



# Investment Adviser Registration for Private Equity Fund Managers

MORRISON | FOERSTER

In 2011, the Dodd-Frank Act created a fundamental shift in registration requirements for private equity, venture capital and hedge fund managers. Five years later, the industry — and its regulators — have largely adjusted to the new regime.

Still, questions arise about which fund managers must register, with whom, and when.

In this handbook, we summarize who may or must register (and where), how registration and exemptions impact fund managers in terms of reporting and compliance obligations, and related timetables.

We note that this handbook contains only general summaries of the Advisers Act, the Dodd-Frank Act, SEC rules and state laws. Please contact your Morrison & Foerster Private Equity Funds Group attorney for more detailed guidance.

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# Who Must Register?

## Background

Prior to the Dodd-Frank Act, an adviser with fewer than 15 clients that did not hold itself out as an investment adviser was generally exempt from registration. In applying the numerical limit in the fewer-than-15-clients exemption, the SEC generally did not require investment advisers to “look through” a private fund to count the individual investors as separate clients. As a result, very few private fund managers were required to register as investment advisers and were, therefore, exempt from many of the compliance and disclosure obligations under the Advisers Act.

The Dodd-Frank Act changed all of that, and investment advisers with assets under management in excess of \$100 million are generally now required to register with the SEC.

## Definition of “Investment Adviser”

The registration and compliance obligations under the Advisers Act apply to “investment advisers,” which are generally defined 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,”<sup>1</sup> other than advisers which are:

- banks or bank holding companies;
- lawyers, accountants, engineers or teachers whose performance of advisory services is incidental to their profession;
- certain broker-dealers;
- newspaper or magazine publishers;
- advisers whose advice or analyses relates to certain U.S. government-related securities;
- nationally recognized statistical rating organizations;
- family offices (described further on page 11); or
- other persons as designated by the SEC.

Most private equity fund managers provide advice with respect to securities and, therefore, generally qualify as investment advisers. If an investment adviser solely

advises about matters other than securities (such as advice about non-securities real estate or precious metals), however, it may not be an “investment adviser” within the meaning of the Advisers Act, and would not be subject to the registration requirements under the Advisers Act.

## Thresholds for SEC Registration

The thresholds for federal registration of investment advisers is generally \$100 million in assets under management (“AUM”), subject to certain exceptions. Under the Advisers Act and its related rules, the following three categories of advisers arise:

- **Small Advisers** (<\$25 million in AUM) – generally prohibited from registering with the SEC, and must register with the state regulators, unless an exemption applies.
- **Mid-Sized Advisers** (\$25 – \$100 million in AUM) – generally prohibited from registering with the SEC, and must register with state regulators, subject to certain exceptions and the “buffer” for advisers with between \$100 million and \$110 million in AUM.<sup>2</sup>
- **Large Advisers** (\$100 million + in AUM) – generally required to register with the SEC.

These thresholds are discussed in more detail in Table 1.

## Calculating Assets Under Management

The first step in determining whether an adviser must register with the SEC or state regulators is to calculate the adviser’s AUM. The SEC has adopted a uniform method for calculating AUM, providing that advisers must include in their AUM securities portfolios (including private equity funds) for which they provide continuous and regular supervisory or management services, including family or proprietary assets,<sup>3</sup> assets managed without receiving compensation, and assets of foreign clients. Under the rules, advisers must calculate their AUM on a gross basis, that is, without deduction of any outstanding indebtedness or other accrued but unpaid liabilities.<sup>4</sup>

The instructions for Form ADV provide specific guidance for fund managers in calculating their AUM. Specifically, the instructions provide that:

- Advisers to private equity funds are required to include the value of any “private fund” over which they exercise continuous and regular supervisory or management services, regardless of the nature of the assets held by the fund.<sup>5</sup> “Private funds” are defined as any issuer that would be an investment company as defined in Section 3 of the Investment Company Act but for the exemptions in Section 3(c)(1) or Section 3(c)(7) of that Act (which are the exemptions upon which most private equity funds rely).
- Value is based on the current market value (or fair value where current market value is unavailable) of the private equity fund’s assets and the contractual amount of any uncalled commitments.
- Advisers that calculate fair value in accordance with GAAP or another international accounting standard for financial reporting purposes are expected to use that same basis for purposes of determining the fair value of their AUM; but other advisers, acting consistently and in good faith, may use another fair valuation standard.

