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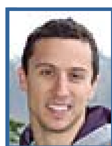
Private Fund Adviser Exemption (under $150M AUM) from Registration under the Advisers Act (Final Dodd-Frank Act Rules)

Posted by Asher Bearmanon July 28, 2011



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The SEC has now finalized the rules implementing the Investment Advisers Act of 1940 (the "Advisers Act") changes, which had been issued in proposed form near the end of 2010 following passage of the Dodd-Frank Act earlier that summer. These rules went into effect July 21, 2011. Fund managers who become obligated to register must do so by March 30, 2012 by filing their applications on or prior to February 14, 2012.

We are covering these new rules in the following series of posts:

1. Venture Capital Fund Exemption (and grandfather rules)
2. Private Fund Advisers Exemption (Having Less Than $150 Million AUM in U.S.) (*This Article*)
3. Foreign Private Adviser Exemption
4. Family Office Exemptions
5. Reporting Requirements of Exempt Fund Managers and Related Rules

This article addresses the private fund adviser exemption, for which fund managers may qualify if they are **investment advisers solely to private funds, with less than $150 million in assets under management in the United States.** These requirements are detailed below.

As noted in #5 above, even exempt advisers will be subject to some reporting requirements including basic identifying information about the fund manager and its owners and about the private funds it manages. In addition, even exempt advisers may be subject to state registration, depending on their jurisdiction.

1. Calculating Fund Assets for the $150M Threshold

Advisers relying on this exemption must calculate, on an annual basis, the amount of the private fund assets they to ensure that their private funds remain under $150M AUM, in the aggregate. For purposes of the calculation, "*assets*" includes managed assets, regardless of whether they are managed for compensation, as well as uncalled fund capital commitments:

Assets = (Market or Fair Value of Holdings) + (Uncalled Capital Commitments)

Private fund assets are valued based on <u>market value</u> (or fair value where market value is unavailable) on a <u>gross basis</u>, without deduction for liabilities such as accrued fees and expenses or the amount of any borrowing (although such an adviser may still hold itself out to clients as managing AUM on a net basis, if it chooses to). The SEC has recognized that calculating the fair value may require fund managers to incur additional costs, and will allow any fair valuation standard (in addition to GAAP) as long as the standard is utilized consistently and in good faith; although the SEC has stated its expectation that such a fair value standard would also be the same standard the fund manager uses for its financial reporting (meaning that the SEC has implied that a fund manager may not cherry pick its valuation methodologies for Form ADV and financial reporting purposes, respectively).

Annual valuations must also be reported in the fund manager's annual updating amendments to its Form ADV. The SEC had previously proposed requiring quarterly valuations, but was persuaded that annual valuations are more appropriate.

If an adviser's assets under management exceed $150 million in the adviser's annual valuation, the adviser likely will need to register under the Adviser's Act going forward, unless it can qualify for a different exemption. For advisers that lose eligibility under this exemption at the time of their annual updating amendments and have complied with all other applicable SEC reporting requirements, a 90-day transition period is provided, by the end of which the adviser is required to register under the Advisers Act. This 90-day transition period is not available to advisers that have failed to comply with all SEC reporting requirements, or that have accepted a client that is not a private fund.

2. Advises Solely "Private Funds"

Advisers with one or more clients that are not private funds are not eligible under this exemption and must register under the Advisers Act (unless another exemption is available). Under this exemption, fund managers may advise an unlimited number of "private funds", provided the aggregate value of their assets is less than $150 million in assets under management ("<u>AUM</u>") in the United States.

Advisers are permitted to treat as a "*private fund*" for the purposes of this exemption, any fund that also qualifies for another exclusion from the definition of "investment company" in section 3 of the Investment Company Act, which includes funds exempt under sections 3(c)(1) (with under 100 accredited investors), 3(c)(7) (with solely qualified purchasers) and certain real estate funds excluded by section 3(c)(5)(C). Advisers that elect to qualify under this exemption must treat a fund as a private fund for all purposes under the Advisers Act (*e.g.*, reporting information about private funds on Form ADV).

Affiliated Fund Managers: The SEC may view two or more separately formed advisory entities as a single adviser for the purposes of assessing the availability of exemptions from registration, if their purpose is to evade registration requirements. As a result, their managed funds may be aggregated for purposes of the $150M AUM test.

Single Investor Funds: Whether a single-investor fund is a private fund for the purposes of this exemption depends on the facts and circumstances. The SEC is concerned with the possibility of advisers converting client accounts to single-investor funds to avoid registration, but recognizes that there are circumstances in which it may be appropriate to treat a single-investor fund as a private fund.

Foreign Fund Managers: In the case of an adviser with a principal office and place of business outside of the United States (a non-U.S. adviser), the exemption is available as long as all of the adviser's clients that are "United States persons" at the time of becoming a client are qualifying "private funds". "*United States person*" is defined generally by incorporating the definition under Regulation S of the Securities Act. Regulation S looks generally to residency in the case of persons, place of organization or incorporation in the case of legal entities, and residency of the trustee for trusts. In addition, discretionary or other fiduciary accounts will be treated as a U.S. person if the account is held for the benefit of a U.S. person by a non-U.S. fiduciary who is a related person of the adviser.

The type or number of a non-U.S. adviser's non-U.S. clients do not affect its eligibility under this exemption, a reflection of the view that non-U.S. activities of non-U.S. advisers are less likely to implicate U.S. regulatory interests. This allows foreign fund managers to enter the United States market and take advantage of the exemption without regard to type or number of its non-U.S. clients or the amount of assets it manages outside of the United States. Effectively, the non-U.S. activities of a foreign fund manager are disregarded in applying this exemption.

3. Assets Managed in the United States

U.S. Managers: A fund manager treated as having a *principal* office and place of business in the United States is treated as a U.S. based manager and all of its assets will be deemed to be "managed in the United States" for purposes of the exemptions, even if the adviser has offices outside of the United States (*i.e.*, assets managed from offices outside the U.S. will count towards the $150M exemption).

Foreign Managers: In contrast to the foreign private adviser exemption, a foreign fund manager may have a U.S. place of business and still rely on this exemption. If it has such a place of business in the United States, a non-U.S. adviser need only count private fund assets it manages at the U.S. place of business towards the $150 million limit (meaning that any funds managed at such a U.S. place of business that are not *private funds* would preclude use of the exemption). If its U.S. place of business is its primary place of business; however, as noted above, all assets managed by the fund manager will be treated as U.S. AUM for purposes of the exemption. Significantly, there is no presumption that a non-U.S. adviser has a place of business in the U.S. solely because it is affiliated with a U.S. adviser.

A fund manager's "*place of business*" is fact-specific and is determined in light of the relevant facts and circumstances. A place of business includes any office where the investment adviser regularly provides advisory services, solicits, meets with, or otherwise communicates with clients, and any location held out to the public as a place where the adviser conducts any such activities. By contrast, providing research and due diligence in the U.S. would not be viewed as having a place of business in the U.S. if a person outside of the United States makes independent investment decisions and implements those decisions.

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