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SEC Adopts Final Dodd-Frank Adviser Registration Rules: Many Non-U.S. Advisers Will Need to File Reports with the SEC

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On June 22, 2011, the U.S. Securities and Exchange Commission (the "**SEC**") adopted final rules and rule amendments (the "**Final Rules**")[1] interpreting, among other things, exemptions from registration under the U.S. Investment **Advisers Act** of 1940, as amended (the "**Advisers Act**") introduced by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "**Dodd-Frank Act**").

The Final Rules will have far reaching consequences for many non-U.S. advisers[2], who will in the main become subject to certain public disclosure and reporting obligations and record-keeping and SEC examination requirements imposed by the Dodd-Frank Act (the "**Reporting and Examination Requirements**"). On a brighter note, the Final Rules fall some way short of requiring most such advisers from registering as investment advisers with the SEC, the information that needs to be provided to the SEC is not quite as extensive as previously proposed, and the date for complying with the Final Rules has been extended to early 2012 which gives affected advisers sufficient lead time to ensure compliance.

The Dodd-Frank Act eliminates the so-called "private adviser exemption," previously relied upon by many U.S. advisers and non-U.S. advisers to privately offered investment funds and puts in place three new but more limited exemptions for (i) foreign private advisers (the "**Foreign Private Adviser Exemption**"), (ii) advisers to private funds with less than $150 million in assets under management in the U.S. (the "**Private Fund Adviser Exemption**"), and (iii) advisers solely to venture capital funds (the "**Venture Capital Fund Exemption**"). As described below, the Private Fund Adviser Exemption is likely to be most frequently availed of by non-U.S. advisers.

The Final Rules were adopted substantially as proposed in November 2010. Many non-U.S. advisers will be disappointed that the SEC has once again passed upon the opportunity to raise the $25 million threshold for the Foreign Private Adviser Exemption, despite having been granted the discretion and urged by a number of commenters to do so. On a more positive note, certain important changes were made in response to the over 115 comment letters submitted on the SEC's initial proposals. For example, in response to serious concerns expressed about public disclosure of private fund data that could reveal sensitive or competitive information, the SEC dropped certain proposed disclosure items (as discussed in section E below). As a result, the reporting required of advisers relying on either the Private Fund Adviser Exemption or the Venture Capital Fund Exemption (together, the "**Exempt Reporting Advisers**"), although still quite broad, will not be as extensive as initially proposed and in any event much narrower than what is required of registered advisers.

A. The Foreign Private Adviser Exemption

Non-U.S. advisers qualifying as "foreign private advisers," will be exempt from registration with the SEC as well as the Reporting and Examination Requirements. The Foreign Private Adviser Exemption is narrow and will only apply to non-U.S. advisers engaged in limited fundraising from U.S. investors. It is only available to a non-U.S. adviser which (i) has no place of business in the U.S., (ii) has, in total, fewer than 15 "clients" in the U.S. and "investors" in the U.S. in private funds advised by the investment adviser, (iii) does not exceed $25 million of aggregate assets under management attributable to such U.S. clients and investors, and (iv) does not hold itself out generally to the public in the U.S. as an investment adviser. A non-U.S. adviser relying on the Foreign Private Adviser Exemption must not only count each U.S. "client," but also each U.S. "investor" in any "private fund" advised by the non-U.S. adviser. Each of these terms are defined in the Final Rules and need to be well understood by any non-U.S. adviser attempting to rely on this exemption.

B. The Private Fund Adviser Exemption

The Private Fund Adviser Exemption applies to a non-U.S. adviser (i) whose advisory activities in the U.S. are limited to solely managing "qualifying" private funds[3] and (ii) if the non-U.S. adviser has a place of business in the U.S., it manages in the aggregate less than $150 million in private fund assets at that place of business in the U.S. This exemption will likely be the most relied-upon exemption for non-U.S. advisers. Most non-U.S. advisers, if qualified under this exemption will be exempt from registration with the SEC but nonetheless subject to the Reporting and Examination Requirements.