## When Is SEC Registration Permissible for Small or Mid-Sized Advisers?

While advisers with less than \$100 million in AUM are generally prohibited from registering with the SEC, the SEC has provided certain exceptions to this rule (thereby permitting SEC registration for certain smaller advisers). These exceptions apply to (i) certain pension consultants, (ii) advisers affiliated with an SEC-registered investment adviser, (iii) advisers expecting to be eligible for SEC registration within 120 days of filing an initial Form ADV, (iv) certain multi-state investment advisers; and (v) certain internet advisers. These exemptions from the prohibition on SEC registration are discussed further in Table 3.

The rules also provide a buffer for advisers with close to \$100 million in AUM to help these advisers determine whether and when they will be required to switch between state and SEC registration. The buffer provides that (i) advisers with between \$100 million and \$110 million in AUM will be permitted, but not required, to register with the SEC and (ii) once an adviser is registered with the SEC, it is not required to withdraw its registration until it has less than \$90 million in AUM.

Eligibility for registration is determined annually as part of an adviser’s annual update amendment to its Form ADV.

Since federal registration preempts state registration, a small or mid-sized adviser may wish, if possible, to register with the SEC instead of the state authorities if, for example, the adviser would be subject to more onerous state rules or would be required to file and pay registration fees in more than one state.

## Exemptions from SEC Registration

Investment advisers that would otherwise be required to register with the SEC may be able to rely upon exemptions from SEC registration that were created or affected by the Dodd-Frank Act.<sup>6</sup> The following describes certain exemptions for private fund managers.

### Advisers Only to Venture Capital Funds

U.S. and non-U.S. fund managers that advise solely venture capital funds, regardless of the number or the size of the funds, are exempt from registration.<sup>7</sup>

However, managers relying on the venture capital exemption are considered “Exempt Reporting Advisers,” subject to certain limited public reporting requirements, including certain parts of Form ADV, and certain limited compliance obligations, discussed below.

### Defining “Venture Capital Funds”

For purposes of the rules, a “venture capital fund” is defined as a “private fund”<sup>8</sup> that:

- represents to its investors and potential investors that it is pursuing a venture capital strategy;
- does not exceed the 20% basket for “non-qualifying investments,” which we discuss below;
- does not borrow, issue debt obligations, provide guarantees, or otherwise incur leverage in excess of 15% of the fund’s capital commitments, which borrowing, indebtedness, guarantee<sup>9</sup> or leverage is on a short-term basis only (for a non-renewable term of no longer than 120 days);<sup>10</sup>
- does not offer its investors redemption or other similar liquidity rights except in extraordinary circumstances, such as withdrawal or excuse rights for legal or regulatory requirements<sup>11</sup>; and
- is not registered under the Investment Company Act and has not elected to be treated as a business development company.

## Defining “Qualifying Investments”

The rules define “qualifying investments”<sup>12</sup> as:

- any equity security issued by a “qualifying portfolio company” that is directly acquired by the private fund from the company (“directly acquired equity”);
- any equity security issued by a qualifying portfolio company in exchange for directly acquired equity issued by the same qualifying portfolio company; or
- any equity security issued by a company of which a qualifying portfolio company is a majority-owned subsidiary<sup>13</sup>, or a predecessor, and that is acquired by the fund in exchange for directly acquired equity described above.

A “qualifying portfolio company”<sup>14</sup> is defined as any company that:

- at the time of any investment by the private fund, is not a reporting or foreign traded company and does not control, is not controlled by or is not under common control with, a reporting or foreign traded company;
- does not borrow or issue debt obligations in connection with the private fund’s investment in the company and then distribute to the private fund the proceeds of such borrowing or issuance in exchange for the private fund’s investment; and
- is not itself a private fund or other pooled investment vehicle (i.e., is an operating company).

