

“What keeps you up at night?”

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Securities and Exchange Commission finalizes registration requirements for investment advisers

By Craig F. Zappetti and Dawn Crowder

SUMMARY

The Securities and Exchange Commission adopted new rules and certain rule amendments that implement the requirements of Section 410 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Section 410 created a new category of "mid-sized advisers" that have between \$25 million and \$100 million in assets under management and requires such advisers to register with the securities commissions in the states in which they conduct business.

On June 22, 2011, the Securities and Exchange Commission (the "Commission") adopted new rules and certain rule amendments, under section 203A of the Investment Advisers Act of 1940, as amended (the "Advisers Act"), that implement the requirements of Section 410 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd Frank Act"). Section 410 of the Dodd-Frank Act increased the statutory threshold for investment advisers registering with the Commission from \$25 million in assets under management to \$100 million in assets under management. Advisers that have assets under management of between \$25 million and \$100 million are now a part of a new category of "mid-sized advisers" that must register with the securities commission(s) in the state(s) in which these advisers conduct business. The new rules also require advisers to hedge funds and other private funds to register with the Commission, and certain advisers to private funds that are exempt from registration under the Advisers Act to file reports with the Commission on a regular basis.

The Commission also adopted amendments to Form ADV to facilitate the transition that mid-sized advisers must make from registration with the Commission to state registration. The new Form ADV also expands the amount of data the Commission will periodically collect from its advisers. The final rules establishing the new registration requirements became effective on July 21, 2011. The Commission is requiring each of its approximately 11,500 registrants to file an amended Form ADV by March 30, 2012 to determine its eligibility to be registered with the Commission. Advisers that are no longer eligible to be registered with the Commission must withdraw from Commission registration and register with the appropriate state securities commission by June 28, 2012.

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BACKGROUND

Title IV of the Dodd-Frank Act (“Title IV”) amends, among other things, certain provisions of the Advisers Act. Among these amendments are provisions that reallocate to the states primary responsibility over certain mid-sized advisers. Title IV also repeals the “private adviser exemption” contained in section 203(b)(3) of the Advisers Act. Many advisers to hedge funds, private equity funds and venture capital funds have relied on this exemption in order to avoid registration under the Advisers Act. The Commission has adopted new rules to provide exemptions for advisers to venture capital funds, private funds with less than \$150 million in assets under management, and foreign private funds (these exemptions are discussed in a separate Saul Ewing Alert that is available at http://www.saul.com/common/publications/pdf_2959.pdf).

Prior to the enactment of the Dodd-Frank Act, Section 203A of the Advisers Act generally prohibited an investment adviser from registering with the Commission unless it had \$25 million of assets under management. This provision required the states to be the primary regulator of smaller advisers and the Commission to be the primary regulator of larger advisers. This limit has now been increased to \$100 million of assets under management. The Commission estimates that the new registration requirements will result in approximately 3,200 mid-sized advisers switching from registration with the Commission to registration with one or more state securities commissions. The Commission will maintain regulatory oversight primarily for larger advisers.

ELIGIBILITY FOR REGISTRATION WITH THE COMMISSION

Under the new rules, an investment adviser that has assets under management of less than \$25 million must still register as an investment adviser in the state in which it maintains its principal office and place of business. An investment adviser that has assets under management of between \$25 million and \$100 million is considered a mid-sized adviser and is required to be registered as an investment adviser in the state in which it maintains its principal office and place of business unless (i) the adviser is not required to be registered with the securities commissioner in such state or (ii) if registered with that state, the adviser would not be subject to examination as an investment adviser by that securities commissioner. In either of these cases,

the mid-sized adviser must register with the Commission. The new rules provide that advisers with at least \$100 million in assets under management are eligible to register with the Commission; but those with more than \$110 million in assets under management must register with the Commission unless they qualify for the venture capital exemption or one of the other aforementioned private adviser exemptions (see Rule 203A-1 implementing a buffer on the \$100 million requirement discussed below).

The new rules require each adviser currently registered with the Commission to determine whether it is eligible to maintain its registration with the Commission by March 30, 2012. Mid-sized advisers are generally prohibited from registering with the Commission and must transition to state registration by June 28, 2012 unless they qualify for an exemption from the prohibition against registering with the Commission.

ASSETS UNDER MANAGEMENT

Generally, the value of assets that an adviser has under management will determine whether the adviser must register with the Commission or a state. Assets under management are defined under section 203(A)(a)(2) of the Advisers Act as the “securities portfolios” with respect to which an adviser provides “continuous and regular supervisory or management services.”

The new Form ADV provides a uniform method for advisers to calculate assets under management. Form ADV refers to these assets as “regulatory assets under management” to distinguish them from the assets under management disclosure that advisory clients receive in Part 2 of Form ADV. An adviser must calculate its regulatory assets under management on a gross basis - without deducting any outstanding indebtedness or other accrued but unpaid liabilities. The adviser must perform this calculation within 90 days of the date on which it files its amended Form ADV with the Commission.

