Goodwin Procter Alert

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Advisers Act Alert Part 5: "Exempt Reporting Advisers" or "ERAs"

Advisers who elect to be ERAs will not be required to register with the SEC, but they will be subject to reporting, recordkeeping and other obligations, such that their compliance obligations may be material and grow over time. In addition to compliance requirements that apply to advisers regardless of their registration status (e.g., Advisers Act anti-fraud provisions), ERAs must file a portion of Form ADV, have and enforce policies and procedures to prevent the misuse of material, nonpublic information, and comply with the Advisers Act “pay to play” rule, and may be subject to specific recordkeeping requirements. ERAs are subject the SEC’s examination authority.

***Form ADV Filing Obligation.*** The Implementing Release provides that ERAs must file their initial Form ADV between January 1, 2012 and March 30, 2012. After March 30, new ERAs must file within 60 days of relying upon the Venture Capital Exemption or the Private Fund Adviser Exemption. ERAs must file the same Form ADV as RIAs, although ERAs need only respond to certain specified items and questions. Notably, an ERA must attest that it qualifies for either the Venture Capital Exemption or the Private Fund Adviser Exemption. Furthermore, the SEC rejected suggestions by commentators that some or all of this information receive confidential treatment – for now at least, the information will be publicly available online.

* ***Required Information.*** Although ERAs will not file a full Form ADV, the required ADV filing will disclose significant information regarding the adviser and its business. ERAs will be required to complete Form ADV Items 1 (Identifying Information), 2.B (SEC Reporting by Exempt Reporting Advisers), 3 (Form of Organization), 6 (Other Business Activities), 7 (Financial Industry Affiliations and Private Fund Reporting), 10 (Control Persons) and 11 (Disclosure Information), along with the corresponding sections of Schedules A, B, C and D. Answers to these items will disclose basic information about the adviser, details about the private funds it advises (name, domicile, investment strategy, gross assets, etc.), other business interests of the adviser and its affiliates, and disciplinary history of the adviser and its employees. For more details on the specific disclosure that will be required please see: (1) the discussion below on Amendments to Form ADV; and (2) a version of the Form ADV that has been highlighted to show the provisions most relevant to ERAs, which is available here.
* ***Public Availability of Reports.*** In the Implementing Release, the SEC reiterated its decision that, under the Advisers Act, reports filed with the SEC must be made available to the public unless the SEC decides the disclosure of such information is “neither necessary nor appropriate in the public interest or for the protection of investors.”5 Therefore, all of the information filed by ERAs on Form ADV will be available to the public through IARD.
* ***Updating Requirements.*** An ERA will be required to update its Form ADV on the same timetable and for the same reasons as a registered investment adviser: at least annually within 90 days of the end of the adviser’s fiscal year, and more frequently for material developments as required by the instructions to Form ADV.
* ***Ongoing Reporting Obligations.*** In Chairman Mary Schapiro’s Opening Statement during last week’s open meeting, she announced that she has directed the SEC staff to reconsider the information the SEC collects from ERAs after the SEC receives and assesses the first year’s ERA filings (although this direction does not appear explicitly in last week’s rule releases). During the same open meeting, a majority of the Commissioners voted in favor of the ERA reporting requirements, but the two dissenting Commissioners expressed concern about the extent of ERA reporting obligations and the possibility that, particularly over time, and in light of the SEC’s examination authority over ERAs, there may be no meaningful distinction between ERA and RIA reporting obligations .

***Recordkeeping Requirements.*** Section 204 of the Advisers Act requires investment advisers to make and keep such records and to make and disseminate such reports as the SEC may prescribe by rule. There is an express exemption for advisers exempt under Section 203(b) (such as foreign private advisers) but not for ERAs. Accordingly, ERAs could be subject to SEC recordkeeping requirements, and the SEC will have the authority to examine such records. Specific recordkeeping obligations, which could significantly increase ERAs’ compliance costs, have not been established, but could be the subject of future SEC rulemaking.

