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A legal update from Dechert's Financial Services Group

SEC Proposes New Investment Adviser Oversight Rules

The Securities and Exchange Commission ("SEC") on November 19, 2010 proposed new rules under the Investment Advisers Act of 1940, as amended ("Advisers Act"), to implement certain provisions of Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), the Private Fund Investment Advisers Registration Act of 2010 ("Advisers Registration Act").[1] The Advisers Registration Act changes take effect on July 21, 2011.

The new rules, among other things would: (i) increase the asset threshold which advisers must meet in order to register with the SEC; (ii) clarify the exemption for foreign private advisers; (iii) clarify the exemption for advisers to venture capital funds and mid-sized advisers; (iv) clarify certain registration requirements for advisers to private funds; and (v) amend Form ADV to facilitate reporting by advisers that are exempt from registration.

New Registration Threshold

The Advisers Act prohibits an adviser from registering with the SEC unless the adviser meets certain criteria, one of which is the amount of assets the adviser has under management.[2] While the Advisers Registration Act changes the threshold of assets under management ("AUM") used to determine whether an adviser may register with the SEC, it does not affect the other criteria used by advisers to determine whether they are eligible to register with the SEC.

The Advisers Act currently generally prohibits an adviser regulated by the state in which it maintains its principal office and place of business ("home state") from registering with the SEC unless the adviser has at least $25 million of AUM.[3] The Advisers Registration Act effectively increases this AUM threshold to $100 million if the adviser is required to be registered in its home state and is subject to examination by the securities commissioner of

1 The proposed rules were presented in two proposing releases: Rules Implementing Amendments to the Investment Advisers Act of 1940, Release No. IA-3110 (Nov. 19, 2010) ("Implementing Release"), *available at* www.sec.gov/rules/proposed/2010/ia-3110.pdf and 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-3111 (Nov. 19, 2010) ("Exemptions Release"), *available at* www.sec.gov/rules/proposed/2010/ia-3111.pdf. The SEC unanimously approved the proposals in the Exemptions Release and approved the proposals in the Implementing Release by a four to one vote, with Commissioner Kathleen Casey dissenting. Commissioner Casey indicated that she disagreed with the proposals in the Implementing Release because she believed the reporting requirements imposed on advisers to venture capital funds were too burdensome and inconsistent with the Congressional intent of the Advisers Registration Act. Commissioner Troy Paredes also expressed concerns that the extent of reporting required by the rules related to venture capital fund advisers would frustrate capital formation and harm the economy as a whole.

2 Other criteria used to determine eligibility for SEC registration include acting as an adviser to a registered investment company or registered business development company, or qualifying for an exemption adopted by the SEC.

3 Advisers Act Rule 203A-1 provides an additional $5 million AUM buffer to the $25 million AUM statutory threshold, to avoid requiring an adviser to switch frequently between state and SEC registration as a result of fluctuating AUM.

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its home state. While small advisers (*i.e.*, those that have less than $25 million of AUM and do not meet any other registration criteria) are still prohibited from registering with the SEC, the new category of "mid-sized advisers" created by the Advisers Registration Act (*i.e.*, those with AUM between $25 million and $100 million) will be permitted to register with the SEC if the adviser is: (i) not required to be registered as an adviser in its home state; (ii) registered in its home state, but not subject to examination;[4] or (iii) required to register in 15 or more states.

Transition. The proposed rules provide for a two-step process to facilitate the transition from SEC registration to state registration of mid-sized advisers. Each investment adviser, regardless of size, that is registered as of July 21, 2011 would be required to file a Form ADV amendment, no later than August 20, 2011, indicating the adviser's eligibility to remain registered with the SEC. Advisers no longer eligible for SEC registration would be required to withdraw their registration from the SEC and submit an application for registration in the appropriate states no later than October 19, 2011.[5] The Implementing Release requests comment on the proposed transition process, specifically on whether the indicated transition times are appropriate.

