

**New Regulatory Provisions in the US
Affecting Non-US Investment Advisers
(Updated in light of SEC Final Rulemaking) ¹**

This memorandum addresses regulatory matters taking place in the United States that most affect non-US investment advisers, private banks, family offices and private funds as, in each case, they may interact with the US in some manner in connection with rendering investment advisory services. Earlier versions of this memorandum were based on proposed rules set forth by the Securities Exchange Commission (“SEC”). This memorandum takes into account the final rulemaking issued by the SEC on June 22, 2011 (“Final Rules”).²

New Legislation

The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act” or “Act”) was signed into law on July 21, 2010 and contains sweeping changes that will impact the US regulatory landscape for years to come. It is comprised of a number of separate parts, called Titles – Title IV is the “Private Fund Investment Advisers Registration Act of 2010.” It amends the US Investment Advisers Act of 1940, as amended (“Advisers Act”) and it is to those changes that this memo is addressed. The Dodd-Frank Act directed the SEC to issue rules regarding certain revisions to the Advisers Act, and these rules (as well as those set forth in the Dodd-Frank Act) are discussed below.

The Advisers Act defines an investment adviser as 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.³ This definition remains unchanged under the Dodd-Frank Act and the Final Rules.

¹ This article is for educational purposes only, should not be construed as legal advice in any jurisdiction and may be considered attorney advertising under rules of certain jurisdictions. For more information, please consult the firm’s website at www.thsh.com.

² The SEC Releases accompanying these Final Rules are IA-3221 entitled “Rules Implementing Amendments to the Investment Advisers Act of 1940” (the “Implementation Release”) and IA-3222 entitled “Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers with less than \$150 million in Assets Under Management, and Foreign Private Advisers” (the “Exemption Release.”)

³ Advisers Act Section 202(a)(11). Certain categories of persons and entities are specifically excluded from this definition, including banks, broker-dealers whose investment advisory services are solely incidental to their regular business, service providers such as lawyers and accountants and publishers of newspapers and other periodicals. There is a family office exception imbedded within the definition; please let us know if you require information about that exception.

Changes Affecting Registration of Investment Advisers

Of particular note is that the so-called private adviser exemption (the one that exempted investment advisers with fewer than 15 clients and upon which so many advisers relied to be exempt from registration)⁴ has been repealed by the Dodd-Frank Act. This is of particular importance to non-US advisers, many of whom maintained funds into which investors invested. In such cases, the “14” client count was made at the fund – not the investor – level (the fund counting as a single client) and as such the exemption was readily available. This has changed.

The regulatory scheme now calls for registration of investment advisers with a nexus to the US, subject, however, to a number of exemptions from registration. The statutory scheme seeks to divide regulation between the various US *state* securities departments and the federal government (i.e. the SEC) based on a variety of factors set forth below. Also, assuming such an adviser is not holding itself out to the public as an investment adviser nor is it advising registered investment companies (mutual funds) or business development companies, its ability to fall within an exemption from registration is generally based on the amount of regulatory assets it has under management (“RAUM”) and the form of the arrangement it utilizes to provide its services (e.g. using a managed account versus a private fund structure). Note that the RAUM computation is different from the “assets under management” computation as that term is generally known in the industry.⁵

Foreign Private Adviser Exemption

The new rules contain an exemption for “foreign private advisers,” a term that now enters the regulatory vocabulary. If the investment adviser is a foreign private adviser, it will be exempt from the registration requirements of the Advisers Act. The definition is as follows:

The term ‘foreign private adviser’ means any investment adviser who:

- (A) has no place of business in the US; and
- (B) has, in total, fewer than 15 clients and investors in the US in private funds advised by the investment adviser; and
- (C) has RAUM attributable to clients in the US and investors in the US in private funds advised by the investment adviser of less than \$25 million;⁶ and, as usual,

⁴ Previously contained in Section 203(b)(3) of the Advisers Act.

⁵ RAUM includes all securities portfolios for which investment advisers “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.” Moreover, the RAUM computation is made in gross, without subtracting any liabilities.

⁶ The SEC was given the authority to increase this amount but it chose not to.

- (D) neither - (i) holds itself out generally to the public in the US as an investment adviser; nor (ii) acts as - (a) an investment adviser to any investment company registered under the Company Act; or (b) an investment adviser to a business development company.