## 20% Basket for Non-Qualifying Investments

The rules include a 20% basket for non-qualifying investments, thus allowing a fund to qualify as a venture capital fund even if it makes other types of investments, such as bridge loans, investments in publicly offered securities, leveraged buyouts, or investments in other venture capital funds.

The 20% limit is calculated immediately after the fund’s purchase of a non-qualifying investment (other than short-term holdings<sup>15</sup>) by calculating the total value<sup>16</sup> of all the fund’s assets held at that time that are invested in non-qualifying investments as a percentage of the fund’s total commitments (i.e., after taking into account the newly acquired non-qualifying

investment).

The rules also clarify that:

- If the fund satisfies the 20% limit, but later exceeds it (e.g., as a result of an increase in the value of the investment), the fund is not required to dispose of the investment, but would be prohibited from acquiring more non-qualifying investments until the value of its then-existing non-qualifying investments falls below the 20% limit.
- Previously acquired securities of a company that subsequently becomes a reporting company (e.g., as a result of an IPO) may be treated as a qualifying investment and, therefore, would not count against the fund’s 20% basket. However, a fund could not later acquire the company’s publicly traded securities in the secondary market unless it had sufficient room in its 20% basket.
- Investments in wholly-owned intermediate holding companies that are formed solely for tax, legal or regulatory reasons to hold the fund’s investment in a qualifying portfolio company, can be disregarded for purposes of the 20% limit and the definition of “qualifying portfolio companies.”

## Advisers Only to Private Funds with less than \$150 Million in Assets Under Management

The private fund adviser exemption exempts from registration any adviser with its principal office and place of business in the United States that:

- acts solely as an investment adviser to one or more “qualifying private funds”; and
- has assets under management attributable to “qualifying private funds” of less than \$150 million.<sup>17</sup>

Like the venture capital fund exemption, advisers relying on the private funds exemption are Exempt Reporting Advisers, subject to certain limited public reporting requirements, including certain parts of Form ADV, and certain limited compliance obligations, which we discuss below.

## Advising Only “Qualifying Private Funds”

Unlike the exemption for advisers to venture capital funds (which limits “private funds” to investment

funds that rely on Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act), the term “qualifying private funds” under the private funds exemption includes funds that rely on any of the exemptions under Section 3 of the Investment Company Act, including Section 3(c)(5)(C), upon which many real estate funds rely. As a result, advisers are permitted to advise a broader category and a greater number of funds and still rely on this exemption. However, advisers must treat each “qualifying private fund” as a “private fund” for other purposes of the Advisers Act (including for purposes of calculating the \$150 million threshold described below).

### Calculating the \$150 Million Threshold

Advisers relying on this exemption must annually calculate the amount of private fund assets (including assets of any qualifying private fund) they have under management and report these amounts in the adviser's annual amendments to its Form ADV. Advisers reporting \$150 million or more of private fund AUM do not qualify for the private fund adviser exemption, and are required to register under the Advisers Act unless another exemption applies. Notably, while advisers may be required to register under the Advisers Act as a result of changes to their AUM as reported in their annual Form ADV updating amendments, they do not lose the benefit of the exemption as a result of fluctuations in the adviser's AUM during the course of a year.

### Application to Non-U.S. Advisers

The private funds exemption also applies to an adviser with its principal office and place of business outside of the United States if the adviser:

- has no client that is a U.S. person except for one or more qualifying private funds; and
- all assets managed by the adviser at a place of business in the United States are solely attributable to private fund assets, the value of which is less than \$150 million.

*Non-U.S. Advisers Advising Only “Qualifying Private Funds.”* When determining whether all of the non-U.S. adviser's clients located in the United States are qualifying private funds (described above), a non-U.S. adviser whose principal office and place of business is outside the United States may enter the U.S. market and rely on the exemption without regard to its advisory services, clients or AUM outside of the United States (*i.e.*, the adviser does not count its non-fund clients outside the United States). However, all

assets managed by the investment adviser at a place of business in the United States must be solely attributable to “private fund assets,” the total value of which is less than \$150 million.