A private fund adviser must include the following assets in its calculation of regulatory assets under management:

- the value of any private fund over which it exercises continuous and regular supervisory or management services, regardless of the nature of the assets held by the fund;

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- the amount of any uncalled capital commitments made to a private fund managed by the adviser; and
- the market value of private fund assets, or the fair value of private fund assets where market value is unavailable.

MID-SIZED ADVISERS TRANSITION TO STATE REGISTRATION

The Commission adopted rule 203A-5 under the Advisers Act to provide mid-sized advisers that will no longer be eligible for registration with the Commission with an orderly transition to state registration. Under the new rule, mid-sized advisers registered with the Commission on July 21, 2011 must remain registered with the Commission until they switch to state registration after January 1, 2012. All existing Commission registrants as of January 1, 2012 must file an amendment to Form ADV by March 30, 2012. Mid-sized advisers that are no longer eligible for Commission registration must withdraw their registration by filing Form ADV-W with the Commission by June 28, 2012. As of July 21, 2011, all new applicants that meet the definition of mid-sized adviser are prohibited from registering with the Commission and must register with the states.

The new Form ADV requires a mid-sized adviser registering with the Commission to affirm upon application and each year thereafter that it is either (i) not required to be registered with the securities commissioner of the state in which it maintains its principal office and place of business; or (ii) if registered with the state, affirm that it is not subject to examination as an investment adviser by that state's securities commissioner. The Commission has listed on its website that Minnesota, New York and Wyoming are the states that do not subject investment advisers registered with them to examination. A mid-sized adviser that maintains its principal office and place of business in these states will generally be required to register with the Commission.

SWITCHING BETWEEN STATE AND COMMISSION REGISTRATION

Rule 203A-1 provides a buffer to the \$100 million threshold for registration with the Commission. This buffer is intended to prevent

an adviser from needing to frequently switch between state and Commission registration as a result of annual changes in the value of assets under management. Under the rule, the threshold at which a mid-sized adviser must register with the Commission is \$110 million. Once registered with the Commission, an adviser does not need to withdraw its registration until it has less than \$90 million of assets under management. Each adviser is required to determine its eligibility for registration with the Commission as a part of its annual updating amendment to Form ADV.

EXEMPTIONS FROM THE PROHIBITION ON REGISTRATION WITH THE COMMISSION FOR CERTAIN ADVISERS

The Commission adopted amendments to three of the exemptions in rule 203A-2 from the prohibition on Commission registration in section 203A to reflect developments since their original adoption including the enactment of the Dodd-Frank Act. Mid-sized advisers are now exempt from the prohibitions on registering with the Commission if they meet the requirements of one of the following six exemptions set forth in Rule 203A-2:

- nationally recognized statistical rating organizations (NRSROs);
- pension consultants to plans with a minimum value of plan assets of at least \$200 million;
- certain investment advisers affiliated with an adviser registered with the Commission;
- investment advisers expecting to be eligible for Commission registration within 120 days of filing Form ADV;
- certain internet advisers; and
- investment advisers who are required to register as an investment adviser with 15 or more states. An adviser relying on this exemption must withdraw from registration with the Commission when it is no longer required to be registered with at least 15 states.

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**ENHANCED REPORTING
REQUIREMENTS FOR
ADVISERS REGISTERED
WITH THE COMMISSION**

Form ADV, the Commission's primary mechanism for collecting data from investment advisers, has been amended to require advisers to provide more comprehensive information about the funds they advise, their advisory business (including data about the types of clients they have, their employees and their advisory activities), and their non-advisory activities, including their financial industry affiliations. Each adviser registered with the Commission will be required to annually update Form ADV, as amended, and the Commission will make certain elements of those reports available to the public.

**PERIODIC REPORTING
REQUIREMENTS FOR EXEMPT
REPORTING ADVISERS**

Pursuant to Sections 203(l) and 203(m) of the Advisers Act, advisers solely to venture capital funds and advisers to private funds with assets under management of less than \$150 million are exempt from registration under the Advisers Act ("Exempt Reporting Advisers"). Exempt Reporting Advisers are now required to submit to the Commission and periodically update reports that consist of a limited subset of items on Form ADV. These reports must be filed electronically with the Commission on Form ADV through the Investment Adviser Registration Depository ("IARD") using the same process used by registered investment advisers. An Exempt Reporting Adviser must submit its initial Form ADV within 60 days of relying on either the Section 203(l) or 203(m) exemptions. These reports must be amended at least annually, within 90 days of the end of the adviser's fiscal year.

**PRACTICAL IMPLICATIONS FOR
INVESTMENT ADVISERS**

- Registered investment advisers should review the new Form ADV and related instructions in anticipation of the new information requirements.

- Investment advisers with less than \$100 million of assets under management should review the state registration requirements in all states in which they conduct business.
- Investment advisers conducting business in multiple states should consider managing their business to meet the new multi-state exemption in order to retain their registration with the Commission.
- Exempt Reporting Advisers should also review the new Form ADV and related instructions in anticipation of the new information requirements.
- Exempt Reporting Advisers should set up an account with Investment Adviser Registration Depository (IARD) by going to www.iard.com and become familiar with the information required to complete Part I of Form ADV.

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