Deadlines Loom for Advisers Required to Register under Dodd-Frank or Become an Exempt Reporting Adviser

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Asset managers are reminded that The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") implemented a significant change in the approach taken under the Investment Advisers Act of 1940, as amended (the "Advisers Act"), regarding the registration with the Securities and Exchange Commission (the "SEC") of advisers to unregistered funds. This change reflects two fundamental alterations of basic regulatory philosophy: a determination that advisers to such funds must register with the Securities and Exchange Commission (the "SEC") unless covered by a specific exemption from registration; and a greater reliance on state regulators to oversee advisers generally. The deadline for managers required to register with the SEC is March 30, 2012. In order to make certain that a registration is effective by March 30, managers should file an application with the SEC by February 14, 2012. Advisers which are exempt from registration going forward may still qualify as an "exempt reporting adviser" and have to file certain forms with the SEC by March 30, 2012, and should also be working to prepare such filing for submission in March.

As a reminder, the main exemptions available to managers are now the Venture Capital Exemption, the Private Fund Adviser Exemption, the Foreign Private Adviser Exemption, the Small Business Investment Company (SBIC) Exemption, and the Family Office Exemption. These exemptions, and the requirements for exempt reporting advisers, are summarized below.

The New Registration Rules

Elimination of the Private Investment Adviser Exemption

The Dodd-Frank Act repealed Section 203(b)(3) of the Advisers Act, the so-called Private Investment Adviser Exemption. Section 203(b)(3) exempted any investment adviser from registration with the SEC if the investment adviser (i) had fewer than 15 clients in the preceding 12 months, (ii) did not hold itself out to the public as an investment adviser and (iii) did not act as an investment adviser to a registered investment company or a business development company. The result of this change is that all investment advisers with at least $100 million of assets under management must register with the SEC as investment advisers unless they qualify for an exemption from registration.

State Registration of Mid-Sized Advisers

The Dodd-Frank Act also established that advisers with assets under management between $25 million and $100 million, or "mid-sized advisers" may not register with the SEC and must register with securities authorities in the state in which they maintain their principal office and place of business unless: (a) (i) the adviser is not required to be registered as an investment adviser with the securities commissioner (or any agency or office performing like functions) of the state in which it maintains its principal office and place of business; or (ii) if registered with that state, the adviser would not be subject to examination as an investment adviser by that securities commissioner1, (b) the adviser is required to register in 15 or more states, or (c) the mid-sized adviser is an adviser to a registered investment company or a business development company under the Investment Company Act of 1940.

Registration Timeline

New Rule 203A-1 establishes a timeline for adviser registration with the SEC and state securities authorities:

- Existing Registrants: Each adviser registered with the SEC as of January 1, 2012 must file an amendment to its Form ADV no later than March 30, 2012. If, based on this filing, it is determined that a mid-sized adviser is no longer eligible to remain registered with the SEC, the adviser must withdraw its registration with the SEC by filing Form ADV-W and register with the appropriate state securities authorities no later than June 28, 2012.
- New Applicants: All mid-sized advisers that are not registered with the SEC should consult the laws of the state in which they maintain their principal office and place of business to determine what state registration requirements may apply going forward. Advisers that are newly required to register with the SEC must do so by March 30, 2012. Because initial applications for registration can take up to 45 days to be approved, the SEC recommends that advisers file a complete application, both Part 1 and a brochure meeting the requirements of Part 2 of Form ADV, by February 14, 2012.

Rule 203A-1 also establishes a "buffer" for mid-sized advisers with assets under management close to $100 million to prevent an adviser from having to switch frequently between state and SEC registration as a result of changes in the value of its assets under management. The Rule raises the threshold above which a mid-sized adviser must register with the SEC to $110 million of assets under management; but, once registered with the SEC, an adviser need not withdraw its registration until it has less than $90 million of assets under management. Mid-sized advisers with assets under management between $100 million and $110 million may, but are not required, to register with the SEC. There are certain limited exceptions to the applicability of the buffer, including the limitation that the buffer does not apply to mid-sized advisers who serve as an investment adviser to a registered investment company or a business development company.

