

ClientAlert

Financial Markets Developments

Capital Markets/Securities

October 2010

The Impact of the Dodd-Frank Private Fund Investment Advisers Registration Act of 2010 for Non-US Advisers



On July 21, 2010, President Obama signed into law the comprehensive US financial regulatory reform bill referred to as the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “**Dodd-Frank Act**”). Title IV of the Dodd-Frank Act, named the Private Fund Investment Advisers Registration Act of 2010 (hereinafter, “**Title IV**”), significantly amends the Investment Advisers Act of 1940 (the “**Advisers Act**”) with the intention of eliminating a heavily relied upon adviser registration exemption so that most investment advisers with US clients will be required to register with the US Securities and Exchange Commission (the “**SEC**”), subject to much more narrow registration exemptions created by Title IV of the Dodd-Frank Act. This Alert focuses on the implications that the Title IV amendments to the Advisers Act are likely to have for investment advisers that have their principal office and place of business outside of the US (“**Non-US Advisers**”).¹

I. Title IV—Overview

The Advisers Act requires certain “investment advisers” to register with the SEC under the Advisers Act and sets forth various fiduciary and related obligations on investment advisers. The Advisers Act defines an “investment adviser” broadly to include any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities. The Advisers Act definition of investment adviser also contains a number of specific exclusions from investment adviser status.

Currently, the Advisers Act prohibits an investment adviser from registering with the SEC under the Advisers Act unless the adviser has at least US\$25 million of assets under management (“**AUM**”). The Advisers Act requires an investment adviser with AUM of US\$30 million or more from US clients to register with the SEC under the Advisers Act. Non-US Advisers are eligible to register with the SEC under the Advisers Act, provided that they meet the eligibility criteria for registering discussed above.

If you have questions or comments regarding this Alert, please contact one of the lawyers listed below or lawyers in the [Investment Funds Group](#):

Monica Arora
Partner, New York
+ 1 212 819 8668
monica.arora@ny.whitecase.com

David Goldstein
Partner, New York
+ 1 212 819 8757
dgoldstein@ny.whitecase.com

Sean O’Malley
Partner, New York
+ 1 212 819 8579
sean.omalley@ny.whitecase.com

Richard Reilly
Partner, New York
+ 1 212 819 8954
rreilly@ny.whitecase.com

Mara Topping
Partner, Washington, DC
+ 1 202 626 3663
mtopping@washdc.whitecase.com

¹ For a more in-depth discussion on the various titles of the Dodd-Frank Act, please see White & Case’s expansive client alert at <http://www.whitecase.com/alerts-08052010-1/>. This expansive alert includes a stand-alone alert that summarizes the key features of Title IV, including many of those sections discussed herein, by providing answers to critical questions that investment advisers will likely have regarding the new law. The Title IV-specific client alert is available at <http://events.whitecase.com/fmd/alerts-Hedge-and-Private-Equity-Funds.pdf>.

Title IV, which has a compliance date of July 21, 2011, amends the Advisers Act to prohibit an investment adviser from registering with the SEC if the adviser (1) is required to be registered with the US state in which the adviser maintains its principal office and place of business and is subject to examination by such state securities commissioner or regulatory agency and (2) has AUM of between US\$25 million and US\$100 million. For Non-US Advisers, we do not believe that this amendment raising the AUM eligibility threshold to US\$100 million would apply because the amendment is predicated upon an adviser being required to be registered as an investment adviser with the US state in which the adviser maintains its principal office and place of business. A Non-US Adviser normally would have its principal office and place of business outside of the US and thus, not in any particular US state. It would therefore seem that the new US\$100 million AUM threshold in Title IV would not apply to a Non-US Adviser. However, we note that it is possible that the SEC, in adopting the rules that are required by Title IV, could interpret this provision differently, although we think that such an interpretation is unlikely.

Many investment advisers, including many Non-US Advisers, have relied on the exemption from registration provided in Section 203(b)(3) of the Advisers Act, commonly known as the “Private Adviser Exemption,” which exempts from registration with the SEC any investment adviser who, during the course of the preceding twelve (12) months, had fewer than fifteen (15) clients² and who neither held itself out generally to the public as an investment adviser nor acted as an investment adviser to a registered investment company or business development company. Effective July 21, 2011, however, Title IV will eliminate the Private Adviser Exemption. As a result, a Non-US Adviser who provides investment advice to even a single US client (e.g., a managed account owned by a US person or a private fund organized in the United States) could be required to register with the SEC under the Advisers Act, unless such Non-US Adviser qualifies for a existing exemption under the Advisers Act or one of the new exemptions created by Title IV of the Dodd-Frank Act. To the extent that a Non-US Adviser qualifies for an exemption