The rules also clarify that, for non-U.S. advisers whose principal office and place of business is outside the United States, a client will not be considered a U.S. person for purposes of this exemption if the client was not a U.S. person at the time it became a client of the adviser. For example, an adviser could still rely on the private adviser exemption even if one of its non-U.S. clients that is not a private fund (such as an individual or a corporation) relocates to the United States or later becomes a U.S. person.

### Foreign Private Advisers

The “foreign private advisers” exemption is available only to advisers that:

- have no place of business in the United States;
- have, in total, fewer than 15 clients in the United States and investors in the United States counted on a “look through” basis in private funds advised by the adviser;
- have less than \$25 million in AUM attributable to clients in the United States and investors in the United States in private funds advised by the adviser;
- do not hold themselves out as an investment adviser in the United States; and
- do not act as an investment adviser to a registered investment company or a company that has elected to be a business development company.<sup>18</sup>

### Counting Clients (and Investors)

The exemption for foreign private advisers requires non-U.S. advisers to “look through” the private funds they advise and count the U.S. investors in those funds toward the 15-client maximum (regardless of whether the fund is a U.S. or non-U.S. domiciled fund).

The rule also includes a number of special rules for counting clients, including a rule that permits an adviser to treat as a single “client” two or more legal organizations that have identical shareholders, partners, limited partners, members, or beneficiaries. Advisers relying on the foreign private advisers exemption are not required to double-count a private fund and the

investors in that fund under certain circumstances.<sup>19</sup>

Further, foreign private advisers are not required to “look through” funds that do not rely on Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act. While most private equity funds rely on these exemptions (and therefore would be considered “private funds” under the new rules), certain funds, such as real estate funds, rely on other exemptions and would not be subject to the “look through” rules.

### **Advisers Only to SBICs**

Section 203(b)(7) of the Advisers Act provides an exemption from registration for any adviser, who is not a business development company, that solely advises:

- small business investment companies (“SBICs”) that are licensed under the Small Business Investment Act of 1958 (the “SBA Act”);
- entities that have received notice to proceed to qualify for a license as an SBIC under the SBA Act; or
- affiliates of a licensed SBIC where the affiliate has a pending application for a license under the SBA Act.

### **Intrastate Advisers**

The exemption for intrastate advisers generally applies to advisers:

- that are not advisers to “private funds;”
- whose clients are residents of the state in which the adviser maintains its principal office and place of business; and
- that do not furnish advice, analyses or reports with respect to securities listed (or admitted to unlisted trading privileges) on any national securities exchange.

### **Advisers to Family Offices**

Subject to certain exceptions, a “family office” is generally excluded from the definition of “investment adviser.” For these purposes, a “family office” is defined as a company that:

- has no clients other than “family clients;”
- is wholly owned by family clients and is exclusively controlled (directly or indirectly) by one or more family members and/or family entities; and
- does not hold itself out to the public as an investment adviser.

“Family clients” include, among others, family members and former family members, key employees and certain former key employees, certain non-profits and charitable organizations or certain trusts, and certain entities owned by and operated for the benefit of family clients.

# Registration Cheat Sheet

Are you an “investment adviser” within the meaning of the Advisers Act?

See discussion on page 4, under the heading Definition of “Investment Adviser”

**YES**

**NO**

You are not required to register under the Advisers Act, and are generally not required to register under state law

Are you required to register with the SEC or one or more state authorities?

See Table 1 on page 10

If you are otherwise required to register with the SEC is an exemption available?

See Table 2 on page 11

If you are required to register with one or more state authorities, is there an exemption that would permit you to register with the SEC instead?

See Table 3 on page 12

# Table 1: Where to Register?

The first step in determining whether an adviser must be registered with the SEC or the state authorities is to assess an adviser's assets under management.

