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A legal update from Dechert's Financial Services Group

SEC Adopts Final Dodd-Frank Amendment Rules Regarding Registration of Investment Advisers

The Securities and Exchange Commission ("SEC") on June 22, 2011 adopted three sets of rules, rule amendments and Form ADV amendments under the Investment Advisers Act of 1940 ("Advisers Act") to implement provisions of Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") regarding the registration of investment advisers with the SEC. The SEC proposed the exemption and implementation rules in November 2010.[1] Each of these rules, except for the exemption for advisers to venture capital funds, has been adopted in substantially the same form as previously proposed by the SEC. In addition, the SEC adopted the "family office" rule, which defines those "family offices" that would be excluded from the definition of investment adviser under the Advisers Act and, thus, would not be subject to regulation under the Advisers Act.[2]

Effective July 21, 2011, the Dodd-Frank Act eliminates Section 203(b)(3) of the Advisers Act, an exemption that 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 rules adopted by the SEC on June 22, 2011 (i) establish new exemptions from SEC registration and reporting requirements for certain advisers, (ii) reallocate regulatory responsibility for advisers between the SEC and the states, and (iii) extend until March 30, 2012 the compliance date for registration of advisers that would have relied on Section 203(b)(3).

A summary of the rules and rule amendments adopted June 22, 2011 by the SEC is set forth below. We will publish a full analysis of the new rules upon reviewing them in their final form.

Rules Implementing Amendments to the Advisers Act

These rules were adopted in substantially the same form as proposed:

- The rules increase the threshold for registration by advisers with the SEC from $25 million to $100 million in assets under management ("AUM").
  - Advisers with AUM between $25 million and $100 million must register in their home state as long as the adviser will be subject to examination in such state (all states confirmed that they will subject advisers registered with them to examination, except for Wyoming, Minnesota and New York).
  - All currently registered advisers will be required to file an updated Form ADV by March 30, 2012, indicating on what basis they qualify to remain registered with the SEC. Those advisers that no longer qualify for registration with the SEC must withdraw their registration by June 28, 2012.

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1 Rules Implementing Amendments to the Investment Advisers Act of 1940, Release No. IA-3221 (June 22, 2011), *available at* www.sec.gov/rules/final/2011/ia-3221.pdf.

2 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), *available at* www.sec.gov/rules/final/2011/ia-3222.pdf.

- Form ADV will be revised to allow the collection of information in the Form substantially similar to what had been proposed.
    - Further, "Exempt Reporting Advisers" (*i.e.*, advisers relying on the venture capital fund exemption or the mid-size private fund exemption) would be required to fill out a subset of items of the Form ADV and file such information with the SEC. In this regard, the SEC directed its staff to reevaluate the reporting requirements for Exempt Reporting Advisers, after the first set of annual filings are made, to better assess whether more or different information should be provided by such advisers to ensure the rules are working as intended.
- Amendments to the Pay-to-Play Rule were enacted to except registered municipal advisors from certain pay-to-play regulations, provided that such municipal advisors are registered with the SEC and subject to the Municipal Securities Rulemaking Board's ("MSRB") pay-to-play rule. In addition, the compliance date for the ban on the use of third-party solicitors has been extended to June 13, 2012, in order to allow the MSRB and FINRA to issue pay-to-play rules.

Exemptions from Registration

- **Venture Capital Fund Adviser Exemption** exempts from registration advisers that only manage "venture capital funds". The rule generally defines a "venture capital fund" as a private fund that (i) primarily invests in "qualifying investments", (ii) is not leveraged except for a limited amount on a short term basis, (iii) does not generally offer redemption rights to its investors, and (iv) represents itself to investors as pursuing a venture capital strategy.

  The most significant difference between the adopted rule and the proposed rule is that the adopted rule now allows up to 20% of a venture capital fund's committed capital to be invested in non-"qualifying investments." "Qualifying investments" are investments that meet the SEC's definition regarding equity securities in portfolio companies directly acquired for the purpose of providing operating and business expansion capital. In addition, as adopted, the venture capital fund exemption will no longer require the venture capital fund to offer or provide significant managerial assistance to a portfolio company, as was contemplated in the proposed rule. Under a grandfathering provision, a fund that (i) represented itself as being a venture capital fund, (ii) began raising capital prior to December 31, 2010, and (iii) ceases raising capital after July 21, 2011, would generally be considered to be a venture capital fund.

- **Mid-Sized Private Fund Adviser Exemption** was adopted substantially as proposed. It continues to bifurcate treatment of U.S. and non-U.S. advisers such that non-U.S. advisers may qualify for the exemption, which exempts advisers that solely advise "qualifying private funds" with less than $150 million AUM in the U.S., by only counting accounts that are managed from within the U.S. or are not qualifying private funds (even if a private fund contains U.S. investors) towards the $150 million AUM threshold. U.S. advisers must include all accounts managed worldwide when determining their AUM. The one substantial change related to this exemption involves how often a private fund adviser must calculate a private fund's assets. The final rule requires an adviser to value its assets annually.
    - **Definition of Private Fund** – Based on commenters' concerns that advisers to entities that could rely either on Section 3(c)(1) or 3(c)(7) under the Investment Company Act of 1940 or another exclusion from the definition of an "investment company" might lose the ability to rely on this exemption, the SEC expanded the definition of a "qualifying private fund" from solely those funds relying on Section 3(c)(1) or 3(c)(7) to include those funds that qualify for any exclusion from the definition of investment company (*i.e.*, certain real estate funds and funds relying on any other exclusions from the definition of an investment company will now qualify as qualifying private funds).
- **Foreign Private Adviser Exemption** rule definitions remain largely unchanged from the proposed rules. The Foreign Private Adviser Exemption, as enacted by the Dodd-Frank Act, refers to an adviser that, among other requirements: (i) has no place of business in the U.S.; (ii) has, in total, fewer than 15 clients and investors in the U.S. in private funds advised by the adviser; and (iii) has aggregate AUM of less than $25 million

(which dollar threshold may be increased by the SEC) attributable to: (x) clients in the U.S. (including U.S.-domiciled private funds); and (y) U.S. investors in private funds advised by the adviser.

- **Participating Affiliate Doctrine**. The SEC also clarified that the *Unibanco* line of no-action letters, which exempt from registration certain non-U.S. affiliates of registered investment advisers that solely advise non-U.S. clients, will still be effective under the new exemptions.

Family Office Rule

Many family offices also relied on the exemption previously found in Section 203(b)(3) and, thus, Congress instructed the SEC to adopt a rule providing for the exclusion of family offices from adviser registration. The rule was originally proposed in October 2010[3] and the definition of a family office has been broadened from its original scope. Specifically, the SEC has significantly expanded the definition of "family client" entities that can receive investment advice without violating the definition of a family office. Advisers not in compliance will also have until March 30, 2012 to register with the SEC, although a later compliance date of December 31, 2013 was granted for family offices that currently manage assets for non-profit organizations or charitable entities funded in part by non-family client assets in order to allow them to orderly transition out of such services.

The implementing rules were adopted upon a 3-2 vote. Commissioners Casey and Paredes objected to the implementing rules on the basis that the regulatory burdens on venture capital fund advisers under the "exempt-but-reporting" regime are too heavy, counter to Congressional intent, and would negatively impact capital formation.

The exemption rules and family office rule were adopted unanimously.

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[3] Family Offices, Release No. IA-3098 (Oct. 12, 2010), *available at* www.sec.gov/rules/proposed/2010/ia-3098.pdf.

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