² By way of background, the SEC issued a rule in 2004 that defined the term “client” for purposes of counting clients toward the fewer than 15-client exemption to include the underlying investors of hedge funds (i.e., private funds that permit owners to redeem any portion of their interests in such private fund within two years of the purchase of such interests). The effect of the rule was that many advisers to hedge funds were required to register under the Advisers Act until the *Goldstein v. SEC* decision in 2006, where the DC Circuit Court of Appeals held that the SEC did not have the authority to issue such a rule. Title IV explicitly provides that the SEC may not define the term “client” for purposes of the anti-fraud provisions of the Advisers Act to include an investor in a private fund managed by an investment adviser, if such private fund has entered into an advisory contract with such adviser. The inclusion of this language reflects US Congress’s recognition that creating a fiduciary duty to both a private fund and its various underlying investors could result in an irresolvable conflict for an investment adviser.

from registration, it may still be subject to certain reporting and recordkeeping requirements imposed by Title IV, which are discussed below.

II. New Registration Exemptions Created by Title IV of the Dodd-Frank Act that are Most Applicable to Non-US Advisers

While Title IV eliminates the Private Adviser Exemption, it created several new exemptions from adviser registration and new exclusions from the definition of investment adviser. The new exemptions and exclusions that are most relevant to Non-US Advisers are discussed here.

A. Limited Exemption for “Foreign Private Advisers”

Title IV amended the Advisers Act to include a new category of foreign private advisers that are exempted from registering under the Advisers Act. Title IV defines a “foreign private adviser” as any investment adviser that (a) has no place of business in the US, (b) has, in total, fewer than fifteen (15) *clients and investors in the United States* in private funds advised by such adviser, (c) has aggregate AUM *attributable to clients or investors in the United States* in private funds advised by such adviser of less than US\$25 million, or such higher amount as the SEC deems appropriate and (d) neither holds itself out generally to the public in the US as an investment adviser or acts as an investment adviser to a registered investment company or business development company (this exemption is referred to hereinafter as, the “**Foreign Private Adviser Exemption**”).

The Foreign Private Adviser Exemption is much narrower than the Private Adviser Exemption that many Non-US Advisers currently rely upon to avoid SEC registration. While the Private Adviser Exemption only requires a Non-US Adviser to count its US clients (i.e., US organized funds and managed accounts owned by US persons) in counting towards the 15 client limit, the Foreign Private Adviser Exemption requires a Non-US Adviser to count *both* (i) the adviser’s clients in the US (i.e., US organized funds and US managed accounts) *and* (ii) all underlying US investors in private funds managed by the Non-US Adviser when counting towards the 15 client and investor limit. It is important to note that the Dodd-Frank Act does not define “*clients and investors in the United States*” for purposes of the Foreign Private Adviser Exemption. As with many other provisions of Title IV, Congress has left this definition to be determined by the SEC, either in rulemaking or in interpretive guidance. In issuing a rule or interpretive guidance relating to the Foreign Private Adviser Exemption, it is quite possible that the SEC could consider a US feeder fund to be a separate client from the offshore master fund into which it feeds, which would mean that, in counting

towards the 15 client and investor limit, a Non-US Adviser with a US feeder fund would need to count the US feeder in addition to the underlying US investors in the US feeder fund.

It should be noted that Title IV requires the SEC to issue rules requiring investment advisers to “private funds”³ to file reports containing such information as the SEC deems necessary and appropriate in the public interest and for the protection of investors, or for the assessment of systemic risk. As an interpretive matter, it is unclear if this reporting requirement will apply to exempt “foreign private advisers” that advise funds that rely upon the 3(c)(1) exemption (funds with fewer than 100 investors) or the 3(c)(7) exemption (funds that have only “qualified purchasers” as investors), but it is possible that the SEC, pursuant to its clear authority under Title IV, could apply some private fund reporting requirements to Non-US Advisers relying upon the Foreign Private Advisers Exemption. We expect that the SEC will have rules in place related to such reporting requirements by July 21, 2011 (Title IV’s effective date).

As mentioned above, Title IV does not define the term “clients and investors in the United States” for purposes of the Foreign Private Adviser Exemption. It also does not define what constitutes assets under management “attributable to clients or investors in the United States.” Instead, the meaning of these terms has been left to the SEC’s interpretation. The SEC has the authority under Title IV to adopt rules to define these terms, and we would expect, given their importance for purposes of relying on this exemption, that the SEC will provide some guidance (either in a rule or possibly in interpretive guidance in the form of “Frequently Asked Questions”).

