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The Private Fund Adviser Exemption and the Foreign Private Adviser Exemption Under the Investment Advisers Act

On June 22, 2011, the Securities and Exchange Commission (the "SEC") adopted rule 203(m)-1 (the "Private Fund Adviser Final Rule") and rule 202(a)(30)-1 (the "Foreign Private Adviser Final Rule"),[1] codifying the private fund adviser exemption and the foreign private adviser exemption from registration under the Investment Advisers Act of 1940, as amended (the "Advisers Act"),[2] as amended by the Private Fund Investment Advisers Registration Act of 2010 (the "Registration Act").[3] Both the Private Fund Adviser Final Rule and the Foreign Private Adviser Final Rule were adopted substantially as proposed by the SEC on November 19, 2010 (the "Proposed Rule"),[4] and both Final Rules became effective on July 21, 2011.[5]

Prior to the Dodd-Frank Act, many hedge fund and private equity fund investment advisers were exempt from registration with the SEC by virtue of the "private adviser exemption" under the Advisers Act,[6] which provided that an investment adviser was exempt from registration if the adviser (i) had fewer than 15 clients during the course of the preceding 12 months and (ii) neither held itself out generally to the public as an investment adviser nor acted as an investment adviser to any registered investment company or business development company. The Registration Act eliminated the private adviser exemption and in its place introduced certain narrower exemptions from registration, including an exemption for private fund advisers with less than $150 million in assets under management and foreign private advisers.

I. Private Fund Advisers With Less Than $150 Million in Assets Under Management

The Registration Act requires the SEC to provide for an exemption from registration for advisers that act solely as advisers to private funds[7] and have less than $150 million

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1 *See* Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, Investment Advisers Act Release No. IA-3222 (June 22, 2011) (the "Exemptions Release"), *available at* http://www.sec.gov/rules/final/2011/ia-3222.pdf. The Final Release sets forth rule 203(m)-1 (the "Private Fund Adviser Final Rule") and rule 202(a)(30)-1 (the "Foreign Private Adviser Final Rule").

2 15 U.S.C. §§ 80b-1 to -21.

3 The Registration Act comprises Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which was signed into law by President Barack Obama on July 21, 2010. Pub. L. No. 111-203, 124 Stat. 1376 (2010).

4 *See* Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, Investment Advisers Act Release No. IA-3111 (Nov. 19, 2010) (the "Proposing Release"), *available at* http://www.sec.gov/rules/proposed/2010/ia-3111.pdf.

5 Exemptions Release at 1.

6 15 U.S.C. § 80b-3(b)(3).

7 Section 202(a)(29) of the Advisers Act, added by Section 402(a) of the Registration Act, defines the term "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. § 8a-3 (the "Investment Company Act"), but for section 3(c)(1) or 3(c)(7) of the Investment Company Act. Registration Act § 402(a). Private funds include hedge funds, private equity funds and other types of pooled investment vehicles. Exemptions Release at 3.

in assets under management in the United States.[8] To effectuate this requirement, the SEC has adopted rule 203(m)-1, which includes provisions addressing several interpretive questions raised by this exemption, including the determination of the amount of an adviser's assets under management for purposes of the $150 million threshold and when those assets are deemed to be managed in the United States. The SEC refers to this new exemption as the "Private Fund Adviser Exemption."[9]

A. Advises Solely Private Funds

An adviser relying on the Private Fund Adviser Exemption would be limited to advising only private funds, but would be permitted to advise an unlimited number of private funds in the United States as long as the aggregate value of the private fund assets is less than $150 million.[10] An adviser who advises other clients, such as individuals or managed accounts, from the United States would not qualify for this exemption.

