FS Regulatory Brief

New reporting requirements for "exempt reporting advisers"

Some practical considerations

Introduction

In June, the Securities and Exchange Commission (SEC) adopted final rules as mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") to require many previously exempt advisers to private funds to become registered as investment advisers with the SEC. The final rules also establish new exemptions from the adviser registration rules.

Advisers relying on either of two exemptions—as advisers (1) to venture capital funds or (2) to private funds with less than $150 million in assets under management—will be considered "exempt reporting advisers." Although not required to become registered with the SEC as advisers, or to come into compliance with all of the provisions of the Investment Advisers Act of 1940 ("Advisers Act"), exempt reporting advisers will nonetheless be required to submit regular reports to the SEC.[1] To assist exempt reporting advisers in navigating the new requirements, we suggest the practical considerations outlined below.

Exempt reporting advisers must make their first filings with the SEC no later than **March 30, 2012.**

Who is an exempt reporting adviser?

The following types of advisers are exempt reporting advisers:

- Advisers to venture capital funds
- Advisers solely to small private funds (less than $150 million in assets under management)[2]

Advisers to venture capital funds

To qualify as a venture capital fund for purposes of the exemption from registration, a private fund must:

- Hold no more than 20% of the fund's capital commitments in non-qualifying investments (other than short-term holdings);
- Not borrow or otherwise incur leverage (other than limited short-term borrowing) in excess of 15% of the venture capital fund's capital contributions and uncalled committed capital, with non-renewable terms of no longer than 120 calendar days (excluding certain guarantees of qualifying portfolio obligations by the fund);
- Represent itself to its investors and prospective investors as pursuing a venture capital strategy; and

[1] Advisers relying on the exemption available to foreign private advisers (advisers who do not have a place of business in the United States and manage less than $25 million attributable to US investors, in addition to other requirements) will not be deemed "exempt reporting advisers" and will not be subject to registration or reporting requirements.

[2] For a complete discussion of the SEC's final rules relating to advisers, including the exemptions from registration, see our recent article *A Closer Look: Impact on Asset Managers*, available at http://www.pwc.com/en_US/us/financial-services/regulatory-services/publications/assets/closer-look-investment-adviser-registration.pdf.

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- Not be registered under the Investment Company Act of 1940 ("Investment Company Act") and not have elected to be treated as a business development company.

Advisers to private funds that do not meet all the conditions to qualify as a venture capital fund may nonetheless qualify for the exemption under the grandfathering provision. The final rules provide that an investment adviser may treat any existing private fund as a venture capital fund for purposes of the Advisers Act if the fund:

- Represented to investors and potential investors at the time the fund offered its securities that it pursues a venture capital strategy;
- Had at least one closing prior to December 31, 2010; and
- Has accepted no new capital commitments since July 21, 2011.

Advisers solely to small private funds

Dodd-Frank also exempts from registration any adviser that solely advises private funds that have less than $150 million in total assets under management in the United States.[3] Under the final rules, an adviser may advise an unlimited number of qualifying private funds, provided the aggregate value of the assets of the private funds is less than $150 million. All private fund assets of an adviser with a principal office and place of business[4] in the United States are considered to be "assets under management in the United States," even if the adviser has offices outside of the United States.

A non-US adviser (one with a principal office and place of business outside the United States), however, need only count private fund assets it manages at a place of business in the United States toward the $150 million asset limit. The exemption is available as long as all the adviser's clients that are United States persons are qualifying private funds.

Advisers must calculate the value of private fund assets pursuant to the instructions in Form ADV, which provide a uniform method of calculating "regulatory assets under management." Advisers must include in their regulatory assets under management any securities portfolios for which they provide continuous and regular supervisory or management services, regardless of whether these assets are family or proprietary assets, assets managed without receiving compensation, or assets of foreign clients.

Even if exempt from registration, advisers will need to assess whether they are subject to the obligations of exempt reporting advisers. If so, these advisers will be subject to reporting requirements, as well as the SEC's anti-fraud and anti-manipulation rules.

And, while the SEC stated that it does not anticipate that its staff will conduct regular compliance examinations of exempt advisers, it said that the staff will conduct cause examinations where there are indications of wrongdoing (e.g., prompted by tips, complaints, and referrals).[5]

[3] Section 202(a)(29) of the Advisers 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, but for Section 3(c)(1) or 3(c)(7) of that act.

[4] The final rules define "principal office and place of business" as the executive office of the investment adviser from which the officers, partners, or managers of the investment adviser direct, control, and coordinate the activities of the investment adviser.

[5] Under Section 204(a) of the Advisers Act, the SEC has the authority to examine records unless the adviser is specifically exempted from the requirement to register pursuant to Section 203(b) of the Advisers Act. Investment advisers that are exempt from registration in reliance on Advisers Act Sections 203(l) (venture capital funds) or 203(m) (private funds with less than $150 million in assets under management in the United States) are not "specifically exempted" from the requirement to register pursuant to Section 203(b)—and so, technically, are subject to the SEC's examination authority.

