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Financial Reform Law Changes Registration Requirements for Advisers to Private Funds

Unregistered managers of private funds need to be aware of significant changes in the laws regarding investment adviser registration. The Wall Street Reform And Consumer Protection Act, signed into law on July 21, 2010 (the "Act"), eliminated the "private adviser" exemption from registration available under Rule 203(b)(3) of the Investment Advisers Act. The "private adviser" exemption allowed an adviser to avoid registration, either state or federal, if the adviser did not hold itself out as an adviser, had fewer than 15 clients in the preceding 12 months, and did not advise an investment company registered under the Investment Company Act of 1940 (the "40 Act"). Advisers that provide investment advice to fewer than 15 private funds, such as private equity funds and hedge funds, commonly relied on this exemption to avoid registration. The Act eliminated the "private adviser" exemption so that advisers to private funds with greater than $150 million in assets under management will now be required to register with the SEC. Advisers solely to private funds with less than $150 million in assets under management will be excluded from federal registration but may be subject to state registration.

New Exemption for Venture Capital Fund Advisers

The Act also excluded from federal registration advisory entities that advise only "venture capital funds" and directed the SEC to conduct rulemaking to provide a definition of that term. In a late November Release, the SEC proposed to define "venture capital fund" as any private fund that:

1. invests in equity securities of private companies in order to provide operating and business expansion capital ("qualifying portfolio companies") and at least 80% of each company's securities owned by the fund were acquired directly from the qualifying portfolio company;
2. directly, or through its investment advisers, offers or provides significant managerial assistance to, or controls, the qualifying portfolio company;
3. does not borrow or otherwise incur leverage (other than limited short-term borrowing);
4. does not offer its investors redemption or other similar liquidity rights except in extraordinary circumstances;
5. represents itself as a venture capital fund to investors; and
6. is not registered under the 40 Act and has not elected to be treated as a business development company.

The SEC has proposed to grandfather an existing fund as a "venture capital fund" if it is a private fund that:

1. has represented to investors and potential investors at the time of the offering of the private fund's securities that it is a venture capital fund;
2. prior to December 31, 2010, has sold securities to one or more investors that are not related persons of any investment adviser of the private fund; and
3. does not sell any securities to (including accepting any committed capital from) any person after July 21, 2011.

Complying with the New Registration Requirements

The Act provides a one-year transition period before its registration requirements take effect. Nonetheless, advisers that will now be required to register should take action promptly, as the registration process takes time. For federal registration, advisers should plan for a minimum of 45 days after filing of the Form ADV, which is the period of time the SEC has to review the application from the date it is filed. State registration timelines vary but may be longer than 45 days. Advisers should keep in mind that it is likely there will be a flood of adviser registration applications going to frequently overworked and understaffed state securities agencies, which could increase approval times. Missouri advisers to private funds, in particular, should be aware that Missouri has instituted a new approval process that requires the applicant to submit a substantial amount of documentation upfront and involves a time-consuming and detailed review of the application materials.

New Recordkeeping Burdens Imposed on Exempt Advisers

In addition to expanding registration requirements, the Act includes provisions that require advisers to private funds, including those excluded or exempted from federal registration, to prepare and file limited disclosure information and to keep records as determined by the SEC. In the November Release, the SEC proposed that this information be submitted on Form ADV Part I through the Investment Adviser Registration Depository (IARD) system no later than August 20, 2011. The disclosures, which will be publicly available, will include basic information about the manager, its officers and owners, its other business activities, disciplinary history and the funds it manages. For each fund managed by the adviser, the adviser would be required to provide basic information about the fund's organization, structure, asset value, valuation structure, investors and key service providers.

If you have questions regarding any information contained in this alert you may contact one of the Thompson Coburn attorneys listed below:

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