The Private Fund Adviser Exemption, as adopted, differentiates between United States advisers, who are advisers with a principal office and place of business in the United States ("U.S. Advisers"), and non-United States advisers, who are advisers with a principal office or place of business outside the United States ("Non-U.S. Advisers"). The SEC states that a Non-U.S. Adviser could take advantage of the exemption if all of its clients that are United States persons (as defined below) are qualifying private funds.[11] Therefore, a Non-U.S. Adviser would not lose its exemption as a result of the size or nature of its advisory activities outside of the United States. However, the SEC also provides that a U.S. Adviser relying on the exemption would not have the ability to conduct offshore advisory activities with non-qualifying clients. This distinction reflects the SEC's long-held belief that the non-United States activities of a Non-U.S. Adviser are less likely to implicate United States regulatory interests, and the SEC believes this distinction is also consistent with general principles of international comity.[12]

In response to the Proposed Rule, commenters questioned the scope of the term "private fund" for purposes of this exemption. Several commenters sought guidance as to whether a fund with a single investor could be a "private fund."[13] The SEC expressed concern that advisers could convert client accounts into single investor funds in order to avoid registration under the Advisers Act and reminded advisers that they would view a structure with no purpose other than circumvention of the Advisers Act as a violation of the Adviser Act's prohibition on doing indirectly what is unlawful to do directly.[14] The SEC also enumerated several examples where a single-investor fund would be a private fund, such as a fund that seeks to raise capital from multiple investors but only has a single, initial investor for a period of time, or a fund in which all but one of the investors have redeemed their interests.[15]

The SEC agreed with another commenter who suggested that advisers should be allowed to treat as a "private fund" a fund that qualifies for an exclusion from the definition of "investment company"

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8 Registration Act § 408.

9 Exemptions Release at 5-6.

10 *Id.* at 76.

11 *Id.*

12 *Id.* at 77.

13 *Id.* at 78-79.

14 *Id.* at 79 & n.324; *see also* Advisers Act § 208(d), 15 U.S.C. § 806-8(d).

15 Exemptions Release at 79, n.325. The SEC is, however, silent on other reasons an adviser could structure a single-investor private fund.

under the Investment Company Act other than section 3(c)(1) or 3(c)(7).[16] The final rule permits, but does not require, an adviser to treat such a fund as a "private fund" for purposes of the Private Fund Adviser Exemption provided that the adviser treats the fund as a private fund under the Advisers Act and the rules thereunder for all purposes.[17] Therefore, if an adviser chooses to treat such a fund as a "private fund" for these purposes, the adviser would also be required, for example, to report the fund as a "private fund" on Form ADV.[18]

B. Private Fund Assets

For purposes of the Private Fund Adviser Exemption's assets under management test, an adviser would be required to aggregate the value of all assets of private funds that it manages in the United States.[19] A subadviser only would need to count the portion of the private fund assets for which it has advisory responsibilities in the United States.[20]

In the SEC's sister release implementing the Registration Act's amendments to the Advisers Act (the "Implementing Release"),[21] the SEC implemented a uniform method to calculate assets under management under various provisions of the Dodd-Frank Act. This uniform method would require advisers to include in their assets under management securities portfolios for which they provide continuous and regular supervisory or management services, regardless of whether these assets are proprietary assets, assets managed without compensation, as well as uncalled capital commitments. In addition, advisers must determine their assets based on market value (or fair value, if unavailable), and must calculate assets on a gross basis, *i.e.*, without deducting liabilities such as borrowings and accrued fees and expenses.[22]

Unlike the Proposed Rule, which would have required advisers relying on the exemption to calculate their private fund assets each quarter on the basis of the fair value of the assets at the end of the quarter, the rule as adopted requires an adviser to calculate its private fund assets annually, in connection with the adviser's annual updating amendments to Form ADV. [23] The use of fair value differs from the current instruction in Form ADV that allows an adviser to value its assets based on the method the adviser uses to report assets to clients or to calculate fees for investment advisory services. The SEC considered, but did not adopt, a requirement to value assets in accordance with generally accepted accounting principles ("GAAP").[24] The SEC stated it would expect that an adviser that calculates fair value in accordance with GAAP or another basis of accounting for financial reporting purposes will also use that same basis for purposes of determining the fair value of its regulatory

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16 *Id.* at 79-80. For example, a fund may simultaneously qualify for section 3(c)(1), 3(c)(7) and 3(c)(5)(C), which excludes certain real estate funds from registration under the Investment Company Act.

17 Rule 203(m)-1(d)(5).

18 Exemptions Release at 80.

19 However, the Exemptions Release distinguishes between U.S. Advisers and Non-U.S. Advisers with respect to the assets managed "in the United States" requirement. *See* Section I.C. below.

