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CLIENT ALERT **JULY 2011**

SEC ADOPTS RULES IMPLEMENTING AMENDMENTS TO THE INVESTMENT ADVISERS ACT

On June 22, 2011, the Securities and Exchange Commission (the "SEC") adopted new rules and rule amendments under the Investment Advisers Act of 1940 (the "Advisers Act") in order to give effect to provisions of Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). The SEC's adopting release can be found here: http://www.sec.gov/rules/final/2011/ia-3221.pdf The new rules reallocate regulatory responsibility between the SEC and the states by increasing the statutory threshold for registration with the SEC, require advisers to many hedge funds and other private funds to register with the SEC as a result of the Dodd-Frank Act's elimination of the Advisers Act Section 203(b)(3) "fewer-than-15 clients" exemption, establish new exemptions from SEC registration, implement reporting requirements for certain exempt advisers, and change Form ADV to allow for increased oversight of advisers required to register with the SEC.

ELIGIBILITY FOR REGISTRATION WITH THE SEC

Transition to State Registration for Mid-Sized Advisers

Under new Advisers Act Rule 203A-5, mid-sized advisers (those with $25-100 million in assets under management) must register with their state securities authorities rather than with the SEC. All advisers currently registered with the SEC must file an amendment to Form ADV by March 30, 2012 that will identify those advisers no longer eligible to remain SEC registered. These advisers will then be required to withdraw their SEC registrations by June 28, 2012. Further, after July 21, 2011, all new mid-sized applicants for registration must register with their state securities authorities instead of the SEC.

The SEC has also changed the manner in which assets under management are calculated to determine eligibility for registration with the SEC or state securities authorities. Under the new provisions, assets under management include any portfolio over which an investment adviser exercises continuous and regular supervisory services whether the assets are family, proprietary, assets of foreign clients, or managed without receiving compensation. In the case of a private fund, any uncalled capital commitments must be included in the calculation. Finally, advisers must utilize the market value of private fund assets or the fair value of private fund assets where the market value is unavailable.

To prevent an adviser from switching frequently between state and SEC registration as the value of its assets under management changes, Advisers Act Rule 203A-1 currently has a buffer of $25-30 million that allows advisers in that range to remain regulated by the states. In light of the increased threshold, the new rule provides for a buffer of $90-110 million.

Exemptions from the Prohibition on Registration with the SEC

The SEC has adopted rule amendments to address three of the current exemptions in Advisers Act Rule 203A-2 from the prohibition on SEC registration. First, the exemption in Advisers Act Rule 203A-2(a) permitting SEC registration for nationally recognized statistical rating organizations ("NRSROs") has been eliminated in light of earlier changes in the law taking some NRSROs out of the definition of "investment adviser." Second, new Advisers

Act Rule 203A-2(a) (formerly Rule 203A-2(b)), exempting pension consultants, has been amended to increase the minimum value of plan assets required to rely on the exemption from $50 million to $200 million. Third, the number of states required in the multi-state adviser exemption in Advisers Act Rule 203A-2(d) has been lowered from 30 states to 15. Finally, because the streamlined instructions to Form ADV will allow for a uniform calculation of assets under management, the SEC has rescinded Advisers Act Rule 203A-4, which previously provided a safe harbor from SEC enforcement actions if an investment adviser registered with its state securities authorities due to a reasonable belief that insufficient assets under management prohibited it from registering with the SEC.

Elimination of the Fewer-than-15-Clients Exemption

Title IV of the Dodd-Frank Act eliminated the Advisers Act Section 203(b)(3) exemption allowing advisers with fewer than 15 clients to avoid registration with the SEC. The elimination of this exemption will affect many advisers to hedge and other private funds because former law counted each fund as a client rather than each investor in a fund. The exemption of Advisers Act Section 203(b)(3) allowed many advisers to remain outside the purview of SEC regulatory oversight. As of March 30, 2012, these advisers will be required to register with the SEC. The SEC has recommended that all applications for registration be filed by February 14, 2012 to ensure compliance with the March 30, 2012 deadline.