Non-U.S. Advisers with No Place of Business in the U.S

A non-U.S. adviser is not required to have a U.S. place of business to take advantage of this exemption. A non-U.S. adviser with no place of business in the U.S. may manage unlimited assets from an unlimited number of U.S. clients and U.S. investors at their non-U.S. place of business so long as all of the adviser's "clients" that are "U.S. persons" are qualifying private funds. The Final Rules define a "U.S. person" generally by incorporating the definition of a U.S. person in Regulation S under the U.S. Securities Act of 1933, which looks generally to the residence of an individual to determine whether the individual is a U.S. person and generally treats legal partnerships and corporations as U.S. persons if they are organized or incorporated in the U.S.

Non-U.S. Advisers with a Place of Business in the U.S.

The Private Fund Adviser Exemption only limits non-U.S. advisers in the amount of private fund assets they manage at a place of business in the U.S. (i.e., less than $150 million). For purposes of this exemption, assets "managed at a place of business in the U.S." are those qualifying private fund assets for which the non-U.S. adviser provides "continuous and regular supervisory or management services" at its place of business in the U.S. Any assets managed at a U.S. place of business for clients other than qualifying private funds would make this exemption unavailable.

Unlike U.S. advisers, who must count all of the assets of all of the U.S. and non-U.S. private funds it manages toward the less than $150 million limit, a non-U.S. adviser with a place of business in the U.S. only needs to count the qualifying private fund assets it manages at its place of business in the U.S. toward the same threshold. Moreover, a non-U.S. adviser will not lose its exempt reporting status as a result of its advisory activities conducted outside the U.S., e.g., non-U.S. funds and separate accounts managed from outside the U.S. are not counted toward the less than $150 million limit.

C. The Venture Capital Fund Exemption

The Venture Capital Fund Exemption exempts from registration with the SEC a non-U.S. adviser that solely advises venture capital funds. Unlike the proposed rules, the SEC has defined a "venture capital fund" to include a fund that invests a portion of its capital in investments that would not otherwise satisfy all of the elements of the rule. This modification provides advisers to venture capital funds with greater investment flexibility while precluding an adviser relying on the exemption from altering the character of a fund's investments to such extent that the fund could no longer be viewed as a "venture capital fund" within the intended scope of the exemption. A non-U.S. adviser, as well as a U.S. adviser, may rely on the Venture Capital Fund Exemption. However, all of such non-U.S. adviser's clients, whether U.S. or non-U.S., must be venture capital funds that satisfy all of the elements of the rule or satisfy the grandfathering provisions. As a result, this exemption will be of limited utility to non-U.S. advisers especially as the reporting requirements for advisers relying upon this exemption are the same as for the Private Fund Adviser Exemption (i.e., they will also be classified as Exempt Reporting Advisers).

D. Calculation of Assets Under Management

The SEC has defined "assets under management" for the purposes of calculating whether an adviser qualifies for an exemption from registration by reference to the calculation of "regulatory assets under management" for Item 5 of Form ADV. An adviser is required to:

- include 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 private fund;
- include the assets of proprietary accounts, accounts managed without receiving compensation, as well as accounts of non-U.S. clients;
- include the amount of any uncalled capital commitments to the private fund;
- use the market value of private fund assets, or the fair value of private fund assets where market value is unavailable; and
- include outstanding indebtedness and other accrued but unpaid liabilities.

In response to concerns expressed by commenters about unnecessary costs and burdens imposed on advisers as well as inappropriately permitting shorter-term fluctuations in assets and potential volatility in currency exchange rates to require advisers to register, the Final Rules require advisers to determine assets under management on an annual basis (rather than quarterly as initially proposed) for purposes of the Private Fund Adviser Exemption. Therefore, changes in the amount of an adviser's private fund assets between annual updating amendments will not affect the availability of the exemption.