Uniform Calculation of Regulatory AUM

Given the increased importance of an adviser's AUM for various regulatory purposes under the Advisers Registration Act, the SEC has proposed a uniform method of calculating "Regulatory AUM" through proposed revisions to Form ADV ("Proposed Amended Form ADV").[6]

The instructions to the Proposed Amended Form ADV would require advisers to calculate their Regulatory AUM based on the securities portfolios for which they provide continuous and regular supervisory or management services, inclusive of proprietary assets, assets managed without receiving compensation, and assets of foreign clients, each of which an adviser may currently exclude in calculating its AUM.[7] Regulatory AUM would also include: (i) the value of any private fund over which an adviser exercises continuous and regular supervisory or management services; (ii) the amount of any uncalled capital commitments of any such private fund (a new concept intended to capture, among others, private equity fund managers); and (iii) the fair value (as opposed to the cost basis) of such private fund assets.[8]

While acknowledging that not all private funds use fair value methodologies as a result of holding illiquid assets, the Implementing Release indicates the SEC's view that the use of the fair value of private fund assets would not create a great burden for advisers, because many private funds already value assets based on their fair value in accordance with U.S. generally accepted accounting principles ("GAAP") or other international accounting standards. The Proposed Amended Form ADV would acknowledge that a fund's governing documents may provide for a specific process for calculating fair value and would allow the adviser to rely on such a process for calculating its Regulatory AUM.

Pension Consultants

In conjunction with the increase in the AUM threshold required for advisers to register with the SEC, the SEC proposes to increase the threshold of plan assets that a pension consultant advises from $50 million to $200 million when determining a pension consultant's eligibility to register with the SEC. While pension consultants do not technically "manage" pension plan assets, the SEC has required certain pension consultants to register because their activities have a direct

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4 The Implementing Release indicates that the SEC will ask state securities commissioners to certify whether they subject advisers registered with them to examinations. The SEC will then make available a list of states that do not conduct examinations, so that an adviser having less than $100 million AUM may evaluate whether it should register with the SEC or the appropriate states.

5 As part of the transitioning process, the Implementing Release clarifies that any adviser required to register with the SEC for the first time on or after January 1, 2011 as a result of having more than $30 million AUM (that is, $25 million AUM plus the additional $5 million buffer allowed by Advisers Act Rule 203A-1) would not have to register if it has less than $100 million Regulatory AUM (see notes 6-8 and accompanying text) and meets certain other requirements.

6 While the uniform calculation for Regulatory AUM would be required for various purposes under the Advisers Act, registered advisers would be able to use a different AUM calculation method for purposes of disclosure to clients in their narrative brochure required by Part 2 of Form ADV and for marketing or other purposes.

7 The Proposed Amended Form ADV would also require unpaid liabilities that remain in a client's account and are managed by the adviser to be included in calculating Regulatory AUM.

8 A sub-adviser to a private fund would include in the calculation of its Regulatory AUM only the value of the portion of the portfolio for which it provides sub-advisory services.

effect on the management of large amounts of pension plan assets. The proposed increase preserves the current ratio between the AUM threshold for advisers and plan assets advised by pension consultants.[9]

Multi-State Advisers

As discussed above, the prohibition on mid-sized advisers registering with the SEC is removed if such adviser is required to register in 15 or more states. This exception is intended to alleviate the regulatory burden of registering in numerous states. The SEC also proposes to amend Advisers Act Rule 203A-2(e), which currently allows an adviser to register with the SEC if it is required to register in 30 or more states, regardless of other prohibitions on registration. The proposed amendments to Rule 203(A)-2(e) would allow an adviser (including a small adviser with less than $25 million Regulatory AUM) to register with the SEC if it is required to register in 15 or more states.

Foreign Private Advisers

The Advisers Registration Act includes a new exemption from registration for any investment adviser that is a foreign private adviser ("Foreign Private Adviser Exemption").[10] The Advisers Registration Act defines a "foreign private adviser" as any investment adviser that:

- has no place of business in the United States;
- has, in total, fewer than 15 clients and investors in the United States in private funds advised by the adviser;
- has aggregate AUM of less than $25 million (which dollar threshold may be increased by the SEC) attributable to: (i) clients in the United States (including U.S.-domiciled private funds); and (ii) U.S. investors in private funds advised by the adviser; and
- neither: (i) holds itself out generally to the public in the United States as an investment adviser; nor (ii) advises registered investment companies or registered business development companies.

The Exemptions Release proposes new Advisers Act Rule 202(a)(30)-1 ("Foreign Private Adviser Rule") that would define certain terms in the Advisers Registration Act for use by advisers seeking to rely on the Foreign Private Adviser Exemption.