Type of Adviser	SEC Registration	State Registration <sup>20</sup>
<b>Small Advisers</b> Less than \$25 million in AUM	<p><i>Prohibited</i>, unless the state in which it maintains its principal office and place of business has not enacted an investment adviser statute (e.g., Wyoming), or unless it acts as an investment adviser to a registered investment company, in which cases the adviser must register with the SEC, unless otherwise exempt.</p> <p><i>Permitted</i>, but not required, if relying on an exemption from the prohibition on registration described in Table 3 on page 12.</p>	<p><i>Required</i> for small advisers that are not registered with the SEC, unless an exception applies under state law.</p> <p><i>Not required</i> for small advisers that are registered with the SEC, since federal registration preempts state registration requirements.</p>
<b>Mid-Sized Advisers</b> Between \$25 million and \$100 million in AUM	<p><i>Prohibited</i> if the adviser is (i) required to be registered (and is not exempt from registration) with the state regulators in the state in which it maintains its principal office and place of business, and (ii) subject to examinations as an investment adviser within such state (a "Covered Mid-Sized Adviser"),<sup>21</sup> unless an exception applies.</p> <p><i>Permitted</i>, but not required, (i) under the buffer rules if the Covered Mid-Sized Adviser has between \$100 million and \$110 million in AUM, or (ii) if the Covered Mid-Sized Adviser is required to register with 15 or more states, or (iii) if relying on an exemption from the prohibition on registration described in Table 3 on page 12.</p> <p><i>Required</i>, unless an exemption applies, if the adviser (i) is not a "Covered Mid-Sized Adviser" (such as advisers with their principal office and place of business in New York or Wyoming) <u>or</u> (ii) the adviser advises a registered investment company or a company that has elected to be a "business development company."</p>	<p><i>Required</i> for mid-sized advisers that are not registered with the SEC (including advisers relying on an exemption from federal registration, such as Exempt Reporting Advisers), unless an exception applies under state law.</p> <p><i>Not required</i> for mid-sized advisers that are registered with the SEC, since federal registration preempts state registration requirements.</p>
<b>Large Advisers</b> \$100 million or more in AUM	<p><i>Required</i>, unless an exemption applies.</p>	<p><i>Required</i> for large advisers that are not registered with the SEC because they are relying on an exemption from federal registration (including Exempt Reporting Advisers), unless an exception applies under state law.</p> <p><i>Not required</i> for large advisers that are registered with the SEC, since federal registration preempts state registration requirements.</p>

## Table 2: Exemptions from SEC Registration

Where an adviser is otherwise required to register with the SEC, the adviser may be able to rely on an exemption from SEC registration.

Type of Adviser	SEC Registration	Registration with State(s)
Adviser manages <u>solely</u> private funds and has less than \$150 million in AUM	<i>Not required</i> , but, if relying upon the exemption, subject to modified reporting obligations of an Exempt Reporting Adviser.	<i>Required</i> in accordance with state law, unless registered with the SEC or exempt under state law.  Note that Exempt Reporting Advisers relying upon the exemption are not <i>registered</i> with the SEC, and therefore may be subject to state registration (although many states have adopted parallel exemptions for these advisers).
Adviser manages <u>solely</u> venture capital funds	<i>Not required</i> , but, if relying upon the exemption, subject to modified reporting obligations of an Exempt Reporting Adviser.	<i>Required</i> in accordance with state law, unless registered with the SEC or exempt under state law.  Note that Exempt Reporting Advisers are not <i>registered</i> with the SEC, and therefore may be subject to state registration (although many states have adopted parallel exemptions for these advisers).
“Foreign private advisers”	<i>Not required.</i>	<i>Required</i> in accordance with state law, unless registered with the SEC or exempt under state law.
Intrastate adviser where adviser does not advise “private funds”	<i>Not required.</i>	<i>Required</i> in accordance with state law, unless registered with the SEC or exempt under state law.
Advisers to “family offices”	<i>Not required.</i>	<i>Required</i> in accordance with state law, unless registered with the SEC or exempt under state law.
SBIC advisers meeting conditions under Section 203(b)(7) of the Advisers Act	<i>Not required.</i>	<i>Required</i> in accordance with state law, unless registered with the SEC or exempt under state law.