20 Exemptions Release at 81, n.332.

21 *See* Rules Implementing Amendments to the Investment Advisers Act of 1940, Investment Advisers Act Release No. IA-3221, (June 22, 2011) (the "Implementing Release"), ***available at*** http://www.sec.gov/rules/final/2011/ia-3221.pdf.

22 Many commenters objected to the requirement that advisers calculate assets on a gross basis, arguing that industry practice is to report net assets under management, so calculating on a gross basis for Form ADV would be confusing to investors. In response, the SEC stated that they would not preclude an adviser from holding itself out to its clients as managing a net amount of assets, as may be its custom. Exemptions Release at 87.

23 *Id.* at 90.

24 Implementing Release at 27, n.99.

assets under management.[25] The rule is also consistent with the timeframes for valuing assets under management and registering with the SEC applicable to state-registered advisers that will need to switch from state to SEC registration.[26]

If an adviser reports in its annual updating amendment that it has over $150 million in assets under management in the United States, the SEC allows for a 90-day transition period for the adviser to become registered with the SEC.[27] This transition period is a safe harbor that is only available for advisers who have complied with all of their reporting requirements under the Private Fund Adviser Exemption.[28] Further, the transition period does not apply to an adviser who takes a client that is not a private fund. Such an adviser would have to be registered with the SEC before accepting a client that is not a private fund.[29]

C. Assets Managed in the United States

The Private Fund Adviser exemption requires that all of the assets of a U.S. Adviser be considered "assets under management in the United States," even if the adviser has offices outside the United States and the day-to-day management of certain assets takes place in such offshore offices, so long as the adviser has its principal office and place of business in the United States.[30] The adviser's principal office and place of business is defined as the executive office of the investment adviser from which the officers, partners or managers of the investment adviser direct, control and coordinate its activities.[31]

Non-U.S. Advisers, however, would need only count assets managed at a "place of business" in the United States toward the $150 million threshold.[32] A "place of business" is defined by reference to Rule 222-1(a) as any office where the 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 investment adviser conducts any such activities.[33] Thus, for purposes of the Private Fund Adviser Exemption, the analysis often will turn on whether the adviser has "assets under management" at such a U.S. place of business.[34] Under the Advisers Act, "assets under management" are the securities portfolios for which an adviser provides "continuous and regular supervisory or management services."[35] The SEC has stated that this is a factual determination, but that they would not view providing research or conducting due diligence to be "continuous and regular supervisory or management services" at a U.S. place of business if a person outside of the United States makes independent investment decisions and implements those decisions.[36] This rule is designed to encourage

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25 *Id.*

26 Exemptions Release at 91-92.

27 *Id.* at 92.

28 *Id.*

29 *Id.* at 92, n.378.

30 *Id.* at 93-94.

31 Rule 203(m)-1(d)(3).

32 Exemptions Release at 94. The SEC revised this provision to refer to assets managed "at" a place of business in the United States, rather than "from" a place of business in the United States as proposed. The SEC intends the revised language to reflect more clearly the rule's territorial focus on the location at which the asset management takes place. *Id.* at 94, n.384.

33 *Id.* at 98.

34 *Id*.

35 *Id* at 98-99.

36 However, the SEC notes that these services may cause an adviser to have a "place of business" in the United States. *See Id.* at 99, n.401.

the participation of Non-U.S. Advisers in the U.S. market by applying the securities laws in a manner that does not impose U.S. regulatory requirements on a Non-U.S. Adviser's non-U.S. business.[37]

The SEC believes that, for most advisers, the rule as adopted will avoid difficult attribution determinations that would be required if assets are managed by teams located in multiple jurisdictions, or if portfolio managers located in one jurisdiction rely heavily on research or other advisory services performed by employees located in another jurisdiction.[38]

D. United States Person

Under the adopted rule, a Non-U.S. Adviser would not qualify for the Private Fund Adviser Exemption if it provides advice to a client that is a United States person other than a qualifying private fund.[39] The SEC has defined a "United States person" by reference to Regulation S under the Securities Act of 1933, as amended ("Regulation S").[40] Under Regulation S, an individual is a United States person if he or she is a resident of the United States; legal partnerships and corporations are generally treated as United States persons if they are organized or formed in the United States; and trusts are United States persons if the trustee is a United States resident.[41] Rule 203(m)-1 also contains a special rule for discretionary accounts maintained outside of the United States for the benefit of United States persons. Under this rule, a discretionary or fiduciary account must be treated as a United States person if the account is held for the benefit of a United States person by a non-United States fiduciary who is a related person of the adviser. The purpose of this special rule is to prevent advisers from structuring the management of United States clients' accounts in ways that would circumvent the principles of Regulation S. In addition, the SEC clarified that a client will not be considered a United States person if the client was not a United States person at the time of becoming a client of the adviser.[42] An analogous carve-out appears in the Foreign Private Adviser Exemption, and this addition serves to establish similar treatment between the two exemptions.[43]

