

Impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act on Registered and Unregistered Asset Managers

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David Gardels – Omaha Office

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Eric Gervais – Kansas City Office

- Managers of Private Funds with \$150,000,000 in Assets
- Managers of Private Funds with less than \$150,000,000 in Assets
- Regulation of Private Funds
- Venture Capital Fund Managers

Investment Advisers Act of 1940 - Background

- Currently, Investment Advisers Act of 1940 (“Advisers Act”) requires investment advisers with at least \$30 million of assets under management to register with the SEC
- Advisers Act currently prohibits investment advisers with less than \$25 million of assets under management from registering with the SEC
- Definition of investment adviser is very broad
- Managers of private funds typically considered investment advisers

Investment Advisers Act of 1940 - Background

- Prior to Dodd-Frank Act, private fund managers avoided registration by relying on “private investment adviser” exemption
- Advisers qualified for exemption if they had fewer than 15 clients during previous 12 months and did not hold themselves out to the public as investment advisers
- A private fund was typically viewed as a single client – even if it had more than 15 investors

Impact of Dodd-Frank Act

- Investment advisers with less than \$100 million of assets under management that (i) are required to register as an investment adviser in the state in which they maintain their principal office and (ii) are subject to examination by state regulators will be prohibited from registering with the SEC
- Investment advisers with more than \$25 million of assets under management that are not required to register with and be examined by the state in which they have their principal office will be required to register with the SEC
- Advisers that would be required to register with more than 15 states may register with the SEC

Impact of Dodd-Frank Act

- Eliminates “private investment adviser” exemption and replaces it with several narrower exemptions, including exemptions for (i) private fund managers with less than \$150 million of assets under management and (ii) advisers to “venture capital funds”
- Excludes advisers to “private funds” from “intrastate exemption” for advisers all of whose clients reside in a single state and that do not provide advice on exchange listed securities
- Requires advisers to “private funds” to register under the Advisers Act by July 2011 unless an exemption applies to them

Impact of Dodd-Frank Act

- “Private fund” is defined as any issuer that would be an investment company under the Investment Company Act of 1940 but for Sections 3(c)(1) or 3(c)(7) thereof
- 3(c)(1) – exemption for funds sold privately and beneficially owned by less than 100 holders
- 3(c)(7) – exemption for funds owned exclusively by qualified purchasers
- Requires advisers to private funds to maintain certain records for each fund

Poll Question #1

Q: How many private funds does your firm manage?

- Fewer than 5
- Greater than 5

Smaller Adviser Exemption

- Dodd-Frank Act directs SEC to provide an exemption from registration under the Advisers Act for investment advisers that manage only one or more private funds and have total assets under management of less than \$150 million
- Exemption not available if adviser provides advice to any client that is not a private fund
- Advisers that utilize exemption will still be required to meet certain new recordkeeping and reporting requirements to be imposed by SEC

Poll Question #2

Q: Is your firm registered as an investment adviser?

- Yes
- No

Venture Capital Fund Exemption

- Investment advisers solely to one or more “venture capital funds” will be exempt from registration with the SEC
- “Venture capital funds” to be defined by SEC by July 21, 2011
- Definition expected to be very narrow and to require strategy of investing in small or startup businesses
- Advisers that utilize exemption will still be required to meet certain new recordkeeping and reporting requirements to be imposed by SEC

New Recordkeeping and Reporting Requirements

- Registered advisers to private funds will be required to maintain and report certain information regarding each private fund they manage, including:
 - the amount of assets under management
 - the use of leverage
 - counterparty credit risk exposures
 - trading and investment decisions
 - valuation policies and practices
 - types of assets held
 - side arrangements or side letters with investors
 - such other information that the SEC determines is necessary and appropriate for the protection of investors or the assessment of systemic risk

New Recordkeeping and Reporting Requirements

- New requirements for registered advisers are in addition to the existing reporting and recordkeeping provisions of the Advisers Act
- Records of registered advisers to private funds will be subject to periodic and special examinations by the SEC
- Exempt advisers to private funds will at some point in the future be required to maintain and provide reports to the SEC as the SEC determines are “necessary or appropriate in the public interest or for the protection of investors”

Dan Peterson – St. Louis Office

- Family Offices
- Commodity Trading Advisers
- SBIC Managers
- Foreign Investment Advisers