***Policies Regarding Material Non-Public Information (“MNPI”).*** Section 204A of the Advisers Act includes a general requirement that all advisers subject to Section 204 (which now includes ERAs) “establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of such investment adviser’s business, to prevent the misuse in violation of this Act or the Securities Exchange Act of 1934, or the rules or regulations thereunder, of material, nonpublic information by such investment adviser or any person associated with such investment adviser.” ERAs should consider the nature of their businesses and establish appropriate written policies designed to prevent the misuse of MNPI.

***SEC Examination.*** The new rules do not *require* ERAs to undergo routine SEC compliance examinations. However, the Implementing Release reiterates the SEC’s authority to examine ERAs’ records, leaving the door open for more regular and robust non-cause examinations. The SEC expects to conduct cause examinations of ERAs when it believes there have been “indications of wrongdoing, e.g., those examinations prompted by tips, complaints, and referrals.”

***Transition Period.*** After March 30, 2012, an ERA relying on the Private Fund Adviser Exemption that has complied with all of its reporting obligations may continue to advise private funds for up to 90 days after filing its annual updating amendment stating that its assets under management in the U.S. equal or exceed $150 million before filing its application for registration. This transition period is not available to an ERA that relies on the Venture Capital Exemption, but anticipates losing the benefit of the exemption. For example, an ERA relying on the Venture Capital Exemption must register with the SEC before advising any client that is not a VC Fund (as defined below) or before making a non-qualifying investment in a VC fund that would cause the VC fund to exceed the 20% basket.

***Additional Considerations.*** ERAs will have a newly created status for regulatory purposes that differs from a simple registration exemption. Accordingly, they may need to give special consideration to various contractual and operational matters. For example, they may wish to consider: (1) whether their existing insurance coverage is sufficient to cover increased regulatory compliance risks or should be upgraded; (2) whether to update undertakings previously made to investors, clients, lenders, landlords or others regarding the availability of registration exemptions; and (3) whether to modify any ongoing disclosure documents that describe such exemptions. They should also monitor regulatory developments under the laws of the states in which they may be doing business, and consider whether other regulations (*e.g.,* non-U.S. regulations and CFTC regulations) may entail different consequences for an ERA than they have for an RIA or an adviser that previously relied on the “fewer than 15 clients” private adviser exemption.

5 Please see the Implementing Release, page 49.

IN THIS ISSUE:

1. [Advisers Act Alert Part 1: SEC Adopts New Advisers Act Rules and Implements Registration Exemptions](http://www.goodwinprocter.com/Publications/Newsletters/Client-Alert/2011/0630_SEC-Adopts-New-Advisers-Act-Rules-and-Implements-Registration-Exemptions.aspx?article=1#news_article_top)
2. [Advisers Act Alert Part 2: Executive Summary](http://www.goodwinprocter.com/Publications/Newsletters/Client-Alert/2011/0630_SEC-Adopts-New-Advisers-Act-Rules-and-Implements-Registration-Exemptions.aspx?article=2#news_article_top)
3. [Advisers Act Alert Part 3: Timing and Exemptions During the Next Year](http://www.goodwinprocter.com/Publications/Newsletters/Client-Alert/2011/0630_SEC-Adopts-New-Advisers-Act-Rules-and-Implements-Registration-Exemptions.aspx?article=3#news_article_top)
4. [Advisers Act Alert Part 4: Foreign Private Adviser Exemption](http://www.goodwinprocter.com/Publications/Newsletters/Client-Alert/2011/0630_SEC-Adopts-New-Advisers-Act-Rules-and-Implements-Registration-Exemptions.aspx?article=4#news_article_top)
5. Advisers Act Alert Part 5: "Exempt Reporting Advisers" or "ERAs"
6. [Advisers Act Alert Part 6: Registration Exemption for "Venture Capital Fund" Advisers](http://www.goodwinprocter.com/Publications/Newsletters/Client-Alert/2011/0630_SEC-Adopts-New-Advisers-Act-Rules-and-Implements-Registration-Exemptions.aspx?article=6#news_article_top)
7. [Advisers Act Alert Part 7: Registration Exemption for Private Fund Advisers](http://www.goodwinprocter.com/Publications/Newsletters/Client-Alert/2011/0630_SEC-Adopts-New-Advisers-Act-Rules-and-Implements-Registration-Exemptions.aspx?article=7#news_article_top)
8. [Advisers Act Alert Part 8: Calculating Assets Under Management and Its Implications](http://www.goodwinprocter.com/Publications/Newsletters/Client-Alert/2011/0630_SEC-Adopts-New-Advisers-Act-Rules-and-Implements-Registration-Exemptions.aspx?article=8#news_article_top)
9. [Advisers Act Alert Part 9: State vs Federal Registration](http://www.goodwinprocter.com/Publications/Newsletters/Client-Alert/2011/0630_SEC-Adopts-New-Advisers-Act-Rules-and-Implements-Registration-Exemptions.aspx?article=9#news_article_top)
10. [Advisers Act Alert Part 10: Other Matters](http://www.goodwinprocter.com/Publications/Newsletters/Client-Alert/2011/0630_SEC-Adopts-New-Advisers-Act-Rules-and-Implements-Registration-Exemptions.aspx?article=10#news_article_top)
11. [Advisers Act Alert Part 11: Resources and Appendices](http://www.goodwinprocter.com/Publications/Newsletters/Client-Alert/2011/0630_SEC-Adopts-New-Advisers-Act-Rules-and-Implements-Registration-Exemptions.aspx?article=11#news_article_top)