E. Reporting by Exempt Reporting Advisers

In order to implement the reporting requirements of the Private Fund Advisers Exemption, the SEC has adopted a new rule, as proposed, requiring advisers relying on the Private Fund Advisers Exemption ("Exempt Reporting Advisers") to submit and periodically update reports that consist of a limited subset of items on Form ADV.[44] As part of the revised Form ADV, an Exempt Reporting Adviser would be required to identify the exemption(s) on which it is relying to report, rather than register, with the SEC.[45] Further, the SEC adopted, as proposed, a requirement that Exempt Reporting Advisers complete the following items of Part 1A of 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

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37 *Id.* at 96.

38 *Id.* at 94.

39 *Id.* at 99.

40 *Id.*

41 *Id.* at 99-100.

42 Note to Rule 203(m)-1(d)(8).

43 Exemptions Release at 99, n.403.

44 Advisers relying on the new exemption for venture capital fund advisers are also considered exempt reporting advisers. *See* Implementing Release at 41.

45 *Id.* at 44.

11 (Disclosure Information).[46] In addition, the SEC is requiring, as proposed, that exempt reporting advisers also complete corresponding sections of Schedules A, B, C, and D of Form ADV.[47]

The SEC notes that most of the rules that apply to registered advisers do not apply to exempt reporting advisers, such as the custody rule, but notes, for example, that the pay to play rule, rule 206(4)-5, does apply to exempt reporting advisers.[48] The SEC does not anticipate conducting compliance examinations of exempt reporting advisers on a regular basis, although it has the right to conduct such examinations and will do so if there are indications of wrongdoing, such as from tips or complaints.[49] Exempt reporting advisers may choose to register with the SEC if they otherwise meet the requirements. Exempt reporting advisers need to evaluate whether they have any state investment adviser registration requirements.[50]

II. Foreign Private Advisers

The Registration Act creates a new exemption for a "foreign private adviser" (the "Foreign Private Adviser Exemption").[51] This new exemption is codified as amended section 203(b)(3) of the Advisers Act. To be eligible for the Foreign Private Adviser Exemption, an adviser must: (i) have no place of business in the United States; (ii) have, in total, fewer than 15 clients (*e.g.*, managed accounts or pooled investment vehicles) and investors in the United States in private funds advised by the investment adviser; (iii) have less than $25 million in aggregate assets under management that are attributable to clients in the United States and investors in the United States in private funds advised by the investment adviser; and (iv) neither hold itself out generally to the public in the United States as an investment adviser nor act as an investment adviser to any registered investment company or business development company.[52] Advisers relying on this new exemption are not subject to reporting or recordkeeping provisions under the Advisers Act and are not subject to examination by the SEC.[53] The SEC has adopted, substantially as proposed, new rule 202(a)(30)-1, which defines certain terms in Section 202(a)(30) for use by advisers seeking to avail themselves of the Foreign Private Adviser Exemption, including: (i) "investor;" (ii) "in the United States;" (iii) "place of business;" and (iv) "assets under management."

A. Clients

Rule 202(a)(30)-1 adopted by the SEC includes a slightly modified version of the safe harbor for counting clients currently used for purposes of the Private Adviser Exemption that is being eliminated. Rule 202(a)(30)-1 allows an adviser to treat as a single client a natural person and (i) that person's minor children (whether or not they share the natural person's principal residence); (ii) any relative, spouse, spousal equivalent, or relative of the spouse or of the spousal equivalent of the natural person who has the same principal residence; and (iii) all accounts and trusts of which the natural person and/or the natural person's minor child, relative, spouse, spousal equivalent, or relative of

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46 *Id.* at 45.

47 *Id.*

48 *Id.* at 47-48 & n.187.