New exemption from the definition of “investment adviser”: Family Offices

- SEC directed to exclude “family offices” from the definition of investment adviser under the Advisers Act by rule, regulation or order:
 - Must be consistent with prior SEC exemptive policy
 - Recognize range of structures used by family offices and
 - Grandfather person/entity not registered or required to be registered on January 1, 2010 solely because provided investment advice to:
 - Officers, directors or employees of the family office who:
 - Invested with the family office before January 1, 2010, and
 - Are accredited investors
 - Any company owned exclusively and controlled by family members of the office (or as the SEC may prescribe), or
 - Any registered adviser that provides advice to the family office and invests in same transactions but does not invest in other funds advised by the office, and the family office does not advise on more than 5% its assets under management
- If grandfathered, the family office would be deemed to be an investment adviser for anti-fraud purposes of the Advisers Act

Expanded exemption from the registration requirement: Commodity Trading Advisers

- §203(b)(6) currently exempts advisers which are:
 - Registered with the CFTC as a commodity trading adviser,
 - Who does not primarily act as an investment adviser, and
 - Does not act as an investment adviser to a registered investment company or business development company ("BDC")
- Revised §203(b)(6) also exempts:
 - An adviser which is registered with the CFTC as a commodity trading adviser, and
 - Advises a "private fund"
- Provided that if after July 21, 2010 the adviser's business becomes predominantly securities-related advice, then the adviser must register

New exemption from the registration requirement:

SBIC Managers

- Investment advisers, other than BDCs, who only advise:
 - SBICs which are licensed under the Small Business Investment Act of 1958
 - Entities which received a notice to proceed to qualify for an SBIC license or
 - Applicants which are affiliated with licensed SBICs that have applied for another SBIC license

New exemption from the registration requirement:

Foreign Investment Advisers

- Currently, most foreign advisers would rely on the less than 15 client exemption from registration provision
- Now, §203(b)(3) exempts “foreign investment advisers” from the registration requirement
- “Foreign investment advisers” are investment advisers who:
 - Have no place of business in the U.S.,
 - Fewer than 15 clients and U.S. investors in any “private funds” managed by the adviser,
 - Have less than \$25,000,000 (or higher amounts set by the SEC) in assets under management attributable to U.S. clients and U.S. investors in any “private funds” managed by the adviser, and
 - Does not hold itself out generally to the U.S. public as an investment adviser,
 - Does not advise a registered investment company or a BDC

Poll Question #3

Q: Is your firm registered other than as an investment adviser?

- Yes
- No

John Short – St. Louis Office

What it Means to Register as an Investment Adviser

- General Requirements

- Adopt and implement policies and procedures reasonably designed to prevent violations of the Advisers Act and Rules
- Review no less frequently than annually the adequacy of the policies and procedures and effectiveness of their implementation
- Designate a supervised person as a chief compliance officer to administrate the policies and procedures

What it Means to Register as an Investment Adviser

- Specific Requirements
 - Periodic and annual updates/amendments to Registration Form ADV
 - Written disclosure document; Part II of Form ADV
 - Annual delivery of disclosure document
 - Investment Advisory contracts
 - Fiduciary duty issues
 - Custody issues
 - Advertising and marketing
 - Use of solicitors
 - Recordkeeping
 - Privacy
 - Proxy voting
 - Business continuity plan

What it Means to Register as an Investment Adviser

– Code of Ethics

- Standard of conduct
- Security ownership reports by access persons
- Gifts and entertainment
- Inside information

– Other policies and procedures, as applicable

- Best execution and broker selection
- Order aggregation and trade allocation

Poll Question #4

Q: When was the last time your firm was examined by the SEC or a state?

- This year
- Last year
- In the past 5 years
- Over 5 years ago

Dan Peterson – St. Louis Office

- Accredited Investor Standard
- Investment Advisers with Less than \$100 Million Under Management
- Performance Fees
- Other Dodd-Frank Bill Changes

Accredited Investor Standard

- Currently, Rule 501 (a) defines, in part, “accredited investors” as:
 - Natural persons whose, or together with their spouse, net worth exceeds \$1 million at the time of purchase (the “Net Worth Test”), or
 - Natural persons who had income of \$200,000 in the prior two years and expect to earn the same in the current year (or \$300,000 together with spouse) (the “Income Test”)

- As of July 21, 2010, the Net Worth Test is modified to exclude the investor's primary residence from the Net Worth test calculation
 - SEC staff has already informally advised that they believe this necessarily means that if the investor has a full recourse mortgage and the amount of debt exceeds the house's market value, that the investor must deduct that amount from their Net Worth Test calculation
 - Will apply even if offer already in process prior to July 2, 2010
 - Will apply to follow-on investments in same offering after July 21, 2010
 - Does not affect purchases made prior to July 21, 2010
 - SEC is directed to adjust \$1 million level of the Net Worth Test (as well as the entire accredited investor standard applicable to natural persons) within four years, and then every four years thereafter