Exemptions from Registration

There are five new exemptions from the registration requirements of the Advisers Act for advisers to certain privately offered investment funds. An investment adviser is not required to rely on these exemptions; an adviser that qualifies for any of the exemptions could choose to register (or remain registered) with the SEC if it meets the other registration requirements. Advisers who qualify for these exemptions, while exempt from registration, may have to comply with certain reporting requirements as described more fully below. Advisers to funds should keep in mind that even though they may be exempt from registration with the SEC they may still have to register under applicable state law.

Venture Capital Exemption

Section 203(l) of the Advisers Act provides that an investment adviser that solely advises "venture capital funds" is exempt from registration under the Advisers Act.

Rule 203(l)-1 defines "venture capital fund" as a private fund that: (i) holds no more than 20 percent of the fund's capital commitments (the "20% Basket") in non-qualifying investments (other than short-term holdings) ("qualifying investments" generally consist of equity securities of "qualifying portfolio companies" that are directly acquired by the fund); (ii) does not borrow or otherwise incur leverage, other than as specifically permitted under the Rule; (iii) does not offer its investors redemption or other similar liquidity rights except in extraordinary circumstances; (iv) represents itself as pursuing a venture capital strategy to its investors and prospective investors; and (v) is not registered under the Investment Company Act of 1940 and has not elected to be treated as a business development company.

For many advisers to venture capital funds the 20% Basket is a key concept. Permitting venture capital funds to engage in some amount of non-qualifying investment activity provides advisers to venture capital funds with some investment flexibility, while precluding an adviser relying on the exemption from altering the primary character of the fund's investments.

The Venture Capital Exemption includes a grandfathering provision. The definition of "venture capital fund" includes any private fund that: (i) represented to investors and potential investors at the time the fund offered its securities that it pursues a venture capital strategy; (ii) has sold securities to one or more investors prior to December 31, 2010; and (iii) does not sell any securities to any person (including calling capital contributions under existing capital commitments) after July 21, 2011.

A non-U.S. adviser may rely on the Venture Capital Exemption if all of its clients, whether U.S. or non-U.S., are venture capital funds.

The SEC has cautioned that the Venture Capital Exemption and the Private Fund Adviser Exemption (described below) may not be combined. The SEC has stated that a combination of these exemptions runs contrary to the language of each exemption, which limits advisers relying on them to advising solely venture capital funds or solely private funds with assets under management in the United States of less than $150 million.

Private Fund Adviser Exemption

Section 203(m) of the Advisers Act provides that an investment adviser that solely advises private funds and has assets under management in the United States of less than $150 million is exempt from registration under the Advisers Act. An adviser that has one or more clients that are not private funds is not eligible for the exemption and must register under the Advisers Act unless another exemption is available. An adviser qualifying for this exemption may advise an unlimited number of private funds, provided the aggregate value of the assets of the private funds is less than $150 million, but, as discussed above, an adviser may not combine this exemption with the Venture Capital Exemption.

Advisers may be required to register under the Advisers Act as a result of increases in their private fund assets that occur from year to year, but changes in the amount of an adviser's private fund assets between annual updating amendments of the Form ADV should not affect the availability of the exemption. If an adviser reports in its annual updating amendment that it has $150 million or more of private fund assets under management, the adviser must apply for registration with the SEC within 90 days after filing the annual updating amendment (unless another exemption applies). This 90-day transition period is only available to advisers who have complied with all exempt adviser reporting requirements (described more fully below). An adviser who has not complied with the reporting requirements must register with the SEC before becoming ineligible for the Private Fund Adviser Exemption.

In the case of an adviser with a principal office and place of business outside of the United States, the exemption is available as long as all of the adviser's clients that are United States persons are qualifying private funds, and all assets that the non-U.S. adviser manages at a place of business in the United States are attributable to private fund assets and have a total value of less than $150 million.