49 *Id.* at 48 & n.188.

50 Exemptions Release at 7 & nn.24-25.

51 Registration Act § 403.

52 Exemptions Release at 102-03.

53 Advisers relying on the Foreign Private Advisers Exemptions are not Exempt Reporting Advisers. *See* Exemptions Release at 6.

the spouse or of the spousal equivalent who has the same principal residence are the only primary beneficiaries. An adviser also would be permitted to treat as a single client: (i) a corporation, general partnership, limited partnership, limited liability company, trust or other legal entity to which the adviser provides investment advice based on the entity's investment objectives; and (ii) two or more legal entities that have identical shareholders, partners, limited partners, members or beneficiaries.[54]

The new rule provides that an adviser now would need to count a person as a client even though the adviser provides investment advisory services to such person without compensation (consistent with including assets managed without compensation as assets under management for purposes of Form ADV). These clients currently are not counted for purposes of the Private Adviser Exemption that is being eliminated. The new rule includes two provisions that clarify that advisers need not double-count private funds and their investors under certain circumstances. One provision specifies that an adviser would not need to count a private fund as a client if the adviser counted any investor in that private fund as an investor for purposes of determining the availability of the exemption. The other provision, which was recommended by commenters, clarifies that an adviser is not required to count a person as an investor if the adviser counts such person as a client of the adviser.[55] Therefore, a client who is also an investor in a private fund advised by the adviser would only be counted once.[56]

B. Private Fund Investor

As proposed, the SEC has defined an "investor" in a private fund as any person who would be considered a beneficial owner of the outstanding securities of a private fund under section 3(c)(1) of the Investment Company Act or who would be included in determining whether the outstanding securities of a private fund are owned exclusively by qualified purchasers under section 3(c)(7) of the Investment Company Act. In addition, a beneficial owner of short-term paper issued by the private fund also is an "investor," notwithstanding that holders of short-term paper need not be counted for purposes of section 3(c)(1).[57] Further, holders of both equity and debt securities must be counted as investors.[58] Lastly, in order to avoid double-counting, the rule provides that an investor investing in two or more private funds advised by the same investment adviser would be treated as a single investor.[59]

In defining the term "investor" by reference to sections 3(c)(1) and 3(c)(7) of the Investment Company Act, the SEC has decided to "look-through" nominee arrangements, other types of intermediate

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54 *Id.* at 104-5.

55 *Id.* At 106.

56 In addition, the Exemptions Release describes the following "special rules:" (i) an adviser must count a shareholder, partner, limited partner, member, or beneficiary (each, an "owner") of a corporation, general partnership, limited partnership, limited liability company, trust, or other legal organization, as a client if the adviser provides investment advisory services to the owner separate and apart from the investment advisory services provided to the legal organization; (ii) an adviser is not required to count an owner as a client solely because the adviser, on behalf of the legal organization, offers, promotes, or sells interests in the legal organization to the owner, or reports periodically to the owners as a group solely with respect to the performance of or plans for the legal organization's assets or similar matters; and (iii) any general partner, managing member or other person acting as an investment adviser to a limited partnership or limited liability company must count the partnership or limited liability company as a client. *Id.* at 105, n.424.

57 Note to *See* Rule 202(a)(30)-1(c)(2). The SEC notes that in certain circumstances, persons other than the nominal holder may be treated as an investor for purposes of section 3(c)(1) or 3(c)(7) (*e.g.*, when the entity holding the investment is the alter ego of another investor, such as a corporate parent), and such a person would have to be counted as an investor for purposes of the Foreign Private Adviser Exemption. *See* Exemptions Release 108-09 & n.441.