## Table 3: When Is SEC Registration Permissible for Small and Mid-Sized Advisers?

Certain small and mid-sized advisers may wish to register with the SEC in order to avoid state registration. To register with the SEC, these advisers must rely on an exemption from the prohibition on SEC registration. Except as noted below, these exemptions allow small and mid-sized advisers to choose to register with the SEC even if they do not meet the AUM thresholds described in Table 1.

Type of Adviser	SEC Registration
<ul style="list-style-type: none"> <li>– <b>Pension Consultants:</b> Advisers that are “pension consultants” with respect to assets for plans having an aggregate value of at least \$200 million meeting certain conditions under Rule 203A-2(a).</li> <li>– <b>Multi-state Advisers:</b> Advisers required to register with 15 or more states meeting certain conditions under Rule 203A-2(d).<sup>22</sup></li> <li>– <b>Internet Advisers:</b> Internet investment advisers meeting certain conditions under Rule 203A-2(e).</li> <li>– <b>Affiliates of Registered Advisers:</b> Advisers that control<sup>23</sup>, are controlled by, or are under common control with, an investment adviser that is registered with the SEC, and whose principal office and place of business is the same as the registered adviser.<sup>24</sup></li> <li>– <b>Advisers Eligible for Registration within 120 days:</b> An adviser that expects to be eligible for SEC registration within 120 days after the date it registers with the SEC and that meets certain conditions under Rule 203A-2(c).</li> </ul>	<p><i>Optional.</i></p>
	<p><b>State Registration.</b></p> <p><i>Required</i> in accordance with state law, unless registered with the SEC or exempt under state law.</p>

# Ongoing Compliance Obligations

## Unregistered and State-Registered Investment Advisers

A state-registered investment adviser is generally subject to the statutes, rules and regulations in the state(s) in which the investment adviser transacts business. Certain state laws and regulations (e.g., anti-fraud provisions) apply even to an investment adviser that is not registered in that state. Advisers Act registration generally preempts only state registration and related requirements, rather than all state regulation.

In addition, a limited number of Advisers Act provisions apply to investment advisers that are unregistered under the Advisers Act, including, without limitation, the following:

### Anti-Fraud Provisions

The anti-fraud provisions of the Advisers Act prohibit advisers from employing “any device, scheme, or artifice to defraud any client or prospective client,” and require advisers, among other things, to disclose all material facts (and not make any material omissions) and to disclose to their clients actual and potential conflicts of interest.

### Pay to Play Rules

The SEC’s “pay to play” rules (i) prohibit payments to certain third parties to solicit government clients on behalf of an adviser, (ii) restrict contributions and payment to certain government officials and political parties, and (iii) prohibit an adviser from receiving compensation for advisory services within two years after a political contribution is made by the adviser (or its covered associates) to an official of certain government entities.

### Supervisory Requirements

All unregistered exempt investment advisers are subject to the supervisory requirements in Section 203(e)(6) of the Advisers Act, which requires advisers to supervise those who act on their behalf with a view to preventing violations of securities laws.

## Principal Transactions

Section 206(3) of the Advisers Act provides that it is unlawful for an investment adviser acting as principal for its own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he or she is acting and obtaining the consent of the client to such transaction.

## Exempt Reporting Advisers

In addition to the compliance obligations of advisers that are not registered under the Advisers Act discussed above, Exempt Reporting Advisers are subject to a limited subset of compliance obligations under the Advisers Act.

### Form ADV

Exempt Reporting Advisers must submit to the SEC, and periodically update, a truncated version of the Form ADV,<sup>25</sup> which is publicly available and accessible through the SEC’s website.

### SEC Examinations

While the SEC has indicated that it does not anticipate that its staff will conduct compliance examinations of Exempt Reporting Advisers on a regular basis, the SEC has the authority to do so and may examine the records of Exempt Reporting Advisers.

