Client Alert

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The Dodd-Frank Act: Registration Requirements for Private Fund Advisers

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). The Act is meant to overhaul the United States financial oversight regime and is considered to effect the most sweeping change to financial sector regulation since the reforms following the Great Depression. The Act touches on a broad range of topics, including responsibilities of public companies under the securities acts, registration requirements for hedge fund and private equity fund advisers, banks and other financial institutions, regulation of securities, over-the-counter derivatives and credit rating agencies, and modification of the regulatory structure under which the Federal Reserve and the Securities and Exchange Commission (the "SEC") operate.

This Client Alert highlights the provisions of the Act that significantly affect the registration requirements for private fund advisers under the Investment Advisers Act of 1940 (the "Investment Advisers Act").

In many cases, the SEC is directed to implement the requirements of the Act by adopting rules. As a result, many of the details and much of the impact of the Act may not be known until such rules are adopted.

Elimination of Private Fund Adviser Exemption

Before the enactment of the Act, many investment advisers were not required to register with the SEC in reliance upon the "private adviser exemption" under Section 203(b)(3) of the Investment Advisers Act. The exemption allowed investment advisers to avoid registration if they had fewer than 15 clients during the preceding 12-month period, did not hold themselves out as investment advisers and did not advise registered investment companies or business development companies. The Act has eliminated this exemption. The Act also requires advisers to private funds with $100 million or more in assets under management to register with the SEC as investment advisers.

The Act creates other registration exemptions for the following groups of investment advisers: (i) advisers to small business investment companies (other than entities regulated as business development companies under the Investment Company Act of 1940), (ii) advisers that are foreign private advisers, (iii) advisers to private funds that are registered with the Commodity Futures Trading Commission as commodity trading advisers, unless the business of the adviser becomes predominantly the provision of securities-related advice and (iv) advisers with less than $150 million of assets under management in the U.S. and that only advise private funds. However, the SEC is directed to require the fourth group of advisers to maintain such records and provide such reports as the SEC determines is appropriate in the public interest and to protect investors, and the SEC is directed to require registration and examination procedures for such advisers, taking into account the size, governance, investment strategy and level of systemic risk posed by such advisers.

Venture Capital Fund Adviser Exemption

An exemption was also created under the Act for advisers of "venture capital funds," a term that the SEC is directed to define within one year after the date of enactment. The Act amends the Investment Advisers Act to exempt from registration those advisers who advise solely venture capital funds, but will require such advisers to maintain such records and provide such reports as the SEC determines is appropriate in the public interest and to protect investors.

Qualified Client Standard

The Act also modifies the "qualified client" standard under the Investment Advisers Act. The Act requires the SEC to adjust for inflation any dollar thresholds (such as the $750,000 "under management" threshold or the $1,500,000 "net worth" threshold) of the qualified client standard within one year after enactment and every five years thereafter. It should be noted that unlike the net worth test for the accredited investor standard, the Act does not explicitly require that an investor's primary residence be excluded from the net worth test for the qualified client standard. Thus, an investor could satisfy the qualified client standard, but not the accredited investor net worth standard.

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Please feel free to contact any of the partners listed below or any Corporate Partner with whom you work if you would like to discuss the Act and its potential ramifications.

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