Definition of "Investor"

The Foreign Private Adviser Rule would define a private fund investor as any person who would be included in determining: (i) the number of beneficial owners of the outstanding securities of a private fund under section 3(c)(1) of the Investment Company Act of 1940, as amended ("Investment Company Act"); or (ii) whether the outstanding securities of a private fund are owned exclusively by "qualified purchasers" under section 3(c)(7) of the Investment Company Act.[11] Specifically, the Foreign Private Adviser Rule would require advisers, when counting the number of U.S. investors for purposes of the Foreign Private Adviser Exemption:

- to "look through" any nominee account to count each beneficial owner of such account as an investor;
- to count holders of equity and debt securities as investors;
- in a master-feeder structure, to "look through" to the investors in the feeder fund formed or operated for the purpose of investing in the master fund and count those investors as investors; and
- to count as an investor any holder of an instrument (such as a total return swap or other structured product) that effectively transfers the risk of investing in the private fund from the record owner of the private fund's securities to the instrument holder.

However, to avoid double counting, an adviser would be able to treat as a single investor any person who is an investor in two or more private funds advised by the adviser. The Foreign Private Adviser Rule would count

9 Currently, the plan assets threshold of $50 million is twice that of the AUM statutory threshold of $25 million for advisers. In light of the increase in AUM statutory threshold for advisers by the Advisers Registration Act to $100 million, the plan assets threshold would remain twice that of the AUM statutory threshold (if increased) to $200 million.

10 Because the Foreign Private Adviser Exemption will be codified in section 203(b) of the Advisers Act, advisers relying on the exemption will be exempt from all registration, reporting and recordkeeping requirements of the Advisers Act. However, advisers relying on the Foreign Private Adviser Exemption to avoid registration with the SEC would still be subject to the anti-fraud provisions of section 206 of the Advisers Act and the Pay-to-Play Rule (see note 29 and accompanying text).

11 Advisers must determine the number of investors in a private fund based on the facts and circumstances and in light of the applicable prohibition not to do indirectly what is unlawful to do directly.

"knowledgeable employees" (as defined in Investment Company Act Rule 3c-5) of a private fund and holders of short-term paper of a private fund as investors for purposes of counting investors, even though such persons are not counted as beneficial owners for purposes of section 3(c)(1) of the Investment Company Act and knowledgeable employees are not required to be qualified purchasers for section 3(c)(7) of the Investment Company Act.

Definition of "Clients"

The Foreign Private Adviser Rule would include a safe harbor for counting clients similar to the safe harbor currently afforded by Advisers Act Rule 203(b)(3)-1. However, the safe harbor for counting clients for purposes of the Foreign Private Adviser Exemption would be narrower as a result of the Advisers Registration Act requirement that U.S. investors in private funds advised by the adviser must be counted as clients.[12] Further, the Foreign Private Adviser Rule would require an adviser to count as a client any person for whom the adviser provides investment advisory services without compensation.[13] The Foreign Private Adviser Rule also specifies that an adviser would not need to count a private fund as a client if the adviser counted any U.S. investor in that private fund as an "investor" (as described above).

Definition of "in the United States"

The Foreign Private Adviser Exemption is based on the adviser, as described above, having no place of business in the United States, having less than 15 clients and investors in the United States, and having less than $25 million of AUM attributable to clients and investors in the United States. The Foreign Private Adviser Rule would define "in the United States" for these purposes with references to Regulation S under the Securities Act of 1933, as amended, except that any discretionary account that is held for the benefit of a U.S. person by a non-U.S. affiliate of the adviser would be deemed to be "in the United States." Further, the Foreign Private Adviser Rule would clarify that a person that is "in the United States" under the Regulation S definition may be treated as not being "in the United States" if such person was not "in the United States" at the time of becoming a client or investing in a private fund advised by the adviser.