Advisers Act Alert Part 7: Registration Exemption for Private Fund Advisers

***U.S.* *Advisers*.**Under the new rules, an adviser with its *principal office and place of business* in the U.S. is exempt from Advisers Act registration under the Private Fund Adviser Exemption if it: (1) acts solely as an adviser to one or more “**Qualifying Private Funds**”11; and (2) manages *private fund* assets of less than $150 million. For these purposes, a “principal office and place of business” means “the executive office of the investment adviser from which the officers, partners or managers of the investment adviser direct, control and coordinate the activities of the investment adviser.”

***Non-U.S. Advisers*.**An adviser with its principal office and place of business outside the U.S. (a “**non-U.S. adviser**”) is exempt from Advisers Act registration under the Private Fund Adviser Exemption if: (1) all of its *clients* that are *U.S. persons* are Qualifying Private Funds; and (2) all assets it manages at any *place of business in the U.S.* are solely attributable to Qualifying Private Funds and have a total value of less than $150 million. For these purposes, a U.S. person is any person that is a “U.S. Person” as defined in Regulation S promulgated under the Securities Act of 1933 (“**Regulation S**”), except with respect to certain discretionary or similar accounts that are held for the benefit of U.S. persons by certain non-U.S. dealers or other non-U.S. professional fiduciaries. A “place of business” has the same [definition](http://www.goodwinprocter.com/Publications/Newsletters/Client-Alert/2011/0630_SEC-Adopts-New-Advisers-Act-Rules-and-Implements-Registration-Exemptions.aspx?article=4#3) as for a Foreign Private Adviser.

***ERA Status*.** An adviser that relies upon the Private Fund Adviser Exemption is an ERA and, as such, is subject to the reporting and compliance requirements discussed above under “*‘*[*Exempt Reporting Advisers’ or ‘ERAs’*](http://www.goodwinprocter.com/sitecore/service/notfound.aspx?item=web%3a%7bEF8C02D8-FEE1-4524-9154-22724748B68E%7d%40en).”

***Interpretive Guidance*.** The new rules and the Releases provide guidance on the following concepts contained in the Private Fund Adviser Exemption:

* ***Assets Managed in the U.S.*** If an adviser has its principal office and place of business in the U.S., it is deemed to manage12 within the U.S. all of its private fund assets, even if the adviser has offices outside of the U.S. Accordingly, for purposes of qualifying for the Private Fund Adviser Exemption, an adviser with its principal office and place of business in the U.S. is required to include all assets under management regardless of where they are managed (even if managed from outside of the U.S.). By contrast, an adviser with a principal office and place of business outside the U.S. is only required to consider assets that are managed at a place of business in the U.S. for purposes of the Private Fund Adviser Exemption and would not lose this exemption by virtue of: (1) managing from outside of the U.S. Qualifying Private Funds with an unlimited amount of investment from U.S. investors; (2) advising clients that are not U.S. persons and are not Qualifying Private Funds; or (3) relying on services that are not considered “management” and are provided by its own employees from within the U.S.