B. Exemption for Investment Advisers to Private Funds that have Assets under Management in the US of Less than US\$150 Million

Title IV creates a new exemption from SEC registration for investment advisers that (i) act *solely* as advisers to private funds and (ii) have less than US\$150 million in “assets under management in the US” (the “**Private Fund Adviser Exemption**”). While the Private Fund Adviser Exemption has a higher AUM threshold (US\$150 million) than the Foreign Private Adviser Exemption (US\$25 million) it is important to note that the Private Fund Adviser Exemption is available to advisers that provide investment advice only to “private funds.”⁴ Thus, a Non-US Adviser that wishes to rely upon the Private Fund Adviser

Exemption will not be able to act as an investment adviser to any separately managed accounts owned by US persons. This could be particularly problematic for a Non-US Adviser that primarily manages private funds but who also permits high net worth individual investors to invest alongside of the Non-US Adviser’s private funds in managed accounts set up and advised by the Non-US Adviser. Nevertheless, a Non-US Adviser that advises solely private funds may rely on this exemption if it does not qualify for the Foreign Private Adviser Exemption.

While advisers that qualify for the Private Fund Adviser Exemption will be exempt from registering with the SEC under the Advisers Act, Title IV mandates that the SEC require such advisers to maintain records and provide to the SEC such annual or other reports as the SEC determines necessary or appropriate in the public interest or for the protection of investors.⁵ This will require the SEC to propose and adopt rules establishing the recordkeeping and reporting requirements for advisers relying upon the Private Fund Adviser Exemption. The full scope and form of those recordkeeping and reporting requirements are left for the SEC to determine in its rulemaking, but it is possible that the SEC will impose recordkeeping and reporting requirements on advisers relying on the Private Fund Adviser Exemption that are similar to the recordkeeping and reporting requirements that Title IV imposes on SEC registered advisers with respect to the “private funds” that they manage.⁶

Title IV does not define “assets under management in the United States”⁷ for purposes of the Private Adviser Exemption. We expect the SEC to adopt a rule to define “assets under management in the United States” or provide some other form of interpretive guidance. Based on past SEC guidance and interpretations, we believe it is unlikely (though not impossible) that the SEC would consider the assets of a private fund organized and based outside of the US to constitute “assets under management in the United States,” particularly where such private fund has no US investors.

5 See White & Case’s Title IV-specific client alert at <http://events.whitecase.com/fmd/alerts-Hedge-and-Private-Equity-Funds.pdf> for a discussion of the types of recordkeeping and reporting requirements contemplated by Title IV.

6 Title IV mandates that the SEC require, at a minimum, that each registered investment adviser to a “private fund” make a record of and make available to the SEC for each private fund advised by such adviser, information regarding (a) the amount of assets under management and use of leverage, including off-balance-sheet leverage, (b) counterparty credit risk exposure, (c) trading and investment positions, (d) valuation policies and practices, (e) types of assets held, (f) side arrangements or side letters and (g) trading practices.

7 For purposes of Section 203A of the Advisers Act, which sets forth minimum assets under management threshold to qualify for SEC registration, “assets under management” are defined as “the securities portfolios with respect to which an investment adviser provides continuous and regular supervisory and management services.”

3 Title IV defines a “private fund” as “an issuer that would be an investment company, as defined in section 3 of the Investment Company Act of 1940 (15 U.S.C.), but for section 3(c)(1) or 3(c)(7) of that Act.”

4 See footnote 3 for the definition of “private fund.”

C. Exemption for Venture Capital Fund Advisers

Title IV provides an exemption from registration for investment advisers that act *solely* as advisers to venture capital funds. The availability of this exemption to Non-US Advisers will depend on how the SEC defines the term “venture capital fund,” which the SEC is required to do by July 21, 2011. Although exempted from registration under the Advisers Act, venture capital fund advisers will be subject to recordkeeping and reporting requirements as the SEC determines necessary or appropriate in the public interest or for the protection of investors.

