

AN ALERT FROM THE BDO PRIVATE EQUITY PRACTICE

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► SUBJECT

SEC ADOPTS REGISTRATION REQUIREMENTS FOR PRIVATE-FUND ADVISERS

► DETAILS

On June 22, 2011, the U.S. Securities and Exchange Commission voted to adopt rules to implement measures included in the Dodd-Frank Wall Street Reform and Consumer Protection Act that amend the Investment Advisers Act of 1940. The new rules require certain private-fund advisers to register with the SEC, establish new exemptions from SEC registration and reporting requirements, and reallocate regulatory responsibility for advisers between the SEC and states. Under these new rules, private equity funds will be subjected to unprecedented governmental oversight.

The rules include a transitional exemption period so that private advisers newly required to register, including private equity fund advisers, do not have to do so until March 30, 2012. The rules regarding these exemptions are effective July 21, 2011.

Registration Requirements

Historically, private-fund advisers were free from registering with the SEC if they met the exemption that applied to advisers with fewer than 15 clients – where each fund was considered one client. The Dodd-Frank legislation eliminates this private adviser exemption and as a result, many advisers that were previously unregistered will have to register with the SEC and provide information about their investors, employees, assets under management and potential conflicts of interest, among other data.

To enhance its oversight of private equity and hedge funds, the new rules to implement this provision will require registered private-fund advisers to provide a comprehensive overview of the funds they manage. Specifically, registered advisers to private funds will now have to provide, on Form ADV:

- Basic organizational and operational information about each fund they manage, such as the type of private fund that it is (e.g., hedge fund, private equity fund, or liquidity fund), general information about the size and ownership of the fund, general fund data and the adviser's services to the fund.
- Identification of five categories of "gatekeepers" that perform critical roles for advisers and the private funds they manage (i.e., auditors, prime brokers, custodians, administrators and marketers).

CONTACT:

For more information on how the Dodd-Frank Wall Street Reform and Consumer Protection Act will impact private equity funds, please contact Lee Duran, Partner and Leader of the Private Equity Practice, or Brian Eccleston, Partner in the Private Equity Practice of BDO USA, LLP.

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In addition, the SEC has adopted amendments that will require all registered advisers to provide more information about their advisory business, including:

- The types of clients they advise, their employees and their advisory activities.
- 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).

The rules also will require advisers to provide additional information about their non-advisory activities and their financial industry affiliations.

Registration Exemptions

While the Dodd-Frank Act extends registration requirements to many private equity funds by eliminating the private adviser exemption, it also establishes three more limited exemptions from registration under the Advisers Act. The SEC's rules to implement this provision provide new exemptions for:

- Advisers solely to venture capital funds. A venture capital fund being defined as a private fund that (a) holds no more than 20 percent of the fund's capital commitments in non-qualifying investments; (b) does not borrow or otherwise incur leverage, other than limited short-term borrowing; (c) does not offer its investors redemption or other similar liquidity rights except in extraordinary circumstances; (d) represents itself as pursuing a venture capital strategy to its investors and prospective investors; and (e) is not registered under the Investment Company Act and has not elected to be treated as a business development company
- Advisers solely to private funds with less than \$150 million in assets under management in the U.S.
- Certain foreign advisers without a place of business in the U.S. Private foreign advisor being defined as an investment advisers that has no place of business in the U.S., has fewer than 15 clients in the U.S. and investors in the U.S. in private funds advised by the adviser, and less than \$25 million in aggregate assets under management from such clients and investors.

The SEC, however, can still impose certain reporting requirements on these advisers. In addition, under the new rules, these advisers will be required to file reports with the SEC providing limited subsets of the data submitted to non-exempt advisers.

Regulatory Responsibilities

In addition to new registration requirements and exemptions for private-fund advisers, the Dodd-Frank Act reallocates primary responsibility for oversight of investment advisers by delegating to the states responsibility over certain "mid-sized advisers" – i.e. those with between \$25 million and \$100 million of assets under management. These advisers generally may not register with the SEC and will be subject to state registration.

This amendment will require about 3,200 of the current 11,500 registered advisers to switch from registration with the SEC to registration with the states.

These new measures will affect how private equity and hedge fund advisers conduct and manage their business, and the full implications of these changes most likely will not be realized for years after they have gone into effect. However, the final outcome for private equity is still unclear. The House of Representatives Subcommittee on Financial Services and Capital Markets has introduced a bill to the full House of Representatives that would provide an exemption from registration under the Advisers Act for advisers to private equity funds. While an adviser to such a fund would not be required to register with the SEC, the proposed legislation, H.R. 1082, does contemplate ongoing reporting requirements, to be determined by the SEC.

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