## SEC Registered Investment Advisers

To the extent an investment adviser registers with the SEC, it will generally be subject to the full scope of the Advisers Act (including, without limitation, the obligations of unregistered investment advisers). These obligations include, without limitation:

- filing current disclosures on Form ADV;
- record keeping requirements;

- examinations by the SEC’s Office of Compliance Inspections and Examinations;
- establishing, maintaining and implementing compliance programs;
- establishing, maintaining and implementing a code of ethics;
- custody requirements;
- complying with advertising rules; and
- restrictions on performance fees.

Below, we summarize a few of the most important compliance obligations of registered investment advisers.

Compliance with the Advisers Act and its related rules is complex and you would be well advised to consult with counsel familiar with these issues.

## Compliance Programs

All registered advisers are required to have a compliance program,<sup>26</sup> including:

- written policies and procedures reasonably designed to prevent violations of the federal securities laws;
- a proxy voting policy, an insider trading policy, and a code of ethics;
- a designated Chief Compliance Officer responsible for administering the firm’s policies and procedures for preventing and detecting violations of the federal securities laws;
- periodic training on policies and procedures; and
- compliance reviews at least annually.

Preparing a compliance program is complex and fact specific. Counsel should be consulted.

## Form ADV

Registered investment advisers must make periodic public filings with the SEC on Form ADV. Form ADV is divided into several parts. In particular, Part 2A (brochure) provides a narrative disclosure of, without limitation, fees and expenses, incentive fees and side-by-side management, investment strategies and methods of analysis, material risk factors and conflicts of interest, financial industry affiliations, codes of ethics, brokerage practices, a review of

accounts, client referrals, custody, discretionary authority and the voting of client securities.

Form ADV requires registered investment advisers to provide the SEC with information about several specific areas of their operations. Among other things, the SEC requires registered investment advisers to provide information about “private funds” they advise.<sup>27</sup> The SEC also requires registered investment advisers to provide the SEC with data about their advisory business<sup>28</sup> (including data about the types of clients they have, their employees, and their advisory activities), as well as about 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). Finally, the SEC requires information about a registered investment adviser’s non-advisory activities and their financial industry affiliations.

## Form PF

Certain advisers are required to file Form PF to provide details about the funds they advise in an effort to gather information necessary for the Financial Stability Oversight Council to assess systemic risk to the financial system. Form PF must be filed by advisers that (i) are registered or required to be registered under the Advisers Act,<sup>29</sup> (ii) advise one or more private funds, and (iii) manage at least \$150 million of AUM attributable to private funds as of the end of its most recently completed fiscal year.

In addition, certain large private fund advisers are required to provide more detailed information in Form PF, and in some cases are required to file Form PF more frequently than smaller advisers.<sup>30</sup>

## SEC Examinations

All records of any registered investment adviser are subject to examinations by the SEC.<sup>31</sup> The SEC is also required to conduct periodic examinations of all records of private funds maintained by a registered investment adviser.<sup>32</sup>

If you wish to receive more information on the topics covered in this handbook, please contact your regular Morrison & Foerster contact or any of the following members of our Private Equity Funds Group.