58 Exemptions Release at 108.

59 *Id.* at 107

accounts or feeder funds to reach the underlying holders of private fund-issued securities.[60] It also forces an adviser to count as an investor the holder of derivative instruments, such as total return swaps, which effectively transfer the economic exposure to private fund securities from the record owner of such securities. An adviser, thus, will determine the number of investors in a private fund based on the facts and circumstances applicable to investor determinations under section 3(c)(1) or 3(c)(7), and in light of the applicable prohibition not to do indirectly, or through or by any other person, what is unlawful to do directly.[61]

In response to comments, the Foreign Private Adviser Final Rule, unlike the proposed rule, does not treat as investors beneficial owners who are "knowledgeable employees" with respect to the private fund, and certain other persons related to such employees (collectively, "knowledgeable employees"). Upon further consideration and in response to comments received, the SEC believes that the same policy considerations that justify disregarding knowledgeable employees for purposes of other provisions of the Investment Company Act provides a sound basis for excluding them from the definition of "investor" under the Foreign Private Adviser Exemption.[62]

C. In the United States

The term "in the United States" is used several times in the definition of "foreign private adviser." The number of clients and investors "in the United States" is limited to fifteen and advisers relying on the exemption cannot have a place of business "in the United States" or hold themselves out to the public "in the United States" as an investment adviser.

The new rule, adopted as proposed, defines "in the United States" generally by incorporating the definitions of a "U.S. person" and "United States" under Regulation S. Specifically, "in the United States" would have the following meanings: (i) with respect to any place of business located in the "United States," as that term is defined in Regulation S;[63] (ii) with respect to any client or investor in the United States, any person that is a "U.S. person" as defined in Regulation S, except that any discretionary account or similar account held for the benefit of a person "in the United States" by a non-United States professional fiduciary would be deemed "in the United States" if such professional fiduciary is a related person of the investment adviser relying on the exemption (as described above); and (iii) with respect to the public in the "United States," as that term is defined in Regulation S.[64]

For purposes of that definition, the SEC has stated that a person that was not "in the United States" when such person became a client, or acquired the securities issued by the fund in the case of an investor, would not be treated as being "in the United States" even though such person later moves to the United States.[65]

D. Place of Business

New rule 202(a)(30)-1, by reference to rule 222-1(a) under the Advisers Act, defines "place of business" to mean: (i) any office where the investment adviser regularly provides advisory services,

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60 *Id.* at 108.

61 *See* Advisers Act section § 208(d), 15 U.S.C. § 806-8(d); Investment Company Act § 48(a), 15 U.S.C. § 80a-47(a).

62 Exemptions Release at 112.

63 Regulation S defines "United States" as "the United States of America, its territories and possessions, any State of the United States, and the District of Columbia." 17 C.F.R. § 230.902(l) (2011).

64 Exemptions Release at 116.

65 *Id.* at 117-18. If the adviser reasonably believes that an investor is not "in the United States," the adviser may treat the investor as not being "in the United States." *See* Exemptions Release at 39,679. *Id.* at 118.

solicits, meets with, or otherwise communicates with clients; and (ii) any location held out to the public as a place where the investment adviser conducts any such activities.[66]

Some commenters requested clarification that a "place of business" would not include an office in the United States where a Non-U.S. Adviser solely conducts research, communicates with non-U.S. clients, or performs administrative services and back-office books and recordkeeping activities. The SEC has addressed this concern by stating that under rule 202(a)(30)-1, an adviser must determine whether it has a place of business, as defined in rule 222-1, in the United States in light of the relevant facts and circumstances.[67] For instance, as noted by the SEC, an office or other location where an adviser regularly conducts research would be a place of business,[68] as would any office from which an adviser regularly communicates with its clients, whether U.S. or non-U.S.[69] However, a place of business would not include an office where an adviser solely performs administrative services and back-office activities if they are not activities intrinsic to providing investment advisory services and do not involve communicating with clients.[70] The SEC also noted that there is no presumption that a Non-U.S. Adviser has a place of business in the United States solely because it is affiliated with a U.S. Adviser.[71] However, if the Non-U.S. Adviser's personnel regularly conducted activities at an affiliate's place of business in the United States, then it might be deemed to have a place of business in the United States.[72]

E. Assets Under Management

The SEC has adopted, as proposed, a definition of "assets under management," by reference to the calculation of assets under management contained in Item 5 of Form ADV.[73] Foreign private advisers would be required to include in their assets under management securities portfolios for which they provide continuous and regular supervisory or management services, regardless of whether these assets are proprietary assets, assets managed without compensation, as well as uncalled capital commitments. In addition, advisers must determine their assets based on market value (or fair value, if unavailable), and must calculate assets on a gross basis; *i.e.*, without deducting liabilities such as borrowings and accrued fees and expenses.[74] This is the same method used for calculation of assets under management for Form ADV and the Private Fund Adviser Exemption. The SEC believes that requiring all advisers to determine if they are required to register or if they are eligible for an exemption using the same method for calculating assets under management will result in a coherent application of the Advisers Act's regulatory requirements and assessment of risk.[75]

III. Subadvisory Relationships and Advisory Affiliates

The SEC generally treats subadvisers like advisers and, therefore, subadvisers are permitted to take advantage of each of the new exemptions, provided they satisfy the respective conditions of such

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66 *Id.* at 120; *see* also Rule 202(a)(30)-1(c)(4).

