

## SEC Offers Custody Rule Relief to Venture Capital and Private Equity Funds

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Following the adoption of the Dodd-Frank Act and amendments to the rules under the Investment Advisers Act of 1940 (the “Advisers Act”) adopted by the SEC, many previously unregistered managers to private funds, including venture capital and private equity funds, were required to register with the SEC under the Advisers Act. Among the new regulatory guidelines and restrictions that these managers became subject to was SEC Rule 206(4)-2 (the “Custody Rule”), which provides that securities and other assets over which an adviser has custody must be held by a “qualified custodian” (typically a bank, broker-dealer or trust company). Although the Custody Rule does contain a carve-out for “privately offered securities,” this exemption was limited to uncertificated securities that were restricted as to transfer. For many managers of private funds whose investments were limited to securities issued in private placements, but which were evidenced by a stock certificate, the result was a need retain a qualified custodian to hold the fund’s stock certificates and other physical evidences of their investments.

Last week the SEC issued IM Guidance Update No. 2013-04, which provides relief from the requirements of the Custody Rule with respect to certain privately offered securities, notwithstanding that that such securities were evidence by a certificate. Based on this guidance, certificates will not be required to be held by a qualified custodian, provided that the following factors are met:

1. the client is a pooled investment vehicle that issues audited financial statements in compliance with the Custody Rule;
2. the certificate can only be used to effect a transfer or to otherwise facilitate a change in beneficial ownership of the security with the prior consent of the issuer or the holders of the outstanding securities of the issuer;
3. ownership of the security is recorded on the books of the issuer or its transfer agent in the name of the client (ie. the fund);
4. the private stock certificate contains a legend restricting transfer; and
5. the private stock certificate is appropriately safeguarded by the adviser and can be replaced upon loss or destruction.

A full copy of the release may be found [here](#).

Advisers to private funds that invest solely in privately offered securities meeting the above criteria may want to examine their custody arrangements to determine what is appropriate based on their funds’ investment strategies. If you have any questions about any of the above, please contact Robert Sawyer of Foley Hoag’s Investment Management group.

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