- Income Test not yet modified, but likely will be by SEC
- GAO also directed to study accredited investor standard and submit to SEC within three years
- The Dodd-Frank Act also directs the SEC to adopt a rule similar to Rule 262 under the Securities Act of 1933 to prohibit “bad boys” from relying on the Regulation D exemption

Investment Advisers with Less than \$100 Million Under Management

- Currently under §203A, an adviser that is regulated as such in the state in which it has its principal place of business may not register under the Advisers Act unless they have at least \$25 million in assets under management (except if they advise a registered investment company)

The Dodd-Frank Act adds a new §203 A(a)(2)(A), which provides that unless:

- The adviser advises a registered investment company or a BDC, or
- The adviser would have to register in 15 or more states because of §203 A(a)(2),

...then the adviser may not register under the Advisers Act if:

- The adviser is required to register as an adviser in the state in which it has its principal place of business, and
- The adviser would be subject to examination as an investment adviser in such state, and
- The adviser has assets under the management of \$25-\$100 million

Investment Advisers with Less than \$100 Million Under Management

- Intent to focus SEC's adviser oversight to larger advisers which present more systemic risk
 - Estimate will result in 40% of advisers (about 4,300) currently federally registered will have to register with one or more states
 - 5% of advisers currently manage about 90% of assets under management
- NASAA believes states are better equipped

- Do states have capabilities?
- Multiple state registration
 - §222(d) of the Advisers Act not changed
 - state may not regulate (other than anti-fraud) adviser with no place of business in a state and fewer than 6 clients in the state in the last 12 months
 - Variances in application requirements
 - Complicates compliance
- Implementation: switch from federal to state registration

Poll Question #5

Q: Do you anticipate needing to switch registration from federal to one or more states?

- Yes
- No

Performance Fees

- Prior to the Dodd-Frank Act, Rule 205-3(d) under the Advisers Act exempted from the §205(b) prohibition on receiving performance fees from clients accounts with “qualified clients,” defined as:
 - Clients who at the time of entering into the advisory contract had \$750,000 under management with the adviser,
 - A person or company that either has more than \$1.5MM net worth or is a “qualified purchaser” under the 1940 Act, or

- Clients who at the time of entering into the advisory contract was:
 - An officer/director/trustee/general partner of the investment adviser, or
 - Advisory employee who has provided advisory services for at least a year
 - The Dodd-Frank Act amends §205(e) of the Advisers Act to provide that whenever the SEC adopts an exemptive provision based upon a dollar amount, such as Rule 205-3(d), the SEC must, by order, adjust such dollar amount for inflation by July 21, 2011 and every five years thereafter
 - The result should be to increase the \$750,000 and/or the \$1.5MM net worth thresholds under Rule 205-3(d)

Other Dodd-Frank Bill Changes

- §405: Amends §201(c) of the Advisers Act to allow the SEC to require disclose client information “for purposes of assessment of potential systemic risk” (in addition to where needed for enforcement)
- §911: Provides authority for Investor Advisory Committee

§913:

- Requires studies which could impact advisers who provide investment advice to “retail customers”
- Permits SEC to adopt rule which imposes same fiduciary standard on brokers and advisers (move from state to federal)
- Requires disclosure of conflicts of interest and requires customer consent to transactions
- Requires SEC to adopt rules and enhance disclosure requirements restricting conflicts and advisers’ compensation

- §921: Amends §205 of Advisers Act to grant SEC authority to restrict the use of mandatory arbitration by advisers and brokers
- §922: Adds new §21F to the Securities Exchange Act of 1934 providing a reward of 10-30% of monetary sanctions to whistleblowers
- §929N: Amends §209 of the Advisers Act to significantly expand antifraud liability from primary registered actors to anyone who knowingly or recklessly aids or abets violation of the securities laws
- §956: Authorizes “appropriate federal regulators” to require the increased disclosure of or restrict the incentive compensation of investment adviser officers, directors and principal shareholders

Title IX of the Dodd-Frank Act

- Expands the SEC's enforcement powers and remedies, including more subpoena authority, more flexibility in civil actions, additional extraterritorial jurisdiction, and more flexibility respecting collateral bars
- Requires studies regarding enhanced examinations and enforcement resources, the financial literacy of investors, mutual fund advertising, and the improvement of investor access to advisers' and brokers' registration information

Poll Question #6

Q: Do you anticipate material differences in your compliance program as a result of the Dodd-Frank Act?

- Yes
- Maybe
- No

Questions and Answers

Thank you.

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