does not regularly offer its investors redemption or other similar liquidity rights;

represents itself as a venture capital fund to investors; and

is not registered under the Investment Company Act and has not elected to be treated as a business development company.

In addition to exempting from federal registration all advisers providing advice solely to venture capital funds fitting the definition above, the proposed regulations also grandfather advisers to certain pre-existing venture capital funds (a term also defined in the proposed regulations).

Private Fund Advisers

Proposed regulation 203(m)-(1) confirms that any investment adviser solely advising “private funds” need not register with the Commission unless the adviser has assets in excess of $150 million under management in the United States. A “private fund” is defined in the Dodd-Frank Act to include any pooled investment vehicle excluded from the definition of investment company by sections 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940. The proposed regulation clarifies the application of the Dodd-Frank Act changes to the Advisers Act to advisers of private funds outside of the United States and clarifies the manner and frequency with which assets under management must be calculated to determine whether they meet the $150 million threshold. Generally, each covered adviser must determine the amount of its private fund assets quarterly, based on the fair value of the assets at the end of the quarter. The proposed regulations contemplate that a private fund adviser with a principal office and place of business in the United States consider all private fund assets as “assets under management in the United States,” even if the adviser maintains offices outside the United States. The proposed regulation also clarifies that advising any “United States person” other than a private fund prevents an adviser from being able to rely on the private fund exemption. Finally, the proposed regulation provides a brief grace period after the $150 million threshold is exceeded before an adviser must register with the Commission.

Please note that an adviser exempt from registration by one of the two foregoing rules will nonetheless be subject to reporting obligations under a set of concurrently proposed regulations. The Commission has proposed requiring such advisers to electronically file Form ADV, the form registered advisers file, although with less information reported, by August 20, 2011. Such exempt advisers would be required to provide general indentifying information about their operations, and any disciplinary or regulatory events, in addition to significant information about each private or venture capital fund they manage. That information is proposed to include such funds’ structure, their valuations in three GAAP categories, their ownership and service providers, such as auditors, brokers, administrators and marketers.

Foreign Private Advisers

Finally, the proposed regulation defines certain terms to clarify the registration exemption from the Advisers Act available to a "foreign private adviser." That term is defined to mean any investment adviser that:

has no place of business in the United States;

has, in total, fewer than fifteen clients in the United States and investors in the United States invested in private funds advised by such adviser;

has aggregate assets under management attributable to a client in the United States and investors in the United States in private funds advised by such adviser of less than $25 million; and

is not holding itself out generally to the public in the United States as an investment adviser. Virtually this entire portion of the proposed regulation focuses on the definition of the key terms "client," "investor," "in the United States," and "holding out."

What this Means to You

Consistent with the objectives articulated in the Dodd-Frank Act, the proposed regulations very narrowly define the group of investment advisers now entitled to an exemption from registration under the Advisers Act. The proposed regulations will provide little comfort to advisers of most private funds that had relied on the 15 client exemption under the Advisers Act and will require them to register under the Advisers Act within three months of the end of the calendar quarter in which they no longer meet the new exemption.

Comment letters on the proposed rule are due by January 24, 2011. Consistent with the Dodd-Frank Act, the proposed regulations would go into effect on July 21, 2011.

Contact Info

If you have questions concerning this or any other investment management issue, please contact your Husch Blackwell attorney.

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