Reporting requirements for exempt reporting advisers

Exempt reporting advisers will be required to submit regular reports to the SEC, containing a subset of the information that all registered advisers report on Part 1 of Form ADV (Form ADV is both a registration and reporting form). Exempt reporting advisers must make their first filing to the SEC no later than March 30, 2012. **Information reported on Form ADV Part 1 will be publicly available.**

Exempt reporting advisers will be required to complete the following items on Form ADV:

- ***Item 1: Identifying information.*** An adviser must provide basic identification details such as legal name, address, and contact information. The name of the chief compliance officer or regulatory contact person must also be provided.
- ***Item 2.B: SEC Reporting by exempt reporting advisers.*** An adviser must identify the exemption(s) to registration on which it is relying.
- ***Item 3: Form of organization.*** An adviser is required to disclose its form of organization, indicate the laws under which it is organized, and indicate the month in which its fiscal year ends.
- ***Item 6: Other business activities.*** Item 6.A requires an adviser to report other business activities and financial services that it provides to clients. For example, an exempt reporting adviser must report whether it is a trust company, registered municipal advisor, registered security-based swap dealer, or major security-based swap participant. Item 6.B requires an adviser to disclose whether it sells products or provides services other than investment advice to its clients.
- ***Item 7.A: Financial industry affiliations.*** This item requires an adviser to provide information about its related persons,[6] including foreign affiliates. Similar to Item 6.A, the adviser must indicate whether it has a related person that provides certain financial services. An adviser must complete Section 7.A of Schedule D for **each related person,** including foreign affiliates that may not be registered or required to be registered in the United States. An adviser need not complete Section 7.A of Schedule D for any related person if it (1) has no business dealings with the related person in connection with advisory services it provides to its clients; (2) does not conduct shared operations with the related person; (3) does not refer clients or business to the related person, and the related person does not refer prospective clients or business to the adviser; (4) does not share supervised persons or premises with the related person; and (5) has no reason to believe that its relationship with the related person otherwise creates a conflict of interest with its clients.
- ***Item 7.B: Private fund reporting.*** Item 7.B and Section 7.B of Schedule D require an adviser to provide basic information regarding the size and organizational, operational, and investment characteristics of **each private fund** that it advises.[7] As part of its response, the adviser must indicate whether the fund is part of a master feeder arrangement or is a fund of funds, and must provide information about the fund's regulatory status (i.e., the exclusion from the Investment Company Act on which the fund relies). The adviser must also provide information regarding the fund's investors, and report the gross asset value of the fund. An adviser must indicate the private fund's minimum investment, the approximate number of the fund's beneficial owners, and the approximate percentage of those beneficial owners' holdings. In addition,

[6] Related persons include all the adviser's advisory affiliates and any person that is under common control with the adviser.

[7] If another adviser reports this information with respect to any private fund in Section 7.B of Schedule D of its Form ADV, the adviser does not need to complete Section 7.B.1, but must complete Section 7.B.2. Section 7.B.2 requires an adviser to provide the name of the private fund, the identification number, and the adviser's SEC number, and indicate whether its clients are solicited to invest in the private fund.

the adviser must identify "gatekeepers" for the fund, including auditors, prime brokers, custodians, administrators, and third-party marketers. An adviser may preserve the anonymity of a private fund client by maintaining its identity in numerical or alphabetical code.

- ***Item 10: Control persons.*** An adviser must identify every person that, directly or indirectly, controls or owns an interest in the adviser. Exempt reporting advisers filing an initial report must also complete Schedule A and Schedule B. Schedule A asks for additional information concerning the adviser's direct owners and executive officers. Schedule B requests information about the adviser's indirect owners.
- ***Item 11: Disclosure information.*** An adviser is required to provide information about its disciplinary history (both civil and criminal) and the disciplinary history of all its advisory affiliates.[8] Exempt reporting advisers may limit their disclosures in this item to ten years following the date of an event. If the adviser needs to disclose disciplinary events, it must complete the appropriate disclosure reporting page for each event.

While exempt from registration, this new class of advisers nonetheless has significant new reporting obligations, with the attendant need to collect timely and accurate information. Given that this information will also be publicly available, it is critical that exempt reporting advisers collect and disseminate accurate and complete information.

In addition to regular reporting, the SEC signaled other obligations with respect to exempt reporting advisers. For example, it stated that it will address recordkeeping requirements for exempt reporting advisers in a separate release.

[8] Advisory affiliates include (1) all the adviser's current employees (other than employees in solely clerical, administrative, support, or similar functions); (2) all the adviser's officers, partners, or directors (or any person performing similar functions); and (3) all persons directly or indirectly controlling the adviser or controlled by the adviser.

