

## SEC Proposes New Reporting Requirements for Certain Advisers to Private Funds

*Advisers exempt from registering with the SEC under exemptions set forth in the Dodd-Frank Act and implemented by the SEC would still be required to comply with extensive recordkeeping and reporting obligations.*

**January 10, 2011**

Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), referred to as the Private Fund Investment Advisers Registration Act of 2010, effected fundamental changes in the Investment Advisers Act of 1940 (Advisers Act) that will result in many previously unregistered advisers, such as advisers to private funds, having to register with the U.S. Securities and Exchange Commission (SEC) or one or more state regulators, absent an exemption from registration. When the Dodd-Frank Act was signed into law on July 21, 2010, most of its impact had not yet been determined, as the implementation was left in the hands of industry regulators.

Now the SEC has spoken. At an open meeting on November 19, 2010, the SEC voted to propose rules that would implement reporting requirements for certain advisers, as required by the Dodd-Frank Act. In the proposing release, the SEC proposed a new rule requiring exempt private fund advisers to file public reports on an expanded version of Form ADV (Reporting Release).<sup>1</sup> Comments on the proposal must be submitted to the SEC by January 24 and may be submitted online at the SEC's website.

### NEW REPORTING AND EXAMINATION REQUIREMENTS

Sections 203(l) and 203(m)(2) of the Advisers Act, as amended by the Dodd-Frank Act, mandate that the SEC require venture capital fund advisers and private fund advisers exempted from registration to maintain records and provide the SEC with reports as the SEC determines necessary or appropriate in the public interest or for the protection of investors. In the Reporting Release, the SEC issued Proposed Rule 204-4 under the Advisers Act (the Proposed Rule), which would require those advisers exempt from registration to complete and electronically file reports on certain items set forth in Form ADV, which would be publicly available on the SEC's website.

The items in Form ADV on which exempt advisers would have to report are the following:

- **Item 1 – Identifying Information.** An exempt adviser would be required to disclose information such as its business name, principal place of business, mailing address, and website address.

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1. See Rules Implementing Amendments to the Investment Advisers Act of 1940, Advisers Act Rel. No. 3110 (Nov. 19, 2010), available at <http://www.sec.gov/rules/proposed/2010/ia-3110.pdf>.

- **Item 2C – Identification of Exemption.** An exempt adviser would be required to identify the exemption that it is relying on to report to, rather than register with, the SEC. This would be a new section that was proposed to be added to Part 1A of Form ADV in the Reporting Release.
- **Item 3 – Form of Organization.** An exempt adviser would be required to disclose its corporate form (e.g., limited liability company, trust), the state under which the adviser is organized, and its fiscal year.
- **Item 6 – Other Business Activities.** An exempt adviser would be required to disclose other businesses in which it is actively engaged (broker-dealer, futures commission merchant, etc.) and whether the adviser sells products or provides services other than investment advice to its advisory clients.
- **Item 7 – Financial Industry Affiliations.** An exempt adviser would have to provide information about whether its related persons are financial industry participants (e.g., investment company, other investment adviser) or otherwise engaged in financial activities. In the Reporting Release, the SEC also proposed to expand the scope of Item 7B and Schedule D of Form ADV to include additional information about private funds advised by a reporting adviser. Under the revised disclosure requirements, a reporting adviser would be required to disclose the organizational, operational, and investment characteristics of each of the private funds it manages; the amount of assets held by such private fund; the nature of such private fund’s investors; and the identity of and other information about five of such fund’s service providers that typically act as “gatekeepers” of each fund (i.e., auditor, prime broker, custodian, administrator, or marketer). Currently, an adviser is required to disclose any “investment-related limited partnership” that either the adviser or a related person of the adviser advises. Under the Reporting Release, an adviser would be required to disclose any private fund (regardless of whether the private fund is organized as a limited partnership) it advises, but would not have to disclose private funds advised by related persons. In addition, under the Reporting Release, sub-advisers of an adviser would not have to disclose private funds that the adviser has already disclosed. Finally, a non-U.S. adviser would not have to disclose private funds organized outside the United States that are not offered to, or owned by, U.S. persons.
- **Item 10 – Control Persons.** An exempt adviser would be required to disclose the identity of every person who directly or indirectly controls the adviser or its management policies. Form ADV defines “control” as the power, directly or indirectly, to direct the management or policies of a *person*, whether through ownership of securities, by contract or otherwise, and presumes control upon ownership of 25% of the adviser’s voting interests.
- **Item 11 – Disclosure Information.** An exempt adviser would have to disclose its disciplinary history as well as that of its employees.

A reporting adviser would be required to amend its Form ADV annually within 90 days of its fiscal year-end. The Proposed Rule would require the adviser’s initial Form ADV to be filed by August 20, 2011.

In a companion release proposing exemptions from registration issued the same day as the Reporting Release, the SEC noted that because venture capital fund advisers and private fund advisers are not

“specifically exempt” from the registration requirement under Section 203(b) of the Advisers Act, their books and records are all still subject to SEC examination under Section 204(a). The books and records of foreign private advisers, on the other hand, which are specifically exempt from registration under Section 203(b)(3), would not be subject to SEC examination.

The Reporting Release did not address other recordkeeping requirements for exempt advisers, but the SEC indicated at its open meeting on November 19 that it expects to propose implementing rules during the first quarter of 2011.<sup>2</sup>

## **PRACTICAL CONSIDERATIONS**

Regardless of whether an adviser qualifies for exemption from registration with the SEC, all venture capital fund advisers and private fund advisers will be subject to the reporting requirements set forth in the Reporting Release, including the proposed revisions to Item 7B and Schedule D of Form ADV, which would require advisers to provide identifying information about each of their private funds, such as each fund’s name and domicile, ownership, service providers, and assets. Such advisers, as discussed above, would also be subject to examination by the SEC. In the Reporting Release, the SEC noted that such increased disclosure of private funds would help the SEC target its examinations.

In determining whether it will classify itself as a private fund adviser or a foreign private adviser, an adviser should consider that foreign private advisers will not be subject to the reporting requirements set forth in the Reporting Release, nor would they be subject to SEC examination or the recordkeeping requirements that the SEC plans to propose in 2011. The reporting requirements that accompany private fund adviser status may serve as a disincentive to many foreign advisers, but in order to remain outside of the reporting requirements, foreign advisers would have to limit their U.S. subscriptions to fewer than 15 investors and under \$25 million in assets under management.

## **ADDITIONAL INFORMATION**

If you have any questions or would like more information on any of the issues discussed in this LawFlash, please contact the authors, **Ethan W. Johnson** (305.415.3394; [ejohnson@morganlewis.com](mailto:ejohnson@morganlewis.com)) and **John J. O’Brien** (215.963.4969; [jobrien@morganlewis.com](mailto:jobrien@morganlewis.com)), or any of the following Morgan Lewis attorneys:

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2. Section 204(b) of the Advisers Act, as amended by the Dodd-Frank Act, states that the SEC may require registered investment advisers to maintain records and file reports regarding the amount of assets under management, use of leverage (including off-balance-sheet leverage), counterparty credit risk exposure, trading and investment positions, trading practices, valuation policies and practices, types of assets held, and side arrangements.

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