Commissioner Previews Potential Private Fund Adviser Rule Changes

Posted In Investment Advisers

3/16/2011

If you're reading this blog, then you had a better Ides of March than Julius Caesar did in 44 B.C.E.

In this March 5 post, I reported that the Commissioner of Corporations would be seeking comments on proposed amendments to Rule 260.204.9. Yesterday, the Commissioner issued this Invitation for Comments. As discussed in several earlier posts, Rule 260.204.9 must be amended to reflect the pending elimination of the "private adviser" exemption in Section 203(b)(3) of the Investment Advisers Act of 1940. The Dodd-Frank Act eliminates the "private adviser" exemption effective July 21, 2010.

The Commissioner has proposed the following changes to Rule 260.204.9:

- Adding a "bad girl" condition;
- Requiring that the person act as an adviser solely to private funds (as defined);
- Adding an application requirement;
- Requiring payment of a nonrefundable filing fee of $125;
- The person either have assets under management of not less than $100 million or provide investment advice solely to venture capital companies (as defined in the rule); and
- The person be exempt from federal registration under Section 203(l) or (m) of the Advisers Act.

I am pleased that the Commissioner is proposing to retain the definition of "venture capital company" found in the current version of the rule.

The Commissioner is specifically seeking comment on the following questions:

- To avoid the "retailization" of private alternative investment funds, should the exemption apply exclusively to advisers to Section 3(c)(7) funds (i.e., not to Section 3(c)(1) funds)?
- Should all persons investing in a Section 3(c)(1) fund be required to be qualified clients? If so, should the Department issue an order that "grandfathers" Section 3(c)(1) funds organized prior to July 21, 2010?
- Should the proposed statutory disqualification provisions be expanded to include additional factors?

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- Should the proposed asset under management threshold (AUM) be a different amount than that set forth in the proposed rule (i.e. $100 million)? If so, what is the basis for a different threshold?
- Are there criteria other than AUM that the Commissioner should consider to determine whether an adviser should be exempt (e.g., the fund is subject to an annual audit)?
- Should the Department's definition of venture capital company/fund conform to the proposed SEC definition?
- Should the Department adopt the North American Securities Administrators Association (NASAA) proposed model rule for an exemption for Private Fund Advisers?

The deadline for submitting comments is March 28, 2011. You can submit comments electronically to regulations@corp.ca.gov.

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