In view of the relatively low dollar threshold, we do not anticipate that this will apply in many cases. Nonetheless, there are a few things to note in applying the provisions of the foreign private adviser exemption:

1. The method of counting to 15 clients is a departure from the way it has traditionally been done in the US. Previously, there was no look-through with respect to a fund – the fund was counted as a single “client.” In computing the number for purposes of this exemption, clients and *investors* in the US are taken into account so one needs to count each of the *investors* in a private fund for purposes of the foreign private adviser exemption.
2. The Dodd-Frank Act incorporates a “safe harbor” in relation to counting “clients” for the purposes of this exemption. An adviser can treat as a single client a natural person as well as (i) that person’s minor children; (ii) any relative, spouse, or relative of the spouse with the same principal residence; and (iii) all accounts and all trusts of which that person and/or the person’s minor child or relative, spouse or relative of the spouse with the same principal residence are the only primary beneficiaries. Advisers can also treat as a single client a corporation, general or limited partnership, trust or other legal organization to which the adviser provides legal advice, as well as two or more legal organizations that have identical shareholders, partners, limited partners, member or beneficiaries.
3. To avoid confusion, note that the “fewer than 15” concept applies only to this foreign private adviser exemption. As stated above, the client count is no longer the basis for an exemption in the US for US managers (or those non-US managers who cannot fall within this foreign private adviser exemption.) In this regard, Advisers Act Sec. 203(b)(3) which contained the “fewer than 15” private adviser exemption, has been replaced with a new Sec. 203(b)(3) which contains the foreign private adviser exemption.
4. It appears from the Final Rules that, in the case of a master-feeder arrangement, the count is to occur at the first feeder level and not beyond.
5. Unfortunately, the Final Rules are silent as to the ability of an adviser to rely, presumably in good faith, on representations or certifications of others as to the presence or lack thereof of US Persons in a fund, or behind a nominee arrangement, et al.

6. The definition of “place of business” is described in the Final Rules as a place where investment discretion is exercised, from which clients are communicated and from which clients are solicited. This is a broad definition indeed, especially insofar as communication or solicitation is concerned. In this regard, some of our clients have locations in the US. As to whether or not such location constitutes a “place of business,” this is a question of fact to be determined on a case-by-case basis.
7. The definition of US Person follows the definition used in Regulation S (governing non-US sales of securities).
8. Lastly, RAUM, per the Final Rules and in the context of this exemption, includes assets not only from outside clients but also from principals, assets for which no compensation is charged, and assets from so called “knowledgeable employees.”⁷

Other More Likely Exemptions

If the foreign private adviser exemption is not available (because perhaps the adviser has a place of business in the US or more likely has RAUM attributable to US clients and investors in excess of \$25 million), one of the other exemptions may provide a separate route to exemption from registration.

Apart from the foreign private adviser exemption noted below, the key RAUM break points to be aware of are as follows (see chart below):

Less than \$25mm RAUM	\$25mm or more RAUM (in managed accounts, with or without private funds)	Less than \$150mm RAUM (for managers of only private funds – no managed accounts)
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⁷ This is a term used under the Investment Company Act when applying section 3(c)(7).

<p>Foreign advisers may need to register at the federal level if they are not eligible for the foreign private adviser exemption (as discussed above).</p> <p>State registration rules will need to be considered on a case-by-case basis.</p>	<p>The Final Rules make it clear that because a foreign adviser does not, by definition, have its <i>principal</i> place of business in any US state, federal registration is required at this level.⁸</p>	<p>This RAUM break point relates to investment advisers who provide advice to only one or more private funds with one or more US Persons as investors, in two variations:</p> <ol style="list-style-type: none"> 1. <u>Managers with a “place of business” in US.</u> For a non-US adviser with a place of business in the US, there is an exemption from registration if the aggregate RAUM from US Persons is less than \$150 million. 2. <u>Managers with no “place of business” in US.</u> If the non-US adviser does not have a place of business in the US, the exemption applies regardless of the level of RAUM from US Persons. <p>Again, this exemption (in each variation) applies to non-US advisers to private funds (3(c)(1) or 3(c)(7) funds in which US Persons invest) and not to managed accounts. The existence of a managed account is fatal to the availability of this exemption.</p>
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Commodity Trading Advisers – Coordinating with the Commodity Futures Trading Commission (“CFTC”)

Traders in commodities continue to face registration with the CFTC and the National Futures Association (“NFA”) as in the past; those rules have not changed. What has changed is that if the adviser is registered with the CFTC, then SEC registration is not required until such time (if ever) that the nature of the adviser’s investment advice is “predominantly the provision of securities-related advice.” This represents an expansion of the exemption. The word “predominantly” will need to be defined by the SEC (although the SEC is not instructed to do so

⁸ This reference to a “principal place of business” relates to the new “mid-sized adviser” classification which prohibits federal registration (subject to certain exceptions to the prohibition) for advisers with a principal place of business in any US state and has between \$25 million and \$100 million in RAUM. By its terms, this will not apply to a non-US adviser as it would not have its *principal* place of business in the US.

under the Act) but we give it its plain meaning for now – “most commonly occurring or prevalent.”

