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SEC Adopts Rules Implementing Dodd-Frank Investment Adviser Registration and Exemption Requirements

The Securities and Exchange Commission ("SEC") recently issued final rules and rule amendments implementing certain provisions of Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") that amend the Investment Advisers Act of 1940, as amended ("Advisers Act"). The new rules are of particular importance to private fund managers and others evaluating whether they must register as investment advisers with the SEC or whether they can rely on an exclusion from the definition of "investment adviser" in the Advisers Act or on certain exemptions from registration created by Dodd-Frank. The final rules are described in two adopting releases issued by the SEC. The "Registration Release" sets forth final rules implementing certain amendments to the Advisers Act required by Dodd-Frank, including:

- increasing the statutory threshold for SEC registration, which will generally be $100 million in assets under management ("AUM") for most U.S. advisers;
- establishing new reporting and record-keeping requirements for certain advisers exempt from registration ("exempt reporting advisers");
- amending the SEC's "pay-to-play" rule, which reflects changes made by Dodd-Frank; and
- detailing various changes made to Form ADV in order to conform to the new rules.

The related release (the "Exemption Release") sets forth final rules implementing new exemptions, created by Dodd-Frank, from the registration requirements of the Advisers Act, including:

- defining "venture capital fund" for purposes of the new Advisers Act exemption for advisers to venture capital funds;
- exempting from registration certain private fund advisers with less than $150 million in private fund AUM in the United States; and
- clarifying the meaning of certain terms used in the new exemption for foreign private advisers.

In addition, the SEC issued a final rule implementing the definition of "family office" as required by Dodd-Frank. Such family offices are excluded from the definition of "investment adviser" and are thereby exempt from regulation under the Advisers Act. Dodd-Frank had tasked the SEC with providing a definition of "family office" that is consistent with past SEC exemptive orders. The definition contained in the final rule, as required by Dodd-Frank, also contains a grandfathering provision that includes in the definition of "family office" persons not registered or required to be registered under the Advisers Act on January 1, 2010, but would be so required under the new "family office" definition. The SEC further announced **that the deadline for investment adviser registration for advisers previously relying on former section 203(b)(3) of the Advisers Act** (also known as the "private adviser" or "fewer than 15 clients" exemption), which is repealed by Dodd-Frank effective July 21, 2011, **is extended to March 30, 2012**. Insofar as the repeal of the private adviser exemption is effective as of July 21, 2011, advisers formed after July 20, 2011, may not avail themselves of the March 30, 2012, registration extension. The SEC further indicated that because the initial applications for registration can take up to 45 days to be approved, advisers relying on the Rule 203-1(e) transition provisions should file a complete application - both Part 1 and a brochure(s) meeting the requirements of Part 2 of Form ADV - no later than **February 14, 2012**. The SEC did not provide an exemption for advisers to private equity firms similar to the exemption to advisers to venture capital firms. However, the House Financial Services Committee passed legislation in H.R. 1082 that would exempt advisers to private equity funds from the investment adviser registration and reporting requirements. The bill was amended to clarify that the exemption would apply only for funds

that have not borrowed a principal amount in excess of twice their funded commitments. The full House of Representatives is not expected to consider H.R. 1082 until after Labor Day. Accordingly, for the time being, advisers to private equity funds remain subject to the provisions of the final rules. The issuance of these final rules and the adoptive releases addresses many of the open questions arising from the rules first proposed by the SEC in October and November 2010, although many other issues will need to be clarified by the SEC in future guidance. This Alert provides a summary of the final rules and certain notable guidance provided by the SEC staff in the adopting releases. **Registration Eligibility - Increase of Threshold** Effective July 21, 2011, the minimum AUM threshold for SEC registration for most U.S. investment advisers (that do not manage registered investment companies or business development companies) will be:

- $100 million in general, but
- $25 million for advisers that are not subject to registration and examination in the state in which they maintain their principal offices and places of business or that otherwise would be required to register with 15 or more states.[1]

Investment advisers must indicate their eligibility to register with the SEC on Item 2.A. of Form ADV. An adviser may register with the SEC if it (i) falls into the category of a "large adviser" and has $100 million or more of AUM (or $90 million or more if an adviser is filing its most recent annual updating amendment and is already registered with the SEC); (ii) is what is referred to as a mid-sized adviser (those with AUM between $25 million and $100 million) that does not meet the criteria for state registration or is not subject to examination by the state; (iii) has its principal place of business in Wyoming or outside the United States; (iv) meets the requirements of one or more of the revised exemptive rules under section 203A of the Advisers Act; (v) is an adviser (or sub-adviser) to a registered investment company; or (vi) received an order permitting the adviser to register with the SEC. New Rule 203A-1 under the Advisers Act creates a "buffer" for mid-sized advisers that provides some flexibility for advisers when determining their registration status. The new Rule raises the threshold above which a mid-sized investment adviser must register with the SEC to $110 million from $100 million; but, once registered with the SEC, an adviser need not withdraw its registration unless and until it has less than $90 million of AUM. **Transition of Mid-Sized Advisers** Under Dodd-Frank, Congress transferred most of the regulatory burden of monitoring many smaller advisers to the states by increasing the threshold for SEC registration. To effectuate the transition of mid-sized advisers (those with AUM between $25 million and $100 million) pursuant to Dodd-Frank, the SEC adopted new Rule 203A-5 under the Advisers Act, which provides for the transition of mid-sized advisers to the appropriate regulatory body. Pursuant to the new Rule, until July 21, 2011, investment advisers applying for registration with the SEC that qualify as mid-sized advisers under section 203A(a)(2) of the Advisers Act may register with either the SEC or the appropriate state securities authority. Thereafter, all such mid-sized advisers are prohibited from registering with the SEC and must register as investment advisers with the appropriate state securities authority. Mid-sized advisers registered with the SEC as of July 21, 2011, must remain registered with the SEC (unless an exemption is available) until January 1, 2012. Furthermore, new Rule 203A-5 under the Advisers Act requires all investment advisers registered with the SEC on January 1, 2012, to file an amendment to the adviser's Form ADV no later than March 30, 2012. This will identify those mid-sized advisers that are no longer eligible to remain registered with the SEC. Mid-sized advisers that are no longer eligible for SEC registration must withdraw their registration with the SEC by filing Form ADV-W within 90 days of filing their amended Form ADV. Accordingly, a mid-sized adviser no longer eligible for SEC registration must withdraw from registration by filing Form ADV-W no later than June 28, 2012. **Venture Capital Exemption** Section 203(l) of the Advisers Act, which was created by Dodd-Frank, provides an exemption from registration for venture capital fund advisers. In new Advisers Act Rule 203(l)-1, the SEC defines a "venture capital fund" as a private fund that: (i) Holds no more than 20 percent of the fund's capital commitments in "non-qualifying investments"; (ii) Does not incur leverage in excess of 15 percent of its committed capital or for a term longer than 120 days; (iii) Does not offer redemption of investor interests except in extreme 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 or elected to be treated as a business development company. The definition of "venture capital fund" includes a fund that invests a portion of its capital in investments that would not otherwise satisfy all the elements of Advisers Act Rule 203(l). The SEC stated that this 20 percent "non-qualifying basket" is intended to provide the flexibility sought by many venture capital funds while precluding an adviser relying on the exemption from altering the character of the fund's investments to such an extent that the fund could no longer be viewed as a venture capital fund. A "qualifying investment" is defined by the SEC as: (i) Any equity security issued by a qualifying portfolio company that is directly acquired by the private fund from the portfolio company; (ii) Any equity security issued by a qualifying portfolio company