Whether an adviser is managing assets at a place of business in the U.S. is a facts and circumstances analysis. For example, while the SEC has indicated that providing research or conducting due diligence at a U.S. place of business may constitute “managing” assets at a place of business in the U.S. under certain circumstances, it would not if a person outside of the U.S. makes independent investment decisions and implements those decisions.
* ***“Qualifying Private Fund” Status; Special Rule.*** As noted above, a Qualifying Private Fund includes an issuer that would be an “investment company” under the 1940 Act *but for* the exclusions from that definition provided in Sections 3(c)(1) or 3(c)(7) of that Act. However, under a special rule, an adviser to a fund qualifying for *another* definitional exclusion, such as a real estate fund that qualifies for Section 3(c)(5)(C), may elect to treat such fund as a “private fund” for purposes of the Private Fund Adviser Exemption, so long as the adviser treats such fund as a “private fund” for all other Advisers Act purposes.13 Accordingly, an adviser to funds that can qualify for other definitional exclusions beyond 3(c)(1)/(7) is not precluded from relying on the Private Fund Adviser Exemption by virtue of this fact. In addition, similar to the flexibility provided under the Venture Capital Exemption (see [above](http://www.goodwinprocter.com/sitecore/service/notfound.aspx?item=web%3a%7b7AF2EE75-1682-40AD-A19D-F6BDC9A7052F%7d%40en)), an adviser could elect to treat a non-U.S. fund that has not made an offering to U.S. persons as a “private fund” for purposes of the Private Fund Adviser Exemption.
* ***Combining Exemptions.*** Given the structure of the Venture Capital and Private Fund Adviser Exemptions, a single adviser generally may not combine the Private Fund Adviser Exemption with other exemptions. For example, a single adviser could not advise VC funds with assets under management in excess of $150 million and also seek to rely on the Private Fund Adviser Exemption for other funds with assets under management of less than $150 million.

***Calculating the Value of Assets*.** Advisers must annually (rather than quarterly, as initially proposed) calculate the amount of private fund assets that they manage to determine whether they continue to be eligible for the Private Fund Adviser Exemption and must report the amount in their annual updating amendments to Form ADV. Changes in the amount of private fund assets between annual updating amendments will not affect the availability of the exemption. If an adviser reports on its annual updating amendment that its assets under management in the U.S. equal or exceed $150 million such that it is no longer eligible for the Private Fund Adviser Exemption, then it will have up to 90 days after filing such amendment to apply for registration (i.e., up to 180 days in total after the end of the adviser’s fiscal year).

The value of private fund assets under management is required to be calculated in accordance with the instructions in Form ADV. As discussed in more detail [below](http://www.goodwinprocter.com/sitecore/service/notfound.aspx?item=web%3a%7bE5F24546-6D47-4796-8937-46AEF92CB24E%7d%40en), the instructions to Form ADV require that the calculation of the value of private fund assets under management (1) be made on a gross basis; (2) be based on market value (or fair value where market value is unavailable); (3) include assets managed without compensation; (4) only include the portion of any “securities portfolio” for which the adviser provides “continuous and regular supervisory or management services;” and (5) include uncalled commitments.