Other Items to Keep in Mind

- Generally, private equity funds and managers are covered by the new legislation but venture capital managers are not. The Final Rules contain lengthy guidelines about venture capitalists and private equity, which are outside the scope of this memo. For further information about these categories, please contact us.
- The recently adopted custody rules continue to apply, unaffected by the new legislation.
- There are new short-selling rules calling for monthly disclosure of relevant data to the SEC.
- New rules have been enacted with regard to swaps and derivatives, the regulation of which are to be divided between the SEC (in the case of security-based swaps) and the CFTC (in the case of all other swaps.) Proposed rules have been issued by the SEC. We can supply you with information about these changes upon request.

Recordkeeping Requirements; Reporting

In terms of recordkeeping, we distinguish between information to be maintained by an investment adviser and open to SEC inspection and information to be submitted to the SEC that can be shared with others and therefore is not confidential:

The Dodd-Frank Act makes the following items part of the “books and records” of the investment adviser (and of investment advisers to private funds even if they are not required to register):

- Amount of assets under management;
- Data with regard to leverage used including “off-balance-sheet” leverage. One area that will need careful review by the SEC is the definition of “leverage.” The definition might differ from strategy to strategy, especially in applying the rules to private equity funds;
- Valuation policies and practices of the fund;
- The types and categories of assets managed by the adviser and held for the benefit of the client;
- The adviser’s trading practices;
- Counterparty credit risk exposure and related details;
- Information with regard to side letters and side arrangements whereby certain investors obtain more favorable rights than others; and

- The catch all: “such other information as the SEC in consultation with the [Financial Stability Oversight] Council [a new body, hereinafter referred to as the “FSOC”], determines is necessary and appropriate in the public interest and for the protection of investors or for the assessment of systemic risk, which may include the establishment of different reporting requirements for different classes of fund advisers, based on the type or size of private fund being advised.”

The SEC has also added the following disclosure requirements to Form ADV based on its new rules promulgated under the Dodd-Frank Act:

- How the adviser qualifies to register with the SEC;
- The size, strategy, organization and other detailed characteristics of each private fund advised by the adviser;
- The relevant service providers that perform services for all advised private funds (including auditors, prime brokers, custodians, administrators and marketers);
- Information regarding the adviser’s business, employees, and client base;
- Information regarding the adviser’s other (non-advisory) business activities and financial industry affiliations.

The SEC is to maintain the confidentiality of this data unless otherwise available under our Freedom of Information Act, although we note that recent congressional action has undermined the confidentiality provisions in certain cases. As to sharing with others, the new law enables the SEC to share the books and records with the FSOC. Certain data is deemed to be proprietary and therefore can be non-public. These might include analytical and research methodologies, trading strategies, special software and the like.

Proposed Form PF

On January 26, 2011, pursuant to the Dodd-Frank Act, the SEC and the CFTC issued joint proposed rules detailing new reporting requirements for both US and non-US registered investment advisers to private funds on a form designated Form PF. Under the proposed version of the SEC and CFTC rules, any registered investment adviser who advises one or more private funds will be subject to the new reporting requirements and must file a Form PF.

Form PF creates two categorical “sizes” of advisers that impact the frequency and detail of an adviser’s reporting requirements. “Smaller” private fund advisers are those that have less than \$1 billion in RAUM.⁹ These advisers will have to make Form PF filings annually. All

⁹ For the purposes of Form PF, included in any aggregate RAUM calculation are (i) “parallel managed accounts” and (ii) the RAUM of any “related person” of the adviser. “Parallel managed accounts” are “assets of managed accounts advised by the firm that pursue substantially the same investment objective and strategy and invest in substantially the same positions as the private fund.” A “related person” is any officer, partner or director of the adviser, all persons directly or indirectly controlling, controlled by or under common control with the adviser, and all of the adviser’s employees (other than those performing clerical function).

smaller private fund advisers will have to make their first filing within ninety (90) days of the end of the adviser's fiscal year, beginning on March 30, 2012. These advisers must fill out Form PF Section 1a (general information about the adviser and its clients), Section 1b (specific information regarding its private funds) and Section 1c (specific information about any hedge fund clients).

"Large Private Fund Advisers" are those that have at least \$1 billion in RAUM. These advisers will have to file Form PF reports quarterly rather than annually within fifteen (15) days following the end of each quarter, beginning on January 15, 2012. In addition to filling out Sections 1a, 1b and 1c of Form PF, Large Private Fund Advisers who advise hedge funds must also fill out Sections 2(a) and 2(b), which require information about the hedge funds being advised, exposures and trading, risk metrics, financing and investor information.