EXEMPT REPORTING ADVISERS

While eliminating the private adviser exemption, the Dodd-Frank Act created three new exemptions from registration with the SEC: (1) for advisers solely to venture capital funds; (2) for advisers solely to private funds with less than $150 million in assets under management in the United States; and (3) for certain foreign advisers without a place of business in the United States. In a separate adopting release, the SEC has issued new rules to implement these exemptions. This adopting release can be found at http://www.sec.gov/rules/final/2011/ia-3222.pdf.

To implement the Advisers Act Section 203(l) exemption of advisers to venture capital funds and 203(m) exemption of advisers to other private funds with less than $150 million in assets under management, the new rules require advisers relying on these exemptions to submit and update reports consisting of selected portions of Form ADV. Advisers Act Rule 204-4 requires exempt reporting advisers to file Form ADV reports with the SEC using the same process as that used by registered advisers and to submit an initial report between January 1 and March 30, 2012. Further, Advisers Act Rule 204-1 has been amended to require that an exempt reporting adviser, like a registered adviser, amend its reports on Form ADV (i) at least annually, within 90 days of the end of the adviser's fiscal year, or (ii) more frequently as required by the instructions to Form ADV.

To meet the definition of an exempt venture capital fund under Advisers Act Section 203(l), the fund must be a private fund that invests primarily in "qualifying investments," generally private operating companies. A venture capital fund may invest in a "basket" of non-qualifying investments of up to 20% of its committed capital and may hold certain short-term investments. Further, a venture capital fund as defined under the new rules represents itself as pursuing a venture capital strategy, does not offer redemption rights to its investors, and is not leveraged except for a minimal amount on a short-term basis. To qualify for the foreign private adviser exemption, the adviser must (1) have no place of business in the United States and (2) have less than $25 million in assets under management from fewer than fifteen U.S. clients and private fund investors.

CHANGES TO INFORMATION REQUIRED BY FORM ADV

To increase the ability of the SEC to oversee investment advisers, a number of modifications have been made to Form ADV. These changes will require additional information from advisers in several areas of their operations. First, the data advisers provide about their advisory business has been expanded to include

information regarding the number of employees registered as investment adviser representatives or licensed insurance agents, the number and types of clients the adviser services, and the types of advisory services that it provides.

Second, advisers must provide additional information about the private funds they advise, including basic information regarding the size and organizational, operational, and investment characteristics of each fund, the name of the fund and the state in which it is organized, whether it is part of a master-feeder arrangement, the type of investment strategy employed by the fund, whether it invests in securities of registered investment companies, and the gross value of the fund. Additionally, Part B of Section 7.B.(1) now requires advisers to identify and report the location of five different types of "gatekeeper" service providers: auditors, prime brokers, custodians, administrators and marketers. The adviser must also divulge any familial relation to any gatekeeper and provide information regarding the nature of the services provided.

Finally, the SEC now requires additional disclosure of information about advisers' non-advisory activities and their financial industry affiliations. This information includes reporting whether the adviser or a related person is a trust company, registered municipal adviser, registered security-based swap dealer, major security-based swap participant, accountant, lawyer, or sponsor, general partner or managing member of a pooled investment vehicle.

OTHER AMENDMENTS

The SEC has also adopted amendments to Advisers Act Rule 206(4)-5, the "pay to play" rule, which prohibits an adviser from providing advisory services to government clients within two years of contribution to certain elected officials or candidates. These amendments will apply to exempt reporting advisers as well as foreign private advisers, and are intended to prevent narrowing of the application of the rule resulting from the repeal of the Adviser Act Section 203(b)(3) private adviser exemption.

ADDITIONAL INFORMATION

For more information regarding the SEC's new Advisers Act rules, please get in touch with your Tucker Ellis & West LLP contact or one of the following attorneys:

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