Foreign Private Advisers Under Dodd-Frank

September 20, 2012

Exemptions From SEC Registration

As of March 31, 2012, many non-U.S. investment advisers were required to register for the first time with the U.S. Securities and Exchange Commission (the "SEC") under the Investment Advisers Act of 1940, as amended (the "Advisers Act"). In the past, non-U.S. advisers often relied on the so-called "private adviser" exemption under the Advisers Act to avoid registration with the SEC. This exemption, available to advisers (located in the U.S. or otherwise) with fewer than 15 U.S. clients over the preceding 12 month period who did not hold themselves out to the public in the U.S. as investment advisers, was eliminated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which became effective on July 14, 2010. Notably, the Advisers Act provides certain new exemptions from registration for non-U.S. advisers, referred to as "foreign private advisers" in the Advisers Act, based on the amount of assets under management, the foreign adviser's clients, and the location where the foreign investment adviser conducts business.

Under the Advisers Act, there are now three primary exemptions from SEC registration available to foreign private advisers:

- the Foreign Private Adviser Exemption
- the Private Fund Adviser Exemption
- the Venture Capital Fund Exemption

The Foreign Private Adviser Exemption and the Private Fund Adviser Exemption are discussed below as most foreign private advisers for which an exemption is available will utilize one of these exemptions.[1]

Foreign Private Adviser Exemption

A "foreign private adviser" is defined under Section 202(a)(30) of the Advisers Act as an investment adviser that meets all of the following conditions:

- has no place of business in the U.S.;
- has in total, fewer than 15 clients and investors in the U.S. in private funds advised by the adviser;
- has aggregate assets under management of less than $25 million attributable to clients in the U.S., including U.S. domiciled private funds and U.S. investors in private funds advised by the adviser;
- does not hold itself out generally to the public in the U.S. as an investment adviser; and

- does not advise registered investment companies or registered business development companies.

An investment adviser satisfying all of the above conditions is not required to register with the SEC as an investment adviser.

"Place of business in the United States"

A "place of business" is defined by Rule 202(a)(30)-1 under the Advisers Act as any office where the investment adviser regularly provides advisory services, solicits, meets with, or otherwise communicates with clients, and any location held out to the public as a place where the adviser conducts such activities. Any office from which an adviser *regularly* communicates with U.S. or non-U.S. clients or where the adviser regularly conducts research would be a place of business. Further, an office of a U.S. affiliate where personnel of a non-U.S. adviser regularly conduct business activities would be deemed a place of business in the U.S. However, an office where an adviser solely performs *administrative services* or *back-office activities* that are not intrinsic to providing advisory services and do not involve communicating with clients would not be considered a place of business.

Counting "clients and investors"

The manner in which advisers count clients and investors is similar to how clients and investors are counted by private fund advisers when counting beneficial owners or qualified purchasers under Section 3(c)(1) or 3(c)(7), respectively, under the Investment Company Act of 1940. Under Rule 202(a)(30)-1 under the Advisers Act, a "client" is any person for whom the adviser provides advisory services for or without compensation and may include the following:

- a "single client" which may include a corporation, general partnership, limited partnership, limited liability company or other legal organization for which the adviser provides investment advice based on the objectives of the legal organization rather than the objectives of the underlying shareholders, partners, limited partners, members or beneficiaries; and

- a "single client" may include two or more legal organizations that have identical owners (an owner of a legal organization is a "separate client" if the adviser provides advisory services to the owner separate and apart from the advisory services provided to the legal organization).

An "investor" generally incorporates the "look-through" rules applicable to counting investors for 3(c)(1) and 3(c)(7) funds and may include the following:

- underlying beneficial owners of the outstanding securities of a private fund (must look through nominees to actual holders);

- all underlying holders of securities of feeder funds in a master-feeder arrangement;

- a single person investor in two or more funds advised by the same adviser may be treated as a single investor;

- an owner of a total return swap in the private fund. In order to avoid double counting, a private fund itself need not be counted if the adviser counted any investors in the private fund as an investor in the U.S. in the private fund and an adviser need not count a person as an investor in a private fund if the adviser counts such person as a client in the U.S.

Calculating assets under management

Assets under management are calculated pursuant to the requirements and instructions in Advisers

Act Form ADV. **Only assets under management attributable to clients in the U.S. and to investors in the U.S. in private funds advised by the adviser are counted.**

Limitations of the Foreign Private Adviser Exemption

The Foreign Private Adviser Exemption is generally of limited use to most foreign private advisers that advise U.S. persons or investors in private funds because of the need to limit both the number of clients and investors in the U.S. as well as the amount of assets attributable to such clients and investors and the need to continually monitor the amount of assets under management. For foreign private advisers who *do not* qualify for the Foreign Private Adviser Exemption and who manage only private funds with U.S. investors (no separate accounts with U.S. investors), the Private Fund Exemption may be more useful.[2]

Private Fund Exemption

Section 203(m) of the Advisers Act provides an exemption from registration with the SEC for any investment adviser that:

- acts solely as an adviser to qualifying private funds (funds that would not be an investment company as defined in Section 3 of the Investment Company Act of 1940 (the “1940 Act”) in addition to the exclusions provided by Section 3(c)(1) or 3(c)(7) of the 1940 Act; and
- has assets under management in the U.S. of less than $150 million.