Please note that these rules still exist in a proposed state and finalized rules have yet to be published. While the current initial compliance date for the Form PF requirements is December 15, 2011, it appears likely that such date will be postponed as systems are developed at the SEC and elsewhere to handle the data inflows.

Exempt Reporting Advisers

The SEC has set forth new reporting requirements for investment advisers claiming an exemption from federal registration. These requirements apply to both US and non-US advisers. Prior to the Dodd-Frank Act, investment advisers who were exempt from registration with the SEC were not subject to any reporting requirements. However, the SEC will now require certain exempt advisers (including those non-US advisers relying on the exemptions found in Advisers Act Sections 203(l) (venture capital fund advisers) and 203(m) (certain private fund advisers)) to fill out and file certain portions of Form ADV¹⁰ on an annual basis. According to the amended Form ADV Instructions, any adviser claiming an exemption under the Advisers Act must submit an initial Form ADV within sixty (60) days of relying on such exemption. In addition, any exempt reporting adviser must file an updated Form ADV annually within ninety (90) days of the end of the adviser's fiscal year. An exempt reporting adviser must also file more frequent updates if certain Form ADV responses become inaccurate. Finally, an adviser must file an amendment to its Form ADV to indicate that it is filing a final report once it no longer relies on an exemption from registration. According to the Implementing Release, the SEC does not plan to conduct compliance examinations of exempt reporting advisers on a regular basis, but it may do so if there are any indications of wrongdoing.

Structure of Registered Entities

A non-US investment adviser should generally create a new entity to serve as its SEC-registered adviser. We generally recommend separating this entity from the non-US adviser in order to limit the scope of any SEC examinations and to minimize liability for the non-US adviser.

¹⁰ Exempt reporting advisers must complete Items 1, 2.B., 3, 6, 7, 10 and 11 of Form ADV.

It is possible that registration of one investment adviser entity will suffice for registration of other affiliated entities. An affiliated or subadviser entity of an SEC-registered adviser may be allowed to remain unregistered depending on the structure of the entities. The SEC analyzed whether affiliated entities of a registered investment adviser must also register with the SEC in the *Unibanco* No-Action Letter (“*Unibanco* Letter”). The “independent affiliate” test set forth in the *Unibanco* Letter analyzes whether an unregistered foreign adviser is considered independent from an affiliated SEC-registered investment adviser and therefore would not have to register. According to the *Unibanco* Letter, the SEC will recognize the separateness of two affiliated entities and will not force the affiliated, unregistered entity to register if:

- the affiliated companies are separately organized (e.g. two distinct entities);
- the registered entity is staffed with personnel (whether physically located in the U.S. or abroad) who are capable of providing investment advice;
- all persons involved in US advisory activities are deemed “associated persons” of the registrant; and
- the SEC has adequate access to trading or other records of each affiliate involved in US advisory activities, and to its personnel, to the extent necessary to monitor and police conduct that may harm US clients or markets.

It is evident from these factors that the “separateness” of affiliated entities will control whether registration is required. Under the Final Rules, the SEC confirmed the continued application of the *Unibanco* Letter and its analysis of affiliated, unregistered entities. Therefore, if an affiliated entity of an investment adviser complies with the above factors, it is likely that the affiliated entity would be allowed to remain unregistered even in light of its relationship with a registered investment adviser.

Effective Dates; SEC Rulemaking.

Existing Registrants. According to the Implementing Release, all advisers currently registered with the SEC must file an amended Form ADV by March 30, 2012. This revised Form ADV asks advisers to indicate whether or not they remain eligible for SEC registration. Any mid-sized adviser that no longer qualifies for SEC registration must file a Form ADV-W, a form indicating their withdrawal from SEC registration, and register at the state level by June 28, 2012. For all currently-registered non-US advisers with no office in the US, continued registration with the SEC will be likely as registration at the state level will not be possible. The Implementing Release also notes that any investment adviser that is currently registered with the SEC must remain registered until January 1, 2012 (unless an exemption from registration applies), in order for the SEC to accommodate updates to the Investment Adviser Registration Depository (“IARD”) system.

New SEC Applicants. Any previously unregistered adviser that qualifies as a mid-sized adviser must register with the appropriate state securities authority. For all non-US advisers with no place of business in the US, registration at the federal level will be required (barring any

exemption from registration). All advisers who are required to register with the SEC must do so by filing a Form ADV by March 30, 2012.

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Please feel free to contact the partner with whom you work at the law firm if you have any questions or comments about the subject matter covered in this memo.

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