

**SEC PROPOSES RULES IMPLEMENTING DODD-FRANK
INVESTMENT ADVISER REGISTRATION AND REPORTING REQUIREMENTS**

On November 19, 2010, the Securities and Exchange Commission proposed rules under the Investment Advisers Act of 1940 designed to implement several investment adviser registration and reporting provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act.¹ These rule proposals are of particular importance to private fund managers that may be evaluating whether they can rely on certain new exemptions from registration as an investment adviser with the Commission created by the Dodd-Frank Act or whether they must register with the Commission by July 21, 2011. This memorandum provides a brief overview of several key aspects of the rule proposals.

The Commission's proposed rules fall into two general categories. The first set of proposals defines terms relating to three exemptions from registration as an investment adviser that were created by the Dodd-Frank Act, namely, the exemption available to an adviser solely to one or more venture capital funds, the exemption available to an adviser solely to private funds that has less than \$150 million of assets under management (called the "private fund adviser exemption" by the proposals), and the exemption for a "foreign private adviser."

The second set of proposals generally relates to investment adviser registration and reporting requirements. The proposals, if adopted, would impose new reporting requirements on all registered investment advisers and would put in place a new reporting regime for advisers relying on the venture capital fund exemption and the private fund adviser exemption. The proposals also provide procedural and other guidance for so-called "mid-sized" investment advisers with between \$25 million and \$100 million of assets under management that may need to switch from registration with the Commission to state registration as a result of the Dodd-Frank Act. We highlight below a few notable aspects of each set of proposals.²

¹ Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers with Less Than \$150 Million in Assets Under Management, and Foreign Private Advisers, Investment Advisers Act Release No. 3111 (Nov. 19, 2010), available at <http://sec.gov/rules/proposed/2010/ia-3111.pdf>; Rules Implementing Amendments to the Investment Advisers Act of 1940, Investment Advisers Act Release No. 3110 (Nov. 19, 2010), available at <http://sec.gov/rules/proposed/2010/ia-3110.pdf>. Release No. 3110 proposes amendments to Form ADV, the investment adviser registration form; the Form and associated instructions reflecting the proposed changes are available on the Commission's website at: <http://sec.gov/rules/proposed.shtml>.

² For a detailed description of the statutory terms of each of these exemptions, see our client memorandum titled The Dodd-Frank Act Overhauls the Regulation of Private Fund Managers and Other Money Managers, available at http://www.willkie.com/files/tbl_s29Publications/FileUpload5686/3435/The-Dodd-Frank-Act-Overhauls-The-Regulation.pdf.

Venture Capital Funds. The definition of “venture capital fund” contained in proposed Rule 203(l)-1 is, as many commentators expected, drawn narrowly. The definition as proposed generally would include as a venture capital fund under the Rule a private fund³ that, among other things, invests only (other than in cash and cash equivalents) in equity securities of private operating companies, of which at least 80% were acquired directly from such companies, employs no long-term leverage, either directly or through its adviser controls or offers substantial managerial assistance to each company in which it invests, does not permit its investors to redeem their interests except under extraordinary circumstances, and represents to investors and potential investors that it is a venture capital fund.

The proposed Rule, reflecting the Commission’s recognition of the operational difficulties an existing venture capital fund may face in meeting the Rule’s definition of venture capital fund, would grandfather existing venture capital funds into the Rule’s definition under certain conditions. The definition would include as a venture capital fund a private fund that has not sold any of its securities after July 21, 2011, that prior to December 31, 2010 sold securities to one or more investors that are not related persons⁴ of an investment adviser to the fund, and that represented to investors and potential investors at the time it was offered that it is a venture capital fund.

Private Fund Advisers; Foreign Private Advisers. The proposals provide some useful guidance with respect to the private fund adviser exemption and the foreign private adviser exemption. Proposed Rule 203(m)-1, which is generally designed to implement the private fund adviser exemption, would provide an exemption from registration for an investment adviser so long as the adviser manages private fund assets of less than \$150 million and acts “solely as an investment adviser to one or more qualifying private funds.” The term qualifying private fund is defined by the proposed Rule to mean a private fund that is not registered under the Investment Company Act of 1940 and that has not elected to be treated as a business development company under the 1940 Act. The proposed Rule seems particularly helpful to at least some non-U.S. private fund managers: a non-U.S. adviser could rely on the exemption so long as it has no clients that are United States persons⁵ other than qualifying private funds, and all assets managed by the investment adviser from a place of business in the United States are attributable to private funds and the total value of those assets is less than \$150 million.

³ The term “private fund” is defined by the Dodd-Frank Act, and codified in new Section 202(a)(29) of the Advisers Act, to mean an issuer that would be an investment company but for the exclusion from that definition under Section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940. The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, § 402.

⁴ The proposed Rule defines “related person” by reference to the definition of that term included in Rule 206(4)-2(d)(7) under the Advisers Act.