Exempt Reporting Advisers

The Advisers Registration Act eliminates the "private adviser" exemption from registration currently set forth in section 203(b)(3) of the Advisers Act, which exempts investment advisers with fewer than 15 clients who meet certain other requirements from registration with the SEC. As a result, advisers to private funds will generally be required to register with the SEC unless another exemption applies.[14] The Advisers Registration Act provides new exemptions for advisers to venture capital funds and private fund advisers with less than $150 million of AUM in the United States (collectively, "Exempt Reporting Advisers"),[15] but requires Exempt Reporting Advisers to maintain such records and

12 The Foreign Private Adviser Rule would mirror Rule 203(b)(3)-1, allowing an adviser to treat as a single client a natural person and: (i) that person's minor children; (ii) any relative, spouse, or relative of the spouse of the person who has the same principal residence; (iii) all accounts of which the person and/or the person's minor child or relative, spouse, or relative of the spouse who has the same principal residence are the only primary beneficiaries; and (iv) all trusts of which the natural person and/or the person's minor child or relative, spouse or relative of the spouse who has the same principal residence are the only primary beneficiaries. Also similar to Rule 203(b)(3)-1, the Foreign Private Adviser Rule would allow an adviser to treat as a single client: (i) a corporation, general partnership, limited partnership, limited liability company, trust, or other legal organization to which the adviser provides investment advice based on the organization's investment objectives; and (ii) two or more legal organizations that have identical shareholders, partners, limited partners, members or beneficiaries.

13 While persons who receive investment advisory services for free (typically, employees, family and close friends) will be counted as a client for counting purposes under the exemption, such persons may continue to be excluded from the national *de minimis* standard, which prohibits any state from imposing any registration requirements or other regulation on an adviser that (i) does not have a place of business within the state and (ii) during the preceding 12-month period, had fewer than six clients resident in that state.

14 The Advisers Registration Act defines "private fund" as any issuer that would be an investment company under the Investment Company Act but for the exceptions found in sections 3(c)(1) or 3(c)(7) of that Act. As a result, advisers managing funds that rely on sections 3(c)(1) or 3(c)(7) will be subject to the registration requirements implemented by the Advisers Registration Act, while advisers to other pooled investment vehicles not so excepted from the definition of investment company (and therefore are not "private funds" for purposes of the Advisers Act) will not be affected by the proposed rules. A non-U.S. fund would be a "private fund" if it relies on section 3(c)(1) or 3(c)(7) in connection with any offerings to U.S. persons.

15 Compare these exemptions to the Foreign Private Adviser Exemption to be codified as section 203(b)(3) of the Advisers Act pursuant to the Advisers Registration Act. Section 203(b)(3) will exempt a foreign private adviser from registration and any reporting or recordkeeping requirements imposed by the Advisers Act.

provide such reports to the SEC as the SEC may require. Importantly, Exempt Reporting Advisers will also be subject to examination by the SEC, the anti-fraud provisions of section 206 of the Advisers Act, and the Pay-to-Play Rule.[16]

Categories of Exempt Reporting Advisers

Advisers to Venture Capital Funds

The Advisers Registration Act provides an exemption from registration for advisers to venture capital funds, but the legislative history of that Act shows that Congress considered, and purposefully chose not to provide, an exemption from registration for advisers to all private equity funds. In light of Congressional intention to distinguish the subset of venture capital funds from the larger category of private equity funds,[17] the SEC proposes to define a "venture capital fund" as a fund that:

- is a private fund (*i.e.*, a fund relying on section 3(c)(1) or section 3(c)(7) of the Investment Company Act to avoid being an investment company);
- invests in equity securities of qualifying portfolio companies[18] in order to provide operating and business expansion capital;
- has acquired at least 80% of its equity investment in each qualifying portfolio company directly from the qualifying portfolio company;[19]
- directly, or through its investment advisers, offers or provides significant managerial assistance to, or controls, the qualifying portfolio company;
- does not borrow or otherwise incur leverage in excess of 15% of the fund's capital contribution and uncalled committed capital, and any such leverage is for a non-renewable term of no longer than 120 calendar days;
- does not offer its investors redemption or other similar liquidity rights except in extraordinary circumstances; and
- represents itself as a venture capital fund to investors.

The Exemptions Release does not specify, but requests comment on, whether a "non-U.S. adviser" (*i.e.*, an adviser with its principal office and place of business outside the United States) would be eligible to rely on the venture capital fund adviser exemption, even if it advises funds outside of the United States that do not meet the definition of venture capital fund described above. The Exemptions Release also requests comment on whether a non-U.S. adviser's fund that is not offering in the United States, and therefore is not technically a "private fund" for purposes of the Advisers Act (because it does not need to rely on sections 3(c)(1) or 3(c)(7) of the Investment Company Act), should be able to qualify as a venture capital fund if it meets all of the other requirements of the venture capital fund definition, in order for the adviser to avail itself of the venture capital fund adviser exemption.