67 Exemptions Release at 121.

68 The SEC views research as "intrinsic to the provision of investment advisory services." *Id.* at 121.

69 Rule 222-1 does not distinguish between U.S. and non-U.S. clients. Exemptions Release at 121, n.492.

70 *Id.* at 121-22.

71 *Id.* at 122.

72 *Id.*

73 *Id.*

74 *See supra* note 21 and accompanying text.

75 Exemptions Release at 123.

exemption. The SEC recognizes that a subadviser may only have contractual privity with the fund's primary adviser rather than the private fund.[76] As such, the SEC has stated that it would consider a subadviser eligible to rely on the private fund adviser exemption if its services relate solely to private funds and the other conditions of the rule are met.[77]

The SEC expected that advisers with advisory affiliates would have interpretative questions as to whether they were allowed to disregard the activities of their affiliates for purposes of determining if they could rely on any of the new exemptions. The SEC refers to its longstanding position that the determination of whether the advisory businesses of an adviser and its affiliate may be required to be integrated depends on the degree of separateness between them and is a question of facts and circumstances.[78]

Additionally, in the final rule the SEC affirmed its position with respect to foreign advisory affiliates that was developed in the *Unibanco* line of no-action letters.[79] In *Unibanco*, the staff provided assurances that it would not recommend enforcement action, subject to certain limitations, against a non-U.S. unregistered adviser that is affiliated with an SEC-registered adviser, despite sharing personnel and resources.[80] The SEC confirmed that nothing in the new rules is intended to withdraw any prior statement of the SEC or the views of the Staff as expressed in *Unibanco*, and that it will provide guidance, where appropriate, regarding the application of *Unibanco* in the context of the new Foreign Private Adviser Exemption and the Private Fund Adviser Exemption.[81]

IV. Transition Period

The Registration Act became effective by its terms on July 21, 2011. In order to allow an orderly transition to registration for previously unregistered advisers, the SEC adopted a transition period that exempts from registration until March 30, 2012 any adviser that was relying on, and entitled to rely on, the private adviser exemption in section 203(b)(3) on July 20, 2011.[82] Because initial applications for registration with the SEC can take up to 45 days to be approved, the SEC recommends that advisers file a complete application by no later than February 14, 2012.[83]

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76 *Id.* at 124.

77 *Id.*

78 *Id.* at 125, n.506. The SEC would treat as a single adviser two or more affiliated advisers that are separately organized but operationally integrated, as discussed in Richard Ellis, Inc., SEC No-Action Letter, 1981 WL 25241, at *1 (Sept. 17, 1981). *See* Exemptions Release at 125, n.506.

79 Uniao de Bancos de Brasileiros S.A., SEC No-Action Letter, 1992 WL 183054 (July 28, 1992) ("Unibanco"). In the Unibanco line of no-action letters, the SEC provided assurances that it would not recommend enforcement action of the substantive provisions of the Advisers Act with respect to a Non-U.S. Adviser's relationships with its non-U.S. clients. *See* Exemptions Release at 126.

80 Generally, the SEC has provided assurances that it would not recommend enforcement action in situations in which the unregistered Non-U.S. Adviser (the "participating affiliate") and its registered affiliate are separately organized; the registered affiliate is staffed with personnel (in the U.S. or abroad) who are capable of providing investment advice; all personnel of the participating affiliate involved in U.S. advisory activities are deemed "associated persons" of the registered affiliate; and the SEC has adequate access to trading and other records of the participating affiliate and to its personnel to the extent necessary to enable it to identify conduct that may harm U.S. clients or markets. *See* Exemptions Release at 126, n.509.

81 *Id.* at 128.

82 The transition period is contained in the Implementing Release. *See* Implementing Release at 94.

83 *Id.*