⁵ The proposed Rule defines the term “United States person” to mean a person that is a “U.S. person” as defined in Regulation S under the Securities Act of 1933 and any discretionary or similar account held for the benefit of a United States person by a dealer or other professional fiduciary if the dealer or professional fiduciary is a related person of the non-U.S. adviser relying on the exemption.

Proposed Rule 202(a)(30)-1 seeks to clarify several aspects of the new exemption from registration for a foreign private adviser under amended Section 203(b)(3) of the Advisers Act, including with respect to how an adviser should count its clients and compute its assets under management for purposes of the exemption. The foreign private adviser exemption is available to an investment adviser that has no place of business in the United States; has fewer than 15 clients in the United States and investors in the United States in private funds advised by the investment adviser; 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 does not hold itself out generally to the public in the United States as an investment adviser.

For purposes of the foreign private adviser exemption, Rule 202(a)(30)-1 as proposed generally incorporates the same client-counting method as that set out under current Advisers Act Rule 203(b)(3)-1, which was made largely irrelevant by the Dodd-Frank Act, except that an adviser would be required to count as a client a person or entity to which it provides investment advice without compensation. The proposed Rule also defines the terms “investor” and “in the United States” for purposes of the exemption. Notably, although the Dodd-Frank Act provides the Commission with explicit authority to increase the exemption’s \$25 million assets under management threshold, the Commission did not propose to do so at this time.

Availability of exemptions for advisers with investment adviser affiliates. The Commission notes in the proposing release that both an investment adviser and a subadviser to a private fund, whether the subadviser contracts with the private fund or with the primary adviser to the private fund, are eligible to rely on each of the three exemptions described above. The Commission acknowledges, however, that an adviser with investment adviser affiliates may encounter interpretive issues in determining whether it must take into account the activities of those affiliates in assessing its eligibility to rely on the exemptions. The proposing release states that while generally an investment adviser that operates independently of an investment adviser affiliate may be eligible to rely on these exemptions if it meets the relevant criteria, “whether the advisory businesses of two separately formed affiliates may be required to be integrated [for purposes of determining eligibility for an exemption] is based on the facts and circumstances.”⁶ The Commission asks for comment on this position and whether the exemptions should be unavailable to an affiliate of a registered investment adviser.

Reporting and Registration Provisions. The second set of Advisers Act rules proposed by the Commission, among other things, sets out new reporting requirements on Form ADV for all registered investment advisers to private funds. The proposed rules would require a registered adviser to provide on Form ADV information about each private fund it manages, including a summary of the current value of the fund’s assets categorized by asset and liability class, disclosure on the types of investors in the fund, and information as to the fund’s auditors, prime brokers, custodians, administrators, and marketers.

⁶ Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers with Less Than \$150 Million in Assets Under Management, and Foreign Private Advisers, Investment Advisers Act Release No. 3111 (Nov. 19, 2010), at 87, available at <http://sec.gov/rules/proposed/2010/ia-3111.pdf>.

The proposals would create a new reporting regime for “exempt reporting advisers,” that is, advisers relying on either the venture capital fund adviser exemption or the private fund adviser exemption. These unregistered advisers would be required to report on Form ADV the information noted above relating to private funds they manage as well as identifying information about their owners and affiliates, business activities that may present conflicts of interest, and disciplinary information for the adviser and its employees. An exempt reporting adviser would be required to file its initial report on Form ADV with the Commission no later than August 21, 2011.

To assist the Commission in implementing certain investor protection provisions of the Dodd-Frank Act, the proposals would require registered investment advisers and exempt reporting advisers to report on Form ADV whether they had \$1 billion or more of total assets as of the last day of their fiscal year-end. This provision is designed to provide the Commission with information it may need to implement a provision of the Dodd-Frank Act that requires federal financial regulators to ban incentive-based compensation arrangements that regulators determine encourage “inappropriate risks” by certain financial institutions, including investment advisers, with assets of more than \$1 billion.⁷

The Commission has requested comments from industry participants on many aspects of the rule proposals, in particular with respect to the definition of “venture capital fund” and the proposed reporting requirements for exempt reporting advisers. Comments to the proposed rules must be submitted within 45 days of publication of the proposing releases in the Federal Register, which period will likely end during the week of January 3, 2011. We stand ready to provide you with more information and guidance on these proposals.

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If you have any questions regarding this memorandum, please contact Daniel Schloendorn (212-728-8265; dschloendorn@willkie.com), James G. Silk (202-303-1275; jsilk@willkie.com), Jai Massari (202-303-1133; jmassari@willkie.com), or the attorney with whom you regularly work.

Willkie Farr & Gallagher LLP is headquartered at 787 Seventh Avenue, New York, NY 10019-6099 and has an office located at 1875 K Street, NW, Washington, DC 20006-1238. Our New York telephone number is (212) 728-8000 and our facsimile number is (212) 728-8111. Our Washington, DC telephone number is (202) 303-1000 and our facsimile number is (202) 303-2000. Our website is located at www.willkie.com.

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⁷ The Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376 § 956.