



NOVEMBER 2010

Heightened Regulation of Fund Managers Under the Financial Reform Act

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The Dodd-Frank Act implements sweeping changes across the U.S. financial regulatory system and includes significant regulatory changes aimed at the private equity and hedge fund industries. As a result of Title IV of the Dodd-Frank Act, referred to as the Private Fund Investment Advisers Registration Act, many fund managers will be subject to new registration, record keeping, and reporting obligations.

EFFECTIVE DATE

Title IV of the Dodd-Frank Act includes a one-year transition period, meaning that the registration provisions summarized below will become effective on July 21, 2011.

REPEAL OF THE PRIVATE ADVISER EXEMPTION

Prior to enactment of the Dodd-Frank Act, many advisers to private investment funds (including sponsors and managers of hedge funds and private equity and venture capital funds) were able to rely on Section 203(b)(3) of the Investment Advisers Act of 1940, as amended (Advisers Act), which exempted from registration with the Securities and Exchange Commission (SEC) advisers with fewer than 15 clients who do not hold themselves out to the public as investment advisers (Private Adviser Exemption). The Dodd-Frank Act eliminated the Private Adviser Exemption in its entirety and replaced it with a set of much more limited exemptions.

REPLACEMENT EXEMPTIONS

In lieu of the Private Adviser Exemption, the Dodd-Frank Act provides the following registration exemptions:

- **Advisers with Less than \$150 Million of Assets under Management:** The Dodd-Frank Act exempts advisers to "private funds" that have less than \$150 million of assets under management. For purposes of this act, a "private fund" is defined as an issuer who would be an "investment company" under the Investment Company Act of 1940, as amended, but for Section 3(c)(1) or Section 3(c)(7) of that act.

- **Advisers to Venture Capital Funds:** The Dodd-Frank Act contains a registration exemption for advisers solely to one or more "venture capital funds." The SEC is directed to issue final rules by July 21, 2011, to define the term "venture capital fund."
- **Foreign Private Advisers:** The Dodd-Frank Act also contains an exemption for "foreign private advisers." For purpose of this act, a "foreign private adviser" is defined as an adviser that (1) has no place of business in the U.S., (2) has fewer than 15 clients and investors in private funds advised by such investment adviser, (3) has less than \$25 million in assets under management attributable to U.S. clients and U.S. investors in private funds, and (4) neither holds itself out generally to the public in the U.S. as an investment adviser, nor acts as an investment adviser to any registered investment company.
- **SBIC Advisers:** The Dodd-Frank Act includes an exemption for advisers who solely advise small business investment companies (SBICs) licensed under the Small Business Investment Act of 1958, as amended.
- **Family Offices:** The Dodd-Frank Act expressly excludes "family offices" from the definition of "investment adviser" in the Advisers Act, enabling them to avoid the registration and record keeping requirements under the Advisers Act.

RECORD KEEPING AND REPORTING REQUIREMENTS

The Dodd-Frank Act also imposes additional record keeping requirements on registered investment advisers, as each registered adviser must maintain, for each private fund, information regarding assets under management, use of leverage, types of assets held, valuation policies, counterparty credit risk exposure, trading practices, side letters, and anything else that regulators may determine "necessary and appropriate in the public and interest, and for the protection of investors or for the assessment of systemic risk." The Dodd-Frank Act also grants the SEC the authority to conduct periodic and special examinations of any records maintained by registered investment advisers.

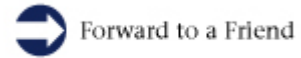
CONSIDERATIONS

Given the regulatory changes set forth in the Dodd-Frank Act, advisers of private funds should consider the following:

- Engaging legal counsel to investigate whether they will now be required to register under the Advisers Act.
- Employing or designating a chief compliance officer to take ownership of compliance obligations under the Advisers Act (even advisers not subject to registration requirements will be subject to increased SEC oversight).
- Updating their document retention and record keeping policies.
- Communicating with legal counsel on a periodic basis to receive updates on SEC rule making and interpretations.

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