



Impact of Dodd–Frank Regulatory Reform for Investment Advisors



Introduction

The implementation of Dodd–Frank reform presents a number of changes in the regulatory landscape regarding the registration of investment advisors.

Private fund advisors with more than \$150 MM in assets under management ,who were previously exempt from registration, will now be required to register with either Securities and Exchange Commission or relevant state securities agencies.

Further, certain currently registered SEC advisors will be deemed “mid–sized” advisors and be required to withdrawal their registration with the SEC and register with the states.

Lastly, filing requirements have been amended including requirements to notify the SEC of your AUM, certain information about funds you manage, and a new FORM ADV Part 1A.

Impact to RIAs to Private Funds

- ▶ Eliminates de minimis client exemption (fewer than 15 clients)
 - Many previously unregistered advisors such as hedge funds and private equity funds will have to register with the commission and be subject to regulatory oversight, rules and examination.
 - Applicable advisors will be required to register with the SEC by March 30, 2012.

Registration Requirements for Newly Registered Advisors

- ▶ Registration with SEC or application with State
- ▶ Utilization of amended advisor registration Form ADV Part 1A:
 - Basic organizational and operational information about each fund they manage, such as the type of private fund that it is (e.g., hedge fund, private equity fund, or liquidity fund), general information about the size and ownership of the fund, general fund data, and the advisor's services to the fund.
 - Identification of five categories of “gatekeepers” that perform critical roles for advisors and the private funds they manage (i.e., auditors, prime brokers, custodians, administrators and marketers).
 - The types of clients they advise, their employees, and their advisory activities.
 - Their business practices that may present significant conflicts of interest (such as the use of affiliated brokers, soft dollar arrangements and compensation for client referrals).
- ▶ Establish and maintain a formal and process-driven compliance program

Mid-Sized Advisors

- ▶ The Dodd-Frank Act raises the threshold for Commission registration to \$100 million by creating a new category of advisors called "mid-sized advisors."
- ▶ *Generally*, a mid-sized advisor, will not be allowed to register with the Commission
- ▶ Mid-sized advisors will be subject to state registration
- ▶ A mid-sized advisor is defined as an advisor that:
 - Manages between \$25 million and \$100 million for its clients.
 - Is required to be registered in the state where it maintains its principal office and place of business.
 - Would be subject to examination by that state, if required to register.

Timing – Notification and Registration

- ▶ Advisors registered with the Commission will have to declare that they are permitted to remain registered by filing their AUM in the first quarter of 2012.
- ▶ Those no longer eligible for Commission registration will have until June 28, 2012 to complete the switch to state registration.

Exemptions From Registration

- ▶ Advisors solely to venture capital funds.
- ▶ Advisors solely to private funds with less than \$150 million in assets under management in the U.S.
- ▶ Certain foreign advisors without a place of business in the U.S.

Exemptions From Registration

- ▶ The Dodd–Frank Act amended the advisors Act to exempt from registration advisors that only manage venture capital funds, and directed the Commission to define the term “venture capital fund.”
- ▶ Under the definition, a venture capital fund is a private fund that:
 - Invests primarily in “qualifying investments” (generally, private, operating companies that do not distribute proceeds from debt financings in exchange for the fund’s investment in the company); may invest in a “basket” of non–qualifying investments of up to 20 percent of its committed capital; and may hold certain short–term investments.
 - Is not leveraged except for a minimal amount on a short–term basis.
 - Does not offer redemption rights to its investors.
 - Represents itself to investors as pursuing a venture capital strategy.

Exemptions From Registration

- ▶ Advisors solely to private funds with less than \$150 million in assets under management in the U.S.
 - The Commission also is adopting a rule that would implement the new statutory exemption for private fund advisors with less than \$150 million in assets under management in the United States.

Exemptions From Registration

- ▶ The Dodd–Frank Act also amended the advisors Act to provide for an exemption from registration for foreign advisors that do not have a place of business in the United States, and have:
 - Less than \$25 million in aggregate assets under management from U.S. clients and private fund investors.
 - Fewer than 15 U.S. clients and private fund investors.

Exempt Reporting Advisor Obligations

- ▶ Under the new rules, exempt reporting advisors will nonetheless be required to file, and periodically update, reports with the Commission, using the same registration form as registered advisors.
- ▶ Rather than completing all of the items on the form, exempt reporting advisors will fill out a limited subset of items, including:
 - Basic identifying information for the advisor and the identity of its owners and affiliates.
 - Information about the private funds the advisor manages and about other business activities that the advisor and its affiliates are engaged in that present conflicts of interest that may suggest significant risk to clients.
 - The disciplinary history (if any) of the advisor and its employees that may reflect on the integrity of the firm. Exempt reporting advisors will file reports on the Commission's investment advisor electronic filing system (IARD), and these reports will be publicly available on the Commission's website. These advisors will be required to file their first reports in the first quarter of 2012.
 - Regardless of registration, all advisors must retain records and file certain reports for each private fund they manage.

Impact to SEC Registered RIAs

- ▶ Assets Under Management – Based on the AUM test, the RIA may have to withdrawal its SEC registration and register under state jurisdiction
- ▶ Must register with state or states by July 28, 2011
 - First apply for registration in you home state via IARD
 - Complete documentation requested by state
 - Obtain approval from the state
 - File a form ADV-W with the SEC
 - If required to register with a state or states, registration requirements need to be evaluated
- ▶ Regulatory Filings – The SEC has created a new Form ADV Part 1A. This will be required for both new registrants and existing RIAs.
- ▶ Regardless of registration, all advisors must retain records and file certain reports for each private fund they manage.

Impact to Advisors Required to Register

- ▶ Registration filing with the SEC
- ▶ Requirement to establish and maintain a formal and process-driven compliance program
 - Policies and procedures
 - Code of Ethics
 - Anti Money Laundering
 - Insider Trading
 - Delegation of a Chief Compliance Officer
 - Annual Compliance Review (SEC Rule 206(4)–(7))

Conclusion

- ▶ Relevant dates for filing are quickly approaching. If RIAs are planning to register and have not submitted their forms it is highly recommended that they begin preparation immediately.
- ▶ SEC rules have modified both the content of the Form ADV and the manner in which new and existing investment advisors submit their regulator filings.
- ▶ The wide sweeping regulation discussed in this document are complex and requires an analysis of each advisors size, location and business practices.
- ▶ Contact Compliance Outsourcing Solutions, LLC (“COS”) for a free consultation regarding how your firm can effectively and efficiently address the new legal requirements.