September 14, 2010

ADVISERS TO PRIVATE FUNDS – DO YOU NOW HAVE TO REGISTER UNDER THE INVESTMENT ADVISERS ACT OF 1940?

This is one of a series of memos issued by the Investment Funds Practice Group of Gibson Dunn to investment advisers to "private funds" that may be required to register under the Investment Advisers Act of 1940 as a result of amendments included in the Dodd-Frank Wall Street Reform and Consumer Protection Act. ***Click here*** *to access the other memos.*

Registration of Private Fund Advisers

Many investment advisers to private funds currently are not required to register with the SEC on the basis of the exemption contained in Section 203(b)(3) of the Advisers Act for investment advisers with fewer than 15 clients. The Dodd-Frank Act eliminates this exemption completely. As a result, those private fund advisers currently relying on this exemption will be required to register with the SEC no later than July 21, 2011 (regardless of the number of clients they have) unless another exemption from registration is available.[1]

Registration Exemptions

The Act introduces a limited set of exemptions that may be available to certain private fund advisers. Many of the details of these exemptions await SEC rulemaking.

Small Private Fund Advisers

The Act exempts from registration "private fund" advisers with assets under management in the United States of less than $150 million. A "private fund" is defined under the Act as any issuer that would be an "investment company" under the Investment Company Act of 1940 (the "Investment Company Act") but for section 3(c)(1) or 3(c)(7) of that Act. Most private equity funds, hedge funds and venture capital funds, as well as many real estate funds, fall under this definition. The Act does not define "assets under management in the United States." However, we understand that the SEC will provide guidance on the meaning of this phrase, either through rulemaking or interpretative guidance.

Small private fund advisers that are exempt from SEC registration will nonetheless be required under the Act to maintain records and provide the SEC annual and other reports.[2]

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[1] The Act also prohibits private fund advisers (other than foreign private advisers, which are discussed below) from relying on the so called "intrastate exemption." Under this exemption, an adviser is not required to register if it does not provide advice with respect to securities listed on a national exchange and has clients only in the state in which the adviser has its principal office and place of business.

[2] Private fund advisers may want to assess whether their funds qualify for investment company exceptions other than under Sections 3(c)(1) or 3(c)(7) of the Investment Company Act in order to avoid the reporting,, record-keeping and certain other provisions of the Act (e.g., the swap clearing requirements) that apply to "private funds".

An adviser that qualifies for this exemption but still desires to register with the SEC is permitted to do so provided it has assets under management in the United States of at least $100 million (or such higher amount up to $150 million as the SEC may determine).[3]

Foreign Private Advisers

The Act establishes a limited exemption from registration for "foreign private advisers". To qualify as a "foreign private adviser" a private fund adviser must:

- have no place of business in the United States;
- have fewer than 15 clients and investors in the United States in private funds advised by the adviser;
- have assets under management attributable to clients in the United States and investors in the United States in private funds advised by the adviser of less than $25 million (or such higher amount as the SEC may determine);[4] and
- neither hold itself out generally to the public in the United States as an investment adviser, nor act as an investment adviser to any registered investment company (including a business development company).

By its terms, this exemption is very narrow. Importantly, when counting the number of investors in the United States, an adviser is required to look through the private fund to the investors. In addition, a non-U.S. adviser to non-U.S. private funds will not be able to rely on this exemption if one or more U.S. investors invest $25 million or more in its private fund(s). Given the narrow scope of this exemption, advisers to non-U.S. funds should assess whether their funds are "private funds" as defined in the Act, in order to avoid or limit the applicability of the look-through rule.

If a non-U.S. adviser does not meet the definition of "foreign private adviser", it may nonetheless avoid federal registration if it qualifies for another exemption. For example, a non-U.S. adviser with assets under management in the United States of less than $150 million would qualify for the small private fund adviser exemption.

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[3] Section 419 of the Act provides that any adviser may, at the discretion of the adviser, register with the SEC prior to July 21, 2011, subject to the SEC's rules. Therefore, advisers with assets under management of $25 million or more may, prior to July 21, 2011, register with the SEC. Absent guidance from the SEC or its staff, it is not clear whether advisers who are registered on July 21, 2011 with assets under management of less than $100 million (or such higher amount up to $150 million as the SEC may determine by rule) will be required to withdraw their registrations with the SEC.

[4] Unlike the exemption for small private fund advisers, which is based on "assets under management in the United States", the definition of "foreign private adviser" looks to whether the adviser has "assets under management *attributable to clients* in the United States and investors in the United States in private funds advised by the adviser" (emphasis added). The SEC is aware of this discrepancy in the language and is expected to address it either through rulemaking or interpretative guidance.

Commodity Trading Advisors

The Act creates a new exemption available to a commodity trading advisor that advises private funds and is registered with the Commodity Futures Exchange Commission, provided that the business of the advisor does not become predominately the provision of securities-related advice.

Venture Capital Fund Advisers

If an adviser is an investment adviser solely to one or more venture capital funds, it will not be required to register with the SEC, but will be subject to recordkeeping and reporting requirements. By no later than July 21, 2011, the SEC is required to issue final rules defining "venture capital fund" and prescribing the recordkeeping and reporting requirements for these advisers.

Family Offices

The Act amends the definition of "investment adviser" to exclude any "family office". The scope of this exclusion is to be clarified through rulemaking but is required to be consistent with existing SEC exemptions, and recognize the range of organizational, management and employment structures and arrangements employed by family offices. Senior SEC staff has indicated some willingness to exempt family offices that did not previously request relief, and clients may wish to consider in advance a definition of "family office" that will apply to them.

SBICs

The Act added an exemption for advisers to small business investment companies ("SBICs") licensed under the Small Business Investment Act of 1958.

Mid-Size Funds

Private fund advisers that are required to register with the SEC and that advise "mid-size" private funds will be subject to registration and examination procedures that may be less burdensome than those applicable to advisers to larger private funds. Congress has left it to the SEC to define "mid-size" private funds and to establish registration and examination procedures that reflect the level of systemic risk posed by "mid-size" funds in light of their size, governance and investment strategy.

State Registration Issues

Advisers that are not registered with the SEC may be required to register with one or more states, in which case they would be subject to regulation (and potentially examination) by

the relevant state regulator(s).[5] Even if registered with the SEC, advisers should assess state filing and licensing issues.[6]

Click here *for information on the SEC registration process and the recently amended Form ADV.*

Click here *for a discussion of the principal regulatory consequences that follow from SEC registration.*

Click here *for a summary checklist of some of the key compliance obligations of SEC-registered investment advisers.*

Gibson Dunn lawyers are available to assist in addressing any questions you may have regarding these issues. Please contact any of the following, or the Gibson Dunn lawyer with whom you work:

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5 An adviser is required to register with the SEC, and not with any state, if it is an adviser to a registered investment company or business development company. In addition, an adviser that is required to register with 15 or more states may elect to register with the SEC in lieu of registering with the states.

6 Generally, an SEC-registered investment adviser must file a notice with each state in which it has an office and may be required to file a notice in additional states depending on the make-up of its clients. Also, the adviser's personnel who provide personalized investment advice may be required to pass the Series 65 or 66 qualification exam and be licensed in one or more states in which the person has a place of business and at least six clients who are natural persons and do not meet the net worth or investments test of the relevant state.