Non-U.S. advisers with a principal office and place of business *outside* of the U.S. can utilize the Private Fund Exemption without regard to the type or number of non-U.S. clients or the amount of assets managed outside the U.S. Non-U.S. advisers are only required to count their U.S. clients and only private fund assets that are managed from a place of business within the U.S. **Accordingly, a non-U.S. adviser is permitted to manage an unlimited amount of qualifying private fund assets provided its principal office and place of business is outside the U.S. and it does not manage any assets for U.S. persons other than qualifying private funds.**

Calculating assets under management

Assets under management are calculated pursuant to the requirements and instructions of Advisers Act Form ADV. Uncalled capital commitments must be included.

“U.S. Person”

The definition of a “U.S. Person” under Rule 203(m)- 1 under the Advisers Act incorporates the definition of a U.S. Person in Regulation S of the Securities Act of 1933. Additionally, a client is only deemed a U.S. Person if the client was a U.S. Person at the time of becoming a client.

Managing assets for U.S. clients that are not private funds

A non-U.S. adviser may not rely on the Private Fund Exemption if it has U.S. clients in *separately managed accounts*. In such cases, the only options available are the Foreign Private Adviser Exemption or registration with the SEC. Non-U.S. advisers relying upon the Private Fund Exemption who have accepted one U.S. client that is not a private fund client may no longer utilize the exemption. Additionally, if the adviser is unable to rely upon the Foreign Private Adviser Exemption, the adviser must register with the SEC before accepting such U.S. client.

Reporting requirements for advisers relying on the Private Fund Exemption

Rule 204-4 under the Advisers Act requires advisers relying on the Private Fund Exemption as well as the Venture Capital Exemption to file reports with the SEC on Form ADV within 60 days of relying on the exemption. An annual update to the Form ADV must be filed within 90 days of fiscal year end.

Reporting requirements for advisers with no place of business in the U.S. and no U.S. qualifying private funds under management

Although it is arguable that no U.S. nexus exists, this area of regulation is untested and not clearly defined. To mitigate regulatory risk, these advisers should consider filing as “exempt reporting advisers” if they have U.S. investors in their offshore funds given that the SEC could take the view that the means and instrumentalities of the U.S. were involved in obtaining the U.S. clients. Exempt reporting advisers generally have less burdensome reporting requirements than registered investment advisers. Further, if these advisers wish to eventually establish a business in the U.S. or manage U.S. domiciled funds and SEC registration is required, they could nonetheless continue to rely upon the Private Fund Exemption when transitioning to SEC registration provided they had complied with the applicable reporting requirements for exempt reporting advisers.

Advantages of the Private Fund Exemption

A non-U.S. adviser may utilize the Private Fund Exemption regardless of the number or type of its non-U.S. clients or the amount of assets it manages outside the U.S. together with any U.S. domiciled qualifying private funds provided that the total value of assets attributable to such U.S. domiciled funds does not exceed $150 million. A non-U.S. adviser with no U.S. clients other than private funds may be able to rely on the Private Fund Exemption more easily than the more narrowly applied Foreign Private Adviser Exemption if the non-U.S. adviser has significant investments by U.S. persons in an offshore fund.

How the Exemptions Work

Location(s) of Adviser	Description of Adviser‘s Business	Assets Under Management	Exemption Available?
India (No U.S. office)	Private funds only with non-U.S. investors	$165 million in private funds	Private Fund Exemption
India (No U.S. office)	Private funds with U.S. investors and separate accounts for U.S. persons	$250 million in private funds with $50 million attributed to U.S. investors; $25 million in separate accounts with $20 million attributed to U.S. persons	Adviser must register with the SEC
India (A portion of the business is managed from a U.S. office)	Private funds only	$250 million in private funds with $100 million managed in the U.S.	Private Fund Exemption

India (No U.S. office)	Private funds with U.S. investors and separate accounts for U.S. persons	$150 million in private funds with $19 million attributed to 10 U.S. investors; $25 million in separate accounts with $5 million managed for 4 U.S. investors	Foreign Private Adviser Exemption

Implications of Registration as an Investment Adviser

A non-U.S. adviser not eligible for an exemption from registration must register with the SEC. Registration involves the following minimum requirements:

- establishment of an online filing account with the Financial Industry Regulatory Authority Inc. (FINRA);
- filing of the Form ADV Parts 1A and 2A and any applicable state notice filings;
- preparation of and delivery of a firm brochure which customarily includes the Form ADV Part 2A information;
- annual (and when necessary) interim updating of the Form ADV;
- establishment of a compliance program with policies and procedures and a code of ethics; and
- recordkeeping and reporting requirements.

State Registration

While non-U.S. advisers may avoid SEC registration under certain circumstances, non-U.S. advisers should be mindful of state registration requirements that may apply to the extent the adviser has U.S. clients. Accordingly, all nonU.S. advisers are encouraged to seek the advice of counsel with respect to state registration requirements.

Fortunately, while each state in the U.S. has its own laws and regulations governing the registration of investment advisers, many advisers are ultimately able to avoid state registration in light of certain federal laws and regulations. Section 222 of the Advisers Act provides that no law of any state may require an investment adviser to register if the adviser does not have a place of business in the state and has had fewer than 6 clients during the preceding 12-month period who are residents of the state. In addition, Rule 203(b)(3)-1 of the Advisers Act provides that a fund (and not the investors in the fund) is considered to be the client of the general partner or the managing member of that fund. Because this federal definition of “client” preempts state-law definitions, fund managers are generally not subject to state-level registration in any state other than the states in which they are located.

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[1] The Venture Capital Fund Exemption, which is generally not available to most advisers, is not addressed in this advisory. For further information, please do not hesitate to contact us.

[2] Notably, advisers are not permitted to combine elements of the Foreign Private Adviser Exemption with the Private Fund Exemption.