D. Family Office Exclusion

Title IV creates an exclusion from the definition of investment advisers for “family offices.” Family offices will be excluded entirely from the definition of “investment adviser,” and thus exempted from all provisions of the Advisers Act, including those pertaining to reporting. As directed by Title IV, the SEC, on October 12, 2010, proposed new Rule 202(a)(11)(G)-1 under the Advisers Act, which defines the term “family office” for the purposes of this exclusion as any firm that provides investment advice only to “family members” and “key employees” (both as defined in the rule) as well as family trusts, private funds and other entities that are wholly owned and controlled by family members.⁸ As set forth in proposed Rule 202(a)(11)(G)-1, the family office exclusion is only available to family offices that manage the assets of a single family and not family offices that manage the assets of multiple families.

E. Private Equity Fund Advisers

The US Senate considered including a specific exemption from registration for advisers that act solely as advisers to “private equity funds.” As contemplated, the SEC would have been required to define the term “private equity fund” for purposes of the exemption. This exemption was the subject of intense lobbying efforts by the private equity industry; however, this proposed exemption ultimately was not incorporated into the Dodd-Frank Act.

III. Registration of Non-US Advisers

Due to the elimination of the Private Adviser Exemption (less than fifteen (15) clients), many Non-US Advisers that advise US clients may be required to register under the Advisers Act if they do not qualify for one or more of the exemptions discussed above.

⁸ For a more in-depth discussion on the Family Office Proposal, please see White & Case’s client alert at http://www.whitecase.com/files/Publication/71fe4395-8955-4a99-a567-f69f99af3dae/Presentation/PublicationAttachment/ed0b09d0-0d56-478f-a36b-fc40b7fa06d1/Alert_SEC_Issues_Proposed_Rule_Defining_Family_Office.pdf.

However, the SEC has traditionally held the position that many of the Advisers Act’s more onerous provisions are generally not applicable to a Non-US Adviser’s relationship with its non-US clients. In letters and releases published by the SEC prior to the passage of the Dodd-Frank Act, the SEC and its staff have stated that Non-US Advisers may treat funds organized outside of the US (“**offshore funds**”) as their “clients” for all purposes under the Advisers Act, other than (1) certain recordkeeping and reporting requirements of the Advisers Act⁹ and (2) the anti-fraud provisions of the Advisers Act. In addition, the SEC has confirmed that a Non-US Adviser that is registered with the SEC but which has no US clients (i.e., an adviser that does not advise any funds organized in the US or any separately managed accounts beneficially owned by any US person) would not be subject to many of the substantive rules under the Advisers Act that otherwise apply to SEC-registered advisers, including (among others): (1) Rule 206(4)-7 (the “**Compliance Rule**”), which requires a registered adviser to adopt and implement written compliance policies and procedures and conduct an annual compliance review, (2) Rule 206(4)-2 (the “**Custody Rule**”), which requires a registered adviser to segregate client funds and securities with a qualified custodian, provide certain notices of changes in custodians to clients, and provide account statements or GAAP audited financials to investors in private funds managed by the adviser, (3) Rule 206(4)-6 (the “**Proxy Voting Rule**”), which requires a registered adviser to disclose to its clients how they may obtain information from the adviser about how it voted their securities and describe the adviser’s proxy voting policies and procedures, and (4) Rule 204A-1 (the “**Code of Ethics Rule**”), which requires the adviser to implement a code requiring its personnel involved in providing investment advice to clients to regularly report their personal securities trades to the adviser and the adviser to pre-clear certain investments by such personnel. This lesser regulatory regime is often referred to as “registration lite.”

Following the passage of the Dodd-Frank Act, it is unclear whether the SEC will reaffirm its prior guidance permitting certain Non-US Advisers to utilize the “registration lite” regime. Although we are hopeful that the SEC will provide guidance on the availability of “registration lite” before Title IV becomes fully effective on July 21, 2011, the SEC has given no indications as of yet whether it will do so, and there can be no assurance at this point that Non-US Advisers that manage offshore funds with US investors will be able to rely upon “registration lite” once Title IV becomes fully effective.

⁹ The SEC staff has stated that, with respect to their non-US clients (including offshore funds), non-US advisers registered with the SEC only must maintain books and records required by subparagraphs 1, 2, 3, 6, 7, 8, 9, 10 and 13 of Rule 204-2(a) under the Advisers Act.