E. Reporting and Examination Requirements

Exempt Reporting Advisers are expected to be required to maintain books and records as required by the SEC. Although the SEC did not provide specific books and records requirements, it indicated that recordkeeping requirements will be addressed in a future release in the event the SEC deems it necessary or appropriate in the public interest or for the protection of investors. The SEC may also exercise its authority under the Dodd-Frank Act to conduct examinations of Exempt Reporting Advisers in order to monitor systemic risk. Exempt Reporting Advisers will become subject to the following filing obligations which will be publicly available on the SEC's website:

- File and periodically update reports by completing the following items of Part IA of Form ADV and the corresponding sections of Schedules A, B, C, and D:
  - Item 1 (Identifying Information)
  - Item 2.B. (SEC Reporting by Exempt Reporting Advisers)
  - Item 3 (Form of Organization)
  - Item 6 (Other Business Activities)
  - Item 7 (Financial Industry Affiliations and Private Fund Reporting)
  - Item 10 (Control Persons)
  - Item 11 (Disciplinary Information of the Adviser and Advisory Affiliates)

- Provide extensive fund-level reporting, similar to the information fund investors commonly seek in diligence questionnaires, such as:
  - Gross asset value of each private fund that the adviser (but not a related person) manages[4];
  - Number of beneficial owners, and percentage of fund owned by funds of funds and non-U.S. Persons, respectively;
  - Identifying information about auditors, prime brokers, custodians, administrators and marketers; and
  - Any sub-advisers to the fund.

A non-U.S. adviser, however, is not required to provide such fund-level information for any private fund that, during the adviser's last fiscal year, was not a U.S. person, was not offered in the U.S. and was not beneficially owned by any U.S. person. The SEC has not adopted certain amendments that would have required any adviser (i) to disclose each private fund's net assets; (ii) to report private fund assets and liabilities by class and categorization in the fair value hierarchy established under GAAP; and (iii) to specify the percentage of each fund owned by particular types of beneficial owners.

F. Other Requirements

All non-U.S. advisers (even those able to rely upon the Foreign Private Adviser Exemption) will be subject to the general anti-fraud rules under Section 206 of the Advisers Act and the SEC's "pay-to-play" rule as amended by the Final Rules.

G. Timetable

Recognizing that the Final Rules were adopted only shortly before July 21, 2011 Dodd Frank Act deadline, the SEC postponed the implementation of the Final Rules until 2012. Advisers previously exempt may delay registering with the SEC until March 30, 2012. However, because initial applications for registration can take up to 45 days to be approved, advisers relying on this transition provision to remain unregistered until March 30, 2012 should file a complete application, both Part 1 and a brochure(s) meeting the requirements of Part 2 of Form ADV, the adviser's registration statement under the Advisers Act, at least by February 14, 2012. Exempt Reporting Advisers must file their first reports on Form ADV between January 1 and March 30, 2012.

H. Next Steps

Now that there is clarity with respect to the registration and/or reporting requirements applicable to non-U.S. advisers it is appropriate to commence the process of preparing materials for the SEC. Please contact any of the authors of this client alert or your usual O’Melveny contact and we will be happy to guide you through the process.

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1. “Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets under Management, and Foreign Private Advisers” (Release No. IA-3222) are available here; “Rules Implementing Amendments to the Investment Advisers Act of 1940” (Release No. IA-3221) are available here.

2. Advisers with a principal office and place of business outside of the U.S.

3. A qualifying private fund means any private fund that is not registered under Section 8 of the U.S. Investment Company Act of 1940, as amended (the “ICA”) and has not elected to be treated as a BDC pursuant to Section 54 of the ICA.

4.Only one adviser must report the full scope of the information for each private fund, even when there are other advisers to the same fund (e.g., sub-advisers). An adviser managing a master-feeder arrangement may submit a single report for the master fund and all of the feeder funds if these funds would otherwise report substantially identical information.

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