The SEC has cautioned that an adviser managing more than $150 million in private fund assets may not reorganize as two separate advisers and rely on the Private Fund Adviser Exemption for each adviser. The SEC has stated that it will treat two or more affiliated advisers that are separately organized but operationally integrated as a single adviser for purposes of evaluating eligibility for the Private Fund Adviser Exemption.

Foreign Private Adviser Exemption

Section 203(b)(3) of the Advisers Act, as amended by the Dodd-Frank Act, provides an exemption from registration for certain foreign private advisers. A foreign private adviser is defined to mean any investment adviser that: (i) has no place of business in the United States; (ii) has, in total, fewer than 15 clients in the United States and investors in the United States in private funds advised by the investment adviser; (iii) has aggregate assets under management attributable to clients in the United States and investors in the United States in private funds advised by the investment adviser of less than $25 million; and (iv) does not hold itself out generally to the public in the United States as an investment adviser.

Non-U.S. advisers with more than $25 million in assets under management attributable to U.S. clients or investors may rely on either the Venture Capital Exemption or the Private Fund Adviser Exemption to the extent the adviser meets the qualifications for one of those exemptions.

SBIC Exemption

The Dodd-Frank Act provides an exemption from registration for any entity, regardless of the amount of its assets under management, that solely advises (a) small business investment companies that are licensees under the Small Business Investment Act of 1958; (b) entities that have received from the Small Business Administration notice to proceed to qualify for a license as a small business investment company under the Small Business Investment Act of 1958, which notice or license has not been revoked; or (c) applicants that are affiliated with 1 or more licensed small business investment companies described in (a) and that have applied for another license under the Small Business Investment Act of 1958 which application remains pending. It should be noted that if an investment adviser manages both a venture fund and a SBIC (that is not a venture fund) then the investment adviser would not be able to rely on either the SBIC exemption or the venture capital exemption, and would instead need to rely (if it qualifies) on the private fund adviser exemption, which is available only if the adviser has less than $150 million in assets under management and advises only private funds.

Family Office Exemption

Entities meeting the definition of "family office" are deemed not to be investment advisers for purposes of the Advisers Act. A family office is a company that (a) has no clients other than "family clients" as defined; (b) is wholly owned by family clients and is exclusively controlled by one or more family members and/or family entities and (c) does not hold itself out to the public as an investment adviser.

Exempt Adviser Reporting Requirements

Under the new rules, advisers relying on the Venture Capital Exemption or the Private Fund Adviser Exemption will be required to file, and periodically update, reports with the SEC. The reporting will involve completing and submitting certain section of Form ADV. These advisers will be required to file their first reports by March 30, 2012, and will need to be set up to do so several weeks in advance. Exempt reporting advisers will file reports on the SEC's investment adviser electronic filing system (IARD), and these reports will be publicly available on the SEC's website.

The SEC has indicated that it does not intend to conduct routine examinations of exempt reporting advisers due to a scarcity of resources. However, the SEC has reserved the right to conduct on-site visits of an exempt reporting adviser if necessary. After receipt of the first year's filings, the SEC plans to reconsider the information collected from exempt reporting advisers.

Amendments to the Pay to Play Rule

The SEC has also adopted amendments to Rule 206(4)-5, the "pay to play" rule, to address certain consequences arising from the Dodd-Frank Act's amendments to the Advisers Act and the Securities Exchange Act of 1934, as amended. These changes include (i) an amendment to the scope of the rule so that it applies both to exempt reporting advisers and foreign private advisers, (ii) the addition of municipal advisors to the categories of "regulated persons" excepted from the rule's prohibition on advisers paying third parties to solicit government entities, and (iii) the extension of the date by which advisers must comply with the ban on certain third-party solicitation from September 13, 2011 to June 13, 2012.

Note: The SEC has confirmed that mid-sized advisers with a principal office and place of business in New York or Wyoming must register or remain registered with the SEC if they have $25 million or more of assets under management and are not otherwise exempt from registration, because advisers are not subject to examination by the securities commissioner in such states.

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