Exempt reporting advisers may also be required to disclose additional information on proposed Form PF. In its rule proposal, the SEC specifically requested comment on whether it should extend this requirement to unregistered advisers. Advisers should continue to monitor the SEC for future developments.[9]

An adviser will be required to file updating amendments to Form ADV on an annual basis within 90 days of the end of the adviser's fiscal year. In addition, exempt reporting advisers must promptly update Items 1 (identifying information), 3 (form of organization), and 11 (disclosure information) if they become inaccurate in any way, and update Item 10 (Control Persons) if it becomes materially inaccurate.

Before filing Form ADV electronically, the adviser must sign the appropriate execution page. An exempt reporting adviser making a first-time report or amending its report must sign and submit either a domestic investment adviser execution page (if the firm is resident of the United States) or a non-resident investment adviser execution page (if the firm is not a resident of the United States). The individual responsible for signing the form is dictated by the form of organization.
The new Form ADV and accompanying instructions are available on the SEC's website at http://sec.gov/divisions/investment/iard/iastuff.shtml.

Filing mechanics

Exempt reporting advisers must file reports electronically through the Investment Advisory Registration Depository (IARD) system. IARD is operated by the Financial Industry Regulatory Authority (FINRA) on

[9] Exempt reporting advisers should also consider the reporting requirements imposed by Treasury's new Form SLT, which requires disclosure of aggregate holdings of long-term securities by US and foreign residents. Financial institutions, including certain advisers, will be required to initially submit Form SLT quarterly (on September 30 and December 31, 2011) and then begin mandatory monthly reporting as of January 31, 2012.

behalf of the SEC. Each exempt reporting adviser that is reporting for the first time must complete the entitlement process, which provides access to IARD.

To file electronically, an adviser must obtain a copy of the IARD Entitlement Packet (available at www.iard.com) and submit the completed packet to FINRA, which then assigns the adviser a CRD number (the firm's Central Registration Depository ID number) and user ID code and password. FINRA also creates a financial account for the firm from which the IARD system will deduct filing fees and any required state fees.

Once an adviser receives its CRD number, ID code, and password, and has funded its account, it is ready to file electronically. An adviser will use its CRD number for its annual updates.

Points to consider

- ***Plan ahead***. Even if an adviser has the data needed to complete Form ADV readily available, it may take up to two weeks to be set up in the IARD system.
- ***Review the reporting requirements***. Although the filing deadline is still several months away, an adviser's senior partners should begin to discuss the new requirements, especially the requirements to disclose information regarding private funds (Item 7.B) and control persons (Item 10).
- ***Information filed on Form ADV will be publicly available via IARD***. Exempt reporting advisers should anticipate that third parties (e.g., academic researchers, journalists, competitors, bloggers, etc.) will review these filings and possibly make inquiries or publish articles based on this information.
- ***Consider naming a chief compliance officer***. Although not required for exempt reporting advisers, an adviser may want to consider naming a chief compliance officer (CCO). Form ADV requires the contact information for an adviser's CCO, if the firm has one. If an adviser does not have a CCO, it must provide the contact information for an "additional regulatory contact" who may respond to questions from the SEC about the firm's Form ADV.
- ***Ensure compliance with the Pay to Play Rule***. The SEC recently amended its Pay to Play Rule to make clear that the rule will continue to apply to all private fund advisers, including exempt reporting advisers. Advisers currently not registered with the SEC must comply with this rule's recordkeeping obligations as of March 14, 2011. Exempt reporting advisers should assess and ensure that they are compliant with the rule.[10]
- ***Ensure compliance with anti-fraud rules***. Exempt reporting advisers (and other advisers, whether registered or not) are subject to the SEC's antifraud rule, which prohibits the use of any device, scheme, or artifice to defraud any client or prospective client. Exempt reporting advisers may wish in particular to review disclosures provided to investors, marketing materials, allocation of opportunities, and expenses.
- ***Switching from being registered to being an exempt reporting adviser***. If an adviser is currently registered with the SEC or with a state securities authority as an investment adviser (or has an application for registration pending) and plans to switch to being an exempt reporting adviser, it must file a Form ADV-W to withdraw from registration in the jurisdictions where it is switching. The adviser must submit Form ADV-W before submitting its first report as an exempt reporting adviser.
- ***Registration with state securities authorities***. Consider whether the adviser may be required to register with or submit a report to one or more state securities authorities.
- ***Consider the possibility of a regulatory examination***. The SEC has

[10] For more information on the new Pay to Play Rule, see our recent FS Regulatory Brief, *Update: The SEC's New Rules on "Pay to Play" Restrictions for Investment Advisers,* available at http://www.pwc.com/us/en/financial-services/regulatory-services/publications/assets/FS-Reg-Brief-pay-to-play.pdf.

stated that it has the authority to conduct examinations, if warranted, of exempt reporting advisers.

- ***Start to think about recordkeeping***. The SEC has signaled that it will adopt recordkeeping requirements for exempt reporting advisers.

Additional information

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