

July 2011

FUND FORMATION & INVESTMENT MANAGEMENT ALERT PRIVATE FUND MANAGER DEVELOPMENTS

As part of the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), advisers whose activities are limited to the management of unregistered investment funds (including private equity funds) with assets under management of less than \$150,000,000 and/or venture capital funds are exempt from registration as investment advisers with the Securities and Exchange Commission (the "SEC"). Recently, the SEC has taken the following steps which affect managers of such private investment funds:

SEC Raises "Qualified Client" Standards

Section 205(a) of the Investment Advisers Act of 1940 (the "Advisers Act") generally prohibits a registered investment adviser from charging performance compensation. Rule 205-3 promulgated under the Advisers Act exempts an investment adviser from the prohibition against charging performance compensation where the client is a "qualified client". The rule defines a "qualified client" as a client (either a natural person or a company) who (i) has at least \$750,000 under the management of the investment adviser; or (ii) has, in the reasonable belief of the investment adviser, a net worth of at least \$1,500,000 at the time the investment management contract is entered into with the advisor.¹ This rule also applies in the context of a registered investment adviser managing a private investment fund; so that each investor in the fund would have to be a "qualified client" in order for the adviser to charge performance compensation.

On July 12, 2011, the SEC amended Rule 205-3 to raise the thresholds of the assets under management test from \$750,000 to \$1,000,000 and the net worth test from \$1,500,000 to \$2,000,000.²

The new requirements under Rule 205-3 go into effect on September 19, 2011. While many managers of private investment funds are not registered as investment advisers with the SEC, they are so registered in states that incorporate the provisions of Rule 205-3 into their regulatory regimes. Accordingly, these state registered investment advisers will be required to qualify new investors admitted into their funds after September 19, 2011 under the heightened "qualified client" standards.

ADV Reporting Requirement

Sections 203(l) and 203(m) adopted into the Advisers Act as a result of the Dodd-Frank Act permits the SEC to require non-SEC registered advisers to private investment funds and venture capital funds to provide records and reports as the SEC shall consider necessary and appropriate in the public interest. Under this authority, the SEC has designated advisers that are exempt from registration because they only manage (i) private investment funds with less than \$150,000,000 in assets or (ii) private venture funds as "exempt reporting advisers". These exempt reporting advisers will be required to file Form ADV, Part 1, through the IARD system containing the following information:

(Please see next page for more information.)

666 Fifth Avenue, 28th Floor • New York • NY 10103-0084
600 Old Country Road • Citibank Building • Garden City • NY 11530-2011
Court Plaza North • 25 Main Street, 6th Floor • Hackensack • NJ 07601-7015

212.977.9700 Tel • 212.262.5152 Fax
516.229.9400 Tel • 516.228.9612 Fax
201.487.3700 Tel • 201.646.1764 Fax

- Item 1 - Identifying Information: The exempt reporting adviser must disclose its principal place of business, web site information and the name and contact information of its chief compliance officer.
- Item 2B – Identification of Exemption: The exempt reporting adviser must state the exemption from SEC registration that it is relying on.
- Item 3 – Form of Organization: The exempt reporting adviser must disclose the its corporate form and state of organization.
- Item 6 – Other Business Activities: The exempt reporting adviser must disclose its other business activities and whether it sells products or services other than investment advice to its advisory clients.
- Item 7A – Related Persons: The exempt reporting adviser must disclose the business activities of any of its affiliated persons.
- Item 7B – Private Funds: The exempt reporting adviser will have to provide information regarding the private investment funds under its management, including organization structure, assets under management and the identity of certain service providers.
- Item 10 – Control Persons: The exempt reporting adviser must disclose the identity of every person who directly or indirectly controls the adviser or its policies.
- Item 11 – Disciplinary History: The disciplinary history of the exempt reporting advisor and its employees must be disclosed.

So-called “exempt reporting advisers” will be required to file their initial Form ADV, Part I, between January 1, 2012 and March 30, 2012, as well as annual updates thereafter. It should be noted that an exempt reporting adviser will not be required to complete and file Form ADV, Part 2, or provide a copy of such form or a brochure containing the same information to its clients.

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- 1 Also included as “qualified clients” are non-U.S. persons and those investors who meet requirements of being a “qualified purchaser” under the Investment Company Act of 1940.
 - 2 The SEC has also proposed to amend Rule 205-3 to exempt the value of a client’s primary residence from the computation of the \$2,000,000 net worth and which would adjust both amounts set forth in asset under management test and the net worth test for inflation every five years.

We are available to provide counsel concerning these issues, as well as other Dodd-Frank concerns. For additional information, please contact the attorney named below or contact the attorney with whom you have a primary relationship.

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This information is provided as a public service to highlight matters of current interest and does not imply an attorney-client relationship. It is not intended to constitute a full review of any subject matter, nor is it a substitute for obtaining specific legal advice from appropriate counsel.