The proposed rule also includes a grandfathering clause which would deem a fund to be a venture capital fund for purposes of the exemption if the fund: (i) represented to investors, at the time its securities were offered, that it is a venture capital fund; (ii) has sold securities to at least one investor prior to December 31, 2010; and (iii) does not sell securities to, nor accept any additional capital commitments from, any person after July 21, 2011 (*i.e.,* the effective date of the Advisers Registration Act). The SEC proposed to include the grandfathering clause in light of the difficulty in requiring existing venture capital funds to adjust their terms or portfolio holdings.

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16 See note 29 and accompanying text for a description of the Pay-to-Play Rule.

17 The Exemptions Release states that the proposed venture capital rule intends to incorporate the Congressional understanding of the nature of investments of venture capital funds, which is based largely on testimony from industry participants. The testimony characterized venture capital funds as long-term investors in early-stage or small companies that are privately-held (as opposed to other types of private equity funds, which may invest in various stages of development) and, because they are generally not leveraged, do not contribute to systemic risk.

18 The proposed venture capital rule defines a "qualifying portfolio company" generally as any company that: (i) is not publicly traded at the time of investment by the private fund (nor does it control, is controlled by, or is under common control with, a publicly traded company); (ii) does not incur leverage in connection with the investment by the private fund; (iii) uses the capital provided by the fund for operating or business expansion purposes rather than to buy out other investors; and (iv) is not itself a fund.

19 A venture capital fund may also hold cash, cash equivalents and U.S. Treasuries with a remaining maturity of 60 days or less.

Private Fund Advisers with less than $150 million Regulatory AUM in the United States

The Advisers Registration Act directs the SEC to provide an exemption from registration for any adviser who acts solely as an investment adviser to private funds, provided such adviser's "Regulatory AUM" in the United States is less than $150 million ("Private Fund Adviser Exemption"). The proposed rule clarifying the Private Fund Adviser Exemption treats U.S. advisers (*i.e.*, advisers with their principal office and place of business in the United States) and non-U.S. advisers differently.

To rely on the Private Fund Adviser Exemption, U.S. advisers may not have more than $150 million in total Regulatory AUM (attributable to U.S. and non-U.S. persons).[20] However, a non-U.S. adviser only needs to include assets managed from a place of business in the United States[21] in calculating whether it falls under the $150 million threshold, provided that its only U.S. clients are qualifying private funds.[22]

As a result, a non-U.S. adviser would not lose the ability to rely on the Private Fund Adviser Exemption based on its business activities outside of the United States even if it manages private funds domiciled in the United States or accepts U.S. investors in such private funds. This position is reflective of the so-called "Regulation Lite" approach previously taken by the SEC staff, where a non-U.S. adviser to non-U.S. funds would not be subject to all of the regulatory requirements of the Advisers Act, even if the non-U.S. funds contained U.S. investors.[23] But, unlike Regulation Lite, under the Private Fund Adviser Exemption, non-U.S. advisers could advise private funds domiciled in the United States without limit as long as the adviser manages such private funds from a place of business outside of the United States.

Reporting Requirements for Exempt Reporting Advisers – Amendments to Form ADV[24]

Exempt Reporting Advisers would be required to submit, and update at least annually, reports to the SEC by completing certain items of Proposed Amended Form ADV, which would be amended to serve as both a reporting and registration form.[25] Exempt Reporting Advisers would be required to provide the SEC with organizational and operational information[26] including:

- basic identification details about the adviser;

20 Advisers would be required to calculate their Regulatory AUM quarterly according to the uniform calculation method described above for purposes of calculating their Private Fund Adviser Exemption eligibility. However, advisers qualifying for the Private Fund Adviser Exemption would only be required to update their Regulatory AUM with the SEC annually.

21 The SEC's interpretation and use of the phrase "in the United States" as used in the Private Fund Adviser Exemption differs from the definition of the phrase "in the United States" as used in the Foreign Private Adviser Exemption (discussed above). The proposed rule implementing the Private Fund Adviser Exemption relates "in the United States" to where the adviser manages its assets, whereas in the Foreign Private Adviser Rule, "in the United States" refers to, among other things, where the clients and investors are located.

