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## GOODWIN PROCTER

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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 to 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."<sup>5</sup> 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.

<sup>5</sup> Please see the Implementing Release, page 49.

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