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1. Advisers Act, Section 202(a)(11).
2. Rule 203A-1(a) includes a 20% "buffer" providing that (i) advisers with between \$100 million and \$110 million in AUM will be permitted, but not required, to register with the SEC, and (ii) once an adviser is registered with the SEC it need not withdraw its registration until it has less than \$90 million in AUM.
3. The SEC takes the position that proprietary assets include, without limitation, investments by an adviser's principals (or other employees) alongside clients, such as co-investments. See Form ADV: Instructions for Part 1A, instr. 5.b.(2).
5. See Form ADV: Instructions for Part 1A, instr. 5.b.(1).
6. Release No. IA-3222, Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers with Less than \$150 Million in Assets under Management, and Foreign Private Advisers (the "Exemptions Release").
7. Dodd-Frank Act, Section 407.
8. As noted above, "private funds" are defined as any issuer that would be an investment company as defined in Section 3 of the Investment Company Act but for the exemptions in Section 3(c)(1) or Section 3(c)(7) of that Act. Most private equity funds rely on the exemptions in Section 3(c)(1) or Section 3(c)(7), and therefore are considered "private funds."
9. A fund's guarantee of a qualifying portfolio company's obligations (up to the amount of the value of the fund's investment in the qualifying portfolio company) is not subject to the 120-day limit. See Rule 230(l)-1.
10. The 15% limitation on borrowing is determined based on the fund's aggregate capital commitments, so in practice, a fund could leverage up to 100% of a particular investment, so long as the overall leverage amount does not exceed the 15% threshold.
11. In the Exemptions Release, the SEC noted that determining whether a specific redemption or "opt out" right would be treated as "extraordinary" will depend on the particular facts and circumstances. However, the SEC also noted that trigger events for these rights would typically be "foreseeable but unexpected circumstances" that are typically beyond the control of the adviser and the investor (such as withdrawal rights triggered by a material change in law that would prohibit an investor's participation in the fund's investments in a particular jurisdiction or industry).
12. See Rule 203(l)-1(c)(3).
13. For purposes of this rule, majority-owned subsidiaries are defined in Section 2(a)(24) of the Investment Company Act.
14. See Rule 203(l)-1(c)(4).
15. A qualifying fund may invest in cash and cash equivalents, U.S. Treasuries with a maturity of 60 days or less and shares of registered money market funds which are not counted as non-qualifying investments for purposes of the 20% limit.
16. Value may be determined based on historical cost or fair value, so long as the same valuation method is consistently applied to all of the fund's investments during the term of the fund.
17. To prevent advisers from seeking to avoid registration by creating two separate entities, each of which would fall below the \$150 million threshold, the SEC has stated that "depending on the facts and circumstances, [the SEC] may view two or more separately formed advisory entities that each has less than \$150 million in private fund assets under management as a single adviser for purposes of assessing the availability of exemptions from registration."
18. Dodd-Frank Act, Section 403.
19. Advisers Act, Rule 202(a)(30)-1(b)(4)-(5).
20. Section 222(d) of the Advisers Act provides that a state may not require an adviser to register if the adviser does not have a place of business within, and has fewer than six clients resident in, the state.
21. Dodd-Frank Act, Section 410; Advisers Act, Section 203A(a)(2)(B).
22. An adviser may not include in the number of states those in which it is not required to register because of applicable state laws or the national de minimis standard of Section 222(d) of the Advisers Act.
23. For purposes of this rule, control means the power to direct or cause the direction of the management or policies of an investment adviser, whether through ownership of securities, by contract, or otherwise. Any person that directly or indirectly has the right to vote 25% or more of the voting securities, or is entitled to 25% or more of the profits, of an adviser is presumed to control the adviser.
24. Advisers Act Rule 203A-2(b).
25. Exempt Reporting Advisers must complete seven items of Form ADV: Items 1 (Identifying Information), 2.B. (SEC Reporting by Exempt Reporting Advisers), 3 (Form of Organization), 6 (Other Business Activities), 7 (Financial Industry Affiliations and Private Fund Reporting), 10 (Control Persons), and 11 (Disclosure Information). See Form ADV: General Instruction 3. Exempt reporting advisers must also complete corresponding sections of Schedules A, B, C, and D.
26. Advisers Act, Rule 206(4)-7.
27. Note that real estate funds relying upon Section 3(c)(5)(C) of the Investment Company Act and investment companies not relying upon Section 3(c)(1) or Section 3(c)(7) would not fall within the definition of "private funds" and therefore would not be subjected to "private funds" information requirements.
28. On August 25, 2016, the SEC adopted amendments to Form ADV that mandate disclosure regarding advisers' separately managed account business. The new requirements are effective October 1, 2017. Release No. IA-4509, Form ADV and Investment Advisers Act Rules.
29. Exempt reporting advisers under exemptions for advisers solely to venture capital funds or advisers solely to private funds with assets under management of less than \$150 million in the United States are not required to file Form PF.
30. For more information on Form PF, please see our Client Alert, available at: <http://www.mofo.com/files/Uploads/Images/111115-Form-PF.pdf>.
31. Advisers Act, Section 204(a).
32. Dodd-Frank Act, Section 404.