22 A "qualifying private fund" is any private fund that is not registered under section 8 of the Investment Company Act and has not elected to be treated as a business development company.

23 *See*, ABA Subcommittee on Private Investment Companies, (pub. avail. Aug. 19, 2006).

24 Pursuant to the Advisers Registration Act, Exempt Reporting Advisers will be subject to recordkeeping rules as determined by the SEC. The SEC has indicated that it will propose recordkeeping rules in a separate rulemaking. However, the proposed rules for Exempt Reporting Advisers include a grandfathering provision to the books and recordkeeping rule (Advisers Act Rule 204-2) that allows advisers currently exempt from registration but potentially required to register as a result of the Advisers Registration Act (and therefore subject to certain rules of the Advisers Act) to be exempt from keeping performance-related records. As a result, advisers newly-required to register would be able to refer to their previous performance record even if they have not retained documentation supporting such performance.

25 It is important to note that, in addition to the reports to be filed by Exempt Reporting Advisers on the Proposed Amended Form ADV, the Adviser Registration Act also gave the SEC authority to impose reporting and recordkeeping requirements for registered advisers for systemic risk assessment purposes. The SEC has not yet provided any indication whether or to what extent it would require such reporting.

26 Specifically, an Exempt Reporting Adviser would be required to complete the following Proposed Amended Form ADV Items: (i) Item 1 - Identifying Information; (ii) Item 2.C - SEC Reporting by Exempt Reporting Advisers; (iii) Item 3 - Form of Organization; (iv) Item 6 - Other Business Activities; (v) Item 7 – Financial Industry Affiliations and Private Fund Reporting; (vi) Item 10 - Control Persons; and (vii) Item 11 - Disclosure Information.

Summary of Implications for Non-U.S. Advisers

- "Foreign Private Advisers" are exempt from registration, reporting and recordkeeping requirements.
- Non-U.S. advisers to venture capital funds that invest in U.S. companies or solicit U.S. investors may rely on the venture capital fund adviser exemption if all of their clients (U.S. and non-U.S.) meet the definition of a venture capital fund.
  - Advisers to venture capital funds would still be required to report to the SEC on the Proposed Amended Form ADV and would still be subject to examination.
- Non-U.S. advisers to private funds would be required to count only assets managed from a place of business in the United States to determine whether they have Regulatory AUM under $150 million for purposes of the Private Fund Adviser Exemption. Investment advisory activity occurring outside of the United States, even if such advisory activity relates to private funds that are domiciled in the United States or that have U.S. investors, could be excluded for purposes of relying on the Private Fund Adviser Exemption. However, a non-U.S. adviser that has any non-private fund clients in the United States would not be eligible for the Private Fund Adviser Exemption.
  - Even if the Private Fund Adviser Exemption applies, the adviser would still be required to report to the SEC on the Proposed Amended Form ADV and would still be subject to examination.

- details regarding other business activities the adviser and its affiliates are engaged in, which would specifically identify conflicts of interests the adviser may have with its clients; and
- a history of any disciplinary actions against the adviser or any of its employees.

The Implementing Release indicates that this information will be reviewed to determine whether the activities of an Exempt Reporting Adviser warrant further SEC attention. A further description of changes to Form ADV applicable to registered advisers as well as Exempt Reporting Advisers, including a description of required reporting for private funds, is found below in the "Proposed Amended Form ADV" section. Notably, the proposed rules do not require an Exempt Reporting Adviser to prepare and deliver the narrative brochure required of registered advisers by Part 2 of the Form ADV.

Exempt Reporting Advisers would file the Proposed Amended Form ADV with the SEC through the Investment Adviser Registration Depository ("IARD") system that is currently used by registered advisers. Exempt Reporting Advisers would be required to pay a filing fee and all reports would be publicly available on the SEC's website.