***Affiliated Advisers / Unibanco No-Action Letters.*** The [SEC](http://www.goodwinprocter.com/Publications/Newsletters/Client-Alert/2011/0630_SEC-Adopts-New-Advisers-Act-Rules-and-Implements-Registration-Exemptions.aspx?article=7#17) noted in the Implementing Release that an adviser cannot satisfy exemptions, such as the $150 million Private Fund Adviser Exemption, by simply reorganizing into two separate advisory entities to split the business so that each entity’s assets under management are below various thresholds, which would violate the general prohibition on doing indirectly what cannot be done directly. The SEC reiterated that whether two affiliated advisers would be integrated is based on a facts and circumstances analysis of certain factors discussed in prior no-action letters issued by the staff of the Division of Investment Management of the SEC (the “**Staff**”).14

Multi-national advisory structures with a registered investment adviser in the U.S. and an affiliated non-U.S. unregistered adviser have historically relied on the line of no-action letters issued by the Staff beginning with the *Unibanco* no-action letter.15 Under this line of no-action letters, the Staff adopted a less stringent approach to integrating a registered U.S. adviser and an affiliated, unregistered non-U.S. adviser than was the case under the position in the *Richard Ellis* no-action letter, by permitting such a non-U.S. adviser to remain separate and unregistered despite sharing resources and personnel with its affiliated, registered U.S. adviser (provided that certain other conditions were met). As noted above, a non-U.S. adviser with its principal office and place of business outside of the U.S. is only required to consider assets that are managed from a place of business in the U.S. for purposes of the $150 million threshold under the Private Fund Adviser Exemption; accordingly, many multi-national advisers sought affirmation from the SEC that it would continue to apply the *Unibanco* position in determining the assets that are managed by a non-U.S. adviser from a place of business in the U.S.

While the SEC stated in the Exemptive Release that it was not intending to withdraw any prior statement or views under the *Unibanco* line of no-action letters, it did not specifically affirm positions taken under the *Unibanco* line of letters, despite acknowledging the request to do so by a number of commentators. Moreover, the SEC noted that “the Unibanco letters were developed by the staff in the context of the private [adviser] exemption, which Congress repealed….. We expect that the staff will provide guidance, as appropriate, based on the facts that may be presented to the staff regarding the application of the Unibanco letters in the context of the new foreign private adviser exemption and the private fund adviser exemption.”

Given these statements made by the SEC and the nature of the new Foreign Private Adviser Exemption and Private Fund Adviser Exemption, which by their terms take a territorial approach that focuses on where assets are being managed, advisers should be cautious in relying on the *Unibanco* letters absent further guidance either generally or in respect of specific situations.

Certain multi-national advisers to private funds have a business model in which investment activities are conducted with relative independence and through separate legal entities, particularly in non-U.S. jurisdictions where local presence, relationships and knowledge are essential. In some cases, these advisers may manage exclusively VC funds in the U.S., but may have a broader mandate in another jurisdiction where the local professionals manage funds that are not VC funds. Viewed as a whole, these advisers may be unable to qualify for the Venture Capital Exemption (because of their non-U.S. business) or for the Private Fund Adviser Exemption (because of their U.S. business), even if each business, when viewed separately, would allow the adviser to be an ERA. Pending further guidance on the *Unibanco* analysis, these advisers may wish to consider whether their operations do or can satisfy the criteria set forth in the *Richard Ellis* no-action letter.16 Under appropriate facts and circumstances, it would not be necessary to integrate the business of affiliated entities for determining registration requirements and the availability of exemptions under the new rules.

11 Qualifying Private Funds means private funds that have not registered as investment companies under the 1940 Act or elected to be business development companies under that Act.

12 “Manage” means to provide continuous and regular supervisory or management services as contemplated in the instructions to Item 5 of Form ADV Part 1A.

13 Including the special rules for calculating private fund “assets under management”, as discussed [below](http://www.goodwinprocter.com/Publications/Newsletters/Client-Alert/2011/0630_SEC-Adopts-New-Advisers-Act-Rules-and-Implements-Registration-Exemptions.aspx?article=8#24).