IV. SEC Examination Procedures¹⁰

Even if the SEC reaffirms the availability of the “registration lite” regime discussed above, a Non-US Adviser that is registered with the SEC will not be excused from being subject to SEC staff examinations of the adviser’s books and records. Technically, all investment advisers that are registered with the SEC under the Advisers Act are subject to regular examination of their books and records pursuant to the SEC’s examination authority. However, primarily due to availability of resources (funding) and practical issues (staffing), the SEC examination staff typically does not travel outside of the US to conduct examinations of investment advisers that do not have a place of business in the US. With the elimination of the Private Adviser Exemption that many Non-US Advisers heretofore have relied upon, it is possible that the SEC will need to address the difference between the examination policy towards registered US advisers and registered Non-US Advisers. The SEC may make efforts to expand the reach of its on-site inspections or the SEC staff could perform more limited examinations of Non-US Advisers based solely on examinations of electronic records without conducting an on-site examination of such advisers; however, it is not clear at this point how the SEC will treat examinations of Non-US Advisers after Title IV of the Dodd-Frank Act becomes fully effective.

V. Effective Date of Title IV

The provisions of Title IV will become effective on July 21, 2011. Investment advisers that will be subject to registration under Title IV, and which can satisfy the minimum AUM requirements discussed above, can voluntarily register with the SEC during the one-year transition period.

¹⁰ It is unclear whether the registration and examination requirements will be the same for all investment advisers. With regard to advisers to “mid-sized private funds” (a term introduced but left undefined in Title IV), the SEC is directed to take into account the size, governance and investment strategy of such funds to determine whether they pose systemic risk and adjust its registration and examination procedures accordingly. The SEC will presumably be required to define the term “mid-sized private funds,” as such term is not defined in Title IV. The shape of any such adjusted registration or examination procedures is unclear and may, or may not, be addressed in the SEC rulemaking process.

VI. Next Steps

As discussed above, many of the details as to how Title IV of the Dodd-Frank Act will be implemented that are particularly relevant to Non-US Advisers have been left to the SEC to determine. The SEC will have broad discretion to, among other things, (a) define and interpret certain key terms, including “clients and investors in the US,” “attributable to clients in the US and investors in the US” and “assets under management in the US;” (b) establish adjusted registration and examination procedures for certain advisers and (c) establish recordkeeping and reporting requirements for certain advisers as it deems necessary and appropriate in the public interest, for the protection of investors and/or for the assessment of systemic risk. Thus, many details regarding the registration and regulation of Non-US Advisers by the SEC will remain uncertain until the SEC enacts rules implementing Title IV’s provisions.

Non-US Advisers who have or expect to have US clients (US organized funds or US managed account clients) should begin to evaluate their organization’s structure, operations and plans related to the services provided to US persons to determine whether they are likely to be required to register under the Advisers Act as amended by Title IV of the Dodd-Frank Act. It is particularly important for Non-US Advisers who have or may soon have US clients to begin considering how the Title IV amendments could impact their businesses. For instance, Non-US Advisers that are registered or subject to regulation in multiple non-US jurisdictions and that end up having to register with the SEC as a result of Title IV will need to consider ways to harmonize their current compliance policies and procedures with the US regulatory requirements applicable to investment advisers registered under the Advisers Act.

We will continue to monitor the regulatory developments relevant to registration and will keep you apprised of the SEC’s rulemaking activity with respect to the implementation of Title IV.

Supporting Clients Across the Globe

White & Case is a leading global law firm with lawyers in 36 offices across 25 countries.

We advise on virtually every area of law that affects cross-border business and our knowledge, like our clients' interests, transcends geographic boundaries.

Whether in established or emerging markets, our commitment is substantial, with dedicated on-the-ground knowledge and presence.

Our lawyers are an integral, often long-established part of the business community, giving clients access to local, English and US law capabilities, plus a unique appreciation of the political, economic and geographic environments in which they operate.

At the same time, working between offices and cross-jurisdiction is second nature and we have the experience, infrastructure and processes in place to make that happen effortlessly.

We work with some of the world's most respected and well-established companies—including two-thirds of the *Global Fortune 100* and half of the *Fortune 500*—as well as start-up visionaries, governments and state-owned entities.

This Client Alert is provided for your convenience and does not constitute legal advice. It is prepared for the general information of our clients and other interested persons. This Client Alert should not be acted upon in any specific situation without appropriate legal advice and it may include links to websites other than the White & Case website.

White & Case has no responsibility for any websites other than its own and does not endorse the information, content, presentation or accuracy, or make any warranty, express or implied, regarding any other website.

This Client Alert is protected by copyright. Material appearing herein may be reproduced or translated with appropriate credit.

www.whitecase.com

In this alert, White & Case means the international legal practice comprising White & Case LLP, a New York State registered limited liability partnership, White & Case LLP, a limited liability partnership incorporated under English law and all other affiliated partnerships, companies and entities.