Proposed Amended Form ADV

The Implementing Release describes certain amendments to Form ADV that would be applicable to all registered advisers as well as Exempt Reporting Advisers. The Proposed Amended Form ADV would require an adviser to disclose, among other things:

- With respect to any private fund the adviser manages, basic organizational, operational and investment information about the private funds, such as information regarding: (i) the gross and net assets held by the fund; (ii) the type of investment strategy employed by the fund (to be identified from a list of available options); (iii) the number and types of investors in the fund; (iv) the minimum investment requirements of the fund; (v) the assets and liabilities held by the fund by class and categorization in the fair value hierarchy of GAAP;[27] (vi) whether clients are solicited to invest in the fund and what percentage of the adviser's other clients are invested in the fund; and (vii) the identity, location, and other information regarding certain "gatekeeper" service providers of the fund (*i.e.*, auditors, prime brokers, custodians, administrators, and marketers).[28]

  The Implementing Release indicates that such information would allow the SEC to assess private fund advisers for purposes of targeting examinations and would provide a level of transparency to

27 While the Implementing Release acknowledges that advisers may use international accounting standards that require information substantially similar to GAAP when calculating Regulatory AUM and submitting reports on the Proposed Amended Form ADV, the Proposed Amended Form ADV itself only provides for the categorization of a private fund's assets and liabilities according to the GAAP fair value hierarchy.

28 An adviser that would be required to complete a Proposed Amended Form ADV (whether due to its status as a registered adviser or an Exempt Reporting Adviser) with a principal office and place of business outside of the United States does not have to provide such information for any private fund that is (i) organized outside of the United States and (ii) not offered to, or owned by, any U.S. persons.

help identify particular practices that may harm investors. The Implementing Release further characterizes such information as information that advisers commonly report to investors in response to due diligence questionnaires, and that, just as investors evaluate the responses, the SEC will evaluate the information to identify advisers that present investors with greater compliance or other risks, possibly in order to prioritize its examinations of advisers.

- Information about its advisory business, including information regarding: (i) the types of clients it advises and the approximate amount of its AUM attributable to each type of client; (ii) the percentage of clients that are not U.S. persons; (iii) the specific number of investment personnel and their advisory activities; and (iv) its business practices that may present significant conflicts of interest, such as the use of affiliated brokers, soft dollar arrangements, and compensation for client referrals. Most of this information is already required to be disclosed in the current Form ADV, except that the options available for answering will be refined and expanded.

- Additional information about the adviser's non-advisory activities and their financial industry affiliations, including non-U.S. affiliates.

Pay-to-Play Rule

The SEC proposes certain changes to Advisers Act Rule 205(4)-5 enacted in July 2010 to prohibit advisers from engaging directly or indirectly in pay-to-play practices identified in the rule ("Pay-to-Play Rule").[29] The proposed amendments would, among other things, subject Exempt Reporting Advisers and foreign private advisers to the requirements of the Pay-to-Play Rule.[30] The Pay-to-Play Rule currently applies to advisers that are registered with the SEC or are exempt from registration under the private fund adviser exemption currently set forth in section 203(b)(3) of the Advisers Act. Because this private fund adviser exemption was eliminated by the Advisers Registration Act and replaced with exemptions for Exempt Reporting Advisers promulgated under different sections of the Advisers Act, Exempt Reporting Advisers would avoid being subject to the Pay-to-Play Rule as currently in effect. The Implementing Release notes that this proposed amendment would eliminate the unintended narrowing of the Pay-to-Play Rule by the Advisers Registration Act.

Conclusion

The comment period for the proposals ends 45 days after publication in the Federal Register.[31] The SEC encourages industry participants to submit substantive comments on a wide range of issues, including any specific interpretative issues relevant to advisers that are not addressed in the Implementing Release or the Exemptions Release and any broader issues related to the adequacy and appropriateness of the proposed rules in fulfilling the Advisers Registration Act's rulemaking mandate.

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29 *See* July 2010 *DechertOnPoint* "SEC Adopts "Pay-to-Play" Rule for Investment Advisers."

30 The proposed amendments to the Pay-to-Play Rule would also permit advisers to pay any "regulated municipal advisor" to solicit government entities on their behalf, provided that the regulated municipal advisor will be subject to separate pay-to-play rules to be adopted by the Municipal Securities Rulemaking Board. *See* September 2010 *DechertOnPoint* "Pay-to-Play: Proposed MSRB Guidance Regarding PACs Under Rule G-37."

31 As of December 1, 2010, the proposed rules had not been published in the Federal Register.

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