14 See, *e.g.*, Richard Ellis, Inc., SEC Staff No-Action Letter (Sept. 17, 1981) (“***Richard Ellis***”).

15 Uniao de Bancos de Brasileiros S.A., SEC Staff No-Action Letter (July 28, 1992) (“***Unibanco***”). Under this no-action letter, the Staff indicated that it would not recommend enforcement action for failure to register against an unregistered non-U.S. adviser that is separately organized from an affiliated, registered U.S. investment adviser if: (1) each is separately organized and staffed with personnel (located in the U.S. or abroad) who are capable of providing investment advice; (2) all personnel of the unregistered adviser involved in the U.S. advisory activities are deemed “associated persons” of the registered adviser; and (3) the SEC has adequate access to trading and other records of each such unregistered affiliate and to its personnel to the extent necessary to enable the SEC to identify conduct that may harm U.S. clients or markets.

16 *Richard Ellis* involved an RIA and its non-U.S. affiliate that was seeking to avoid having its business integrated with the RIA, requiring the affiliate to be registered. The *Richard Ellis* letter conditioned relief for the affiliated entity of the RIA on the basis that the affiliate (1) is adequately capitalized; (2) has a buffer, such as a board of directors a majority of whose members are independent of the RIA; (3) has employees dedicated to the entity and not engaged in the advisory business of the RIA; (4) uses independent sources of investment information and itself makes the investment decisions; and (5) keeps its investment decisions and advice confidential until communicated to the client.

IN THIS ISSUE:

1. [Advisers Act Alert Part 1: SEC Adopts New Advisers Act Rules and Implements Registration Exemptions](http://www.goodwinprocter.com/Publications/Newsletters/Client-Alert/2011/0630_SEC-Adopts-New-Advisers-Act-Rules-and-Implements-Registration-Exemptions.aspx?article=1#news_article_top)
2. [Advisers Act Alert Part 2: Executive Summary](http://www.goodwinprocter.com/Publications/Newsletters/Client-Alert/2011/0630_SEC-Adopts-New-Advisers-Act-Rules-and-Implements-Registration-Exemptions.aspx?article=2#news_article_top)
3. [Advisers Act Alert Part 3: Timing and Exemptions During the Next Year](http://www.goodwinprocter.com/Publications/Newsletters/Client-Alert/2011/0630_SEC-Adopts-New-Advisers-Act-Rules-and-Implements-Registration-Exemptions.aspx?article=3#news_article_top)
4. [Advisers Act Alert Part 4: Foreign Private Adviser Exemption](http://www.goodwinprocter.com/Publications/Newsletters/Client-Alert/2011/0630_SEC-Adopts-New-Advisers-Act-Rules-and-Implements-Registration-Exemptions.aspx?article=4#news_article_top)
5. [Advisers Act Alert Part 5: "Exempt Reporting Advisers" or "ERAs"](http://www.goodwinprocter.com/Publications/Newsletters/Client-Alert/2011/0630_SEC-Adopts-New-Advisers-Act-Rules-and-Implements-Registration-Exemptions.aspx?article=5#news_article_top)
6. [Advisers Act Alert Part 6: Registration Exemption for "Venture Capital Fund" Advisers](http://www.goodwinprocter.com/Publications/Newsletters/Client-Alert/2011/0630_SEC-Adopts-New-Advisers-Act-Rules-and-Implements-Registration-Exemptions.aspx?article=6#news_article_top)
7. Advisers Act Alert Part 7: Registration Exemption for Private Fund Advisers
8. [Advisers Act Alert Part 8: Calculating Assets Under Management and Its Implications](http://www.goodwinprocter.com/Publications/Newsletters/Client-Alert/2011/0630_SEC-Adopts-New-Advisers-Act-Rules-and-Implements-Registration-Exemptions.aspx?article=8#news_article_top)
9. [Advisers Act Alert Part 9: State vs Federal Registration](http://www.goodwinprocter.com/Publications/Newsletters/Client-Alert/2011/0630_SEC-Adopts-New-Advisers-Act-Rules-and-Implements-Registration-Exemptions.aspx?article=9#news_article_top)
10. [Advisers Act Alert Part 10: Other Matters](http://www.goodwinprocter.com/Publications/Newsletters/Client-Alert/2011/0630_SEC-Adopts-New-Advisers-Act-Rules-and-Implements-Registration-Exemptions.aspx?article=10#news_article_top)
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