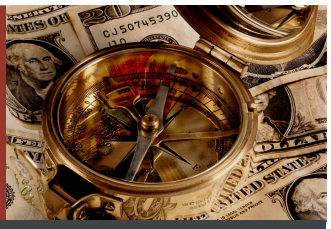
Venture Capital and Private Equity Team Alert



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Private Fund Investment Advisers Registration Act of 2010 Brings Sweeping Changes to Investment Adviser Regulation

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The Private Fund Investment Advisers Registration Act of 2010 (the "Act"), included as Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act enacted last week, will bring sweeping changes to the regulation of investment advisers. ***If you are a general partner or manager of an investment fund, a registered investment adviser or a family office, then this Act affects you***. This alert highlights key areas of importance for the investment industry. Generally, the provisions discussed below will become effective on July 22, 2011. In addition, many of the changes discussed herein are subject to SEC rulemaking and guidance. Please keep in mind that even if an investment adviser is not required to register with the SEC, it may be required to register with one or more states.

Elimination of Private Adviser/Less than 15 Clients Exemption

The Act eliminates the heavily relied on "private investment adviser" exemption contained in Section 203(b)(3) of the Investment Advisers Act of 1940 (the "Investment Advisers Act") for investment advisers who had fewer than fifteen clients during the preceding twelve months and who neither held themselves out to the public as investment adviser nor served as an investment adviser to a registered investment company or business development company. ***Many currently unregistered investment advisers will be required to register unless another exemption is applicable***.

New Exemptions from Registration under the Advisers Act

While the Act eliminates the private adviser exemption, it provides a few new exemptions from registration:

- *Small Private Fund Advisers*: Exemption for investment advisers who only advise "private funds" and who have less than $150 million in assets under management. A "private fund" is a fund that relies on either Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act to avoid registration as an investment company (this includes the vast majority of venture capital funds, hedge funds and other private equity funds). Advisers claiming this

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Related Attorneys

James W. Childs, Jr.
Chairman
205.521.8207
jchilds@babc.com

Jeffrey S. Buschmann
615.252.2388
jbuschmann@babc.com

Doug Franck
615.252.2354
dfranck@babc.com

Stuart J. Frentz
205.521.8216
sfrentz@babc.com

Jonathan D. Kipp
205.521.8361
jkipp@babc.com

Gordon Earle Nichols
615.252.2387
gnichols@babc.com

Jim Stewart
205.521.8087
jstewart@babc.com

Kevin L. Turner
205.521.8209
kturner@babc.com

Laura P. Washburn
205.521.8370
lwashburn@babc.com

exemption will be subject to record keeping and reporting requirements to be determined by the SEC.

- *Venture Capital Fund Advisers*: Exemption for investment advisors who only advise "venture capital funds." The Act does not define "venture capital funds," but the SEC is required to define the term within one year of the Act's enactment. Advisers claiming this exemption will be subject to record keeping and reporting requirements to be determined by the SEC.
- *Foreign Private Advisers*: Exemption for an investment adviser who (i) has no place of business in the U.S.; (ii) has fewer than 15 U.S. clients and U.S. investors in private funds that it manages; (iii) has less than $25 million in assets under management attributable to U.S. clients or U.S. investors in private funds that it manages; and (iv) neither holds itself out to the U.S. public as an investment adviser nor acts as an adviser to any registered investment company or business development company.
- *Small Business Investment Company Advisers*: Exemption for investment advisers (other than business development companies) who advise only small business investment companies ("SBICs") licensed under the Small Business Investment Act of 1958.
- *Commodity Trading Advisors*: Exemption for an investment adviser registered with the CFTC as a "commodity trading advisor" that advises a private fund. Registration will be required, however, if the adviser's business is "predominately the provision of securities related advice."
- *Intrastate Advisers Not Advising Private Funds*: Exemption for an investment adviser, all of whose clients are residents of the state in which the investment adviser maintains its principal place of business, is retained, except that this exemption will no longer be available for investment advisers who advise private funds or advise on exchange-traded securities.
- *Family Offices*: "Family offices" are excluded from the definition of an "investment adviser," and thus not subject to registration. The Act does not define "family office," but requires the SEC to promulgate a definition of the term.

State Registration of Mid-Sized Investment Advisers

Prior to the enactment of the Act, an investment adviser was required to register with the SEC if it had assets under management of $30 million or more, it had the option to register with the SEC or the applicable states if it had assets under management between $25 million and $30 million, and it was required to register with the applicable states if it had assets under management of less than $25 million. The Act raises the SEC registration threshold to $100 million, which means that investment advisers with less than $100 million in assets under management will generally be required to register with the applicable states rather than the SEC. The $25 million SEC registration threshold remains for investment advisers that would either (i) otherwise be required to register in fifteen or more states, or (ii) not be subject to state registration in the state of the investment adviser's principal place of business.

Record Keeping and Reporting Requirements

The Act imposes significant new reporting and recordkeeping requirements on SEC registered investment advisers. Records of private funds advised by an SEC registered investment adviser will now be treated as records of such investment adviser. All of these records are subject to periodic inspection and examination by the SEC.

SEC registered investment advisers to private funds will be required to maintain records and reports regarding each private fund advised by the adviser that include:

- amount of assets under management,
- use of leverage,
- counterparty exposure,
- trading and investment positions,
- valuation policies and practices,
- types of assets held,
- side arrangements or side letters,
- trading practices, and
- other information deemed by the SEC, in consultation with the Financial Stability Oversight Council ("FSOC"), to be necessary and

appropriate in the public interest and for the protection of investors or for the assessment of systemic risk by the FSOC.

The SEC may require SEC registered investment advisers to a private fund to file reports containing such information as the SEC deems necessary and appropriate in the public interest and for the protection of investors or for the assessment of systemic risk by the FSOC.

Change in Accredited Investor Net Worth Standard

For years the definition of "accredited investor" for natural persons has included persons whose (i) net worth exceeded $1,000,000, or (ii) whose individual annual income exceeded $200,000 for the last two years and was expected to exceed that amount in the current year, or (iii) whose joint income with their spouse exceeded $300,000 for the last two years and was expected to exceed that amount in the current year.

Beginning immediately, in order for a natural person to be an accredited investor based on net worth, the person must have a **net worth of $1,000,000, excluding that person's primary residence**. In addition, the SEC is charged with reassessing the test every four years, presumably to consider inflation and other factors that might require an adjustment in the net worth test. The effect will be to reduce the universe of potential investors in private offerings of securities for companies in all industries – especially start up and emerging growth companies who most often rely on the Regulation D exemption. Offerings that are "in process" as of the effective date will need to be carefully examined to avoid violation of this new rule.

Change in Qualified Client Standard

Within one year after enactment of the Act and every five years thereafter, the SEC is required to adjust for inflation the assets under management and net worth tests for determining "qualified client" status, which is central to determining whom an investment adviser may charge a performance fee under Rule 205-3 under the Advisers Act.

Please contact the authors of this Alert, Jim Stewart (205/521-8087) or Kevin Turner (205/521-8209), or another member of Bradley Arant Boult Cummings LLP's Venture Capital and Private Equity Team if you have any questions about the Act.