Orrick Alert

Final Regulations Affecting Private Fund Advisers Adopted under the Dodd-Frank Act

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[In development]

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I. INTRODUCTION

On June 22, 2011, the Securities and Exchange Commission (the "SEC") adopted final rules and rule amendments implementing the provisions of Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") through the issuance of two Releases. Release IA-3222 (the "Exemptions Release") defines terms and addresses certain issues with respect to the new exemptions from registration provided to investment advisers. Release IA-3221 (the "Implementing Release" and, together with the Exemptions Release, the "Releases") implements companion amendments to the Investment Advisers Act of 1940 (the "Advisers Act").[1]

The exemption provided by Section 203(b)(3) of the Advisers Act[2] (the "Private Adviser Exemption"), on which many advisers to "Private Funds"[3] have relied, was repealed by the Dodd-Frank Act, effective July 21, 2011. As anticipated, the SEC granted relief to such advisers by providing, pursuant to new subsection (e) of Rule 203-1, that such an adviser is "exempt from registration with the [SEC] as an investment adviser until March 30, 2012," provided that such adviser satisfies conditions which closely follow the requirements of the Private Adviser Exemption[4]. This Client Alert provides an overview of how the new exemptions will be interpreted under the Exemptions Release and implemented under the Implementing Release.

II. THE EXEMPTIONS RELEASE

The Dodd-Frank Act repealed the Private Adviser Exemption and provides new exemptions from registration to three classes of investment advisers:

(i) advisers "solely to 1 or more venture capital funds" (each, a "Venture Capital Fund Adviser");

(ii) advisers that act "solely as an adviser to private funds and has assets under management in the United States of less than $150,000,000" (each, a "Private Fund Adviser"); and

(iii) advisers that:

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[1] On June 22, 2011, the SEC also adopted Rule 202(a)(11)(G)-1 to implement the exemption from the definition of "investment adviser" set forth in Section 202(a)(11)(G) of the Advisers Act for a "family office, as defined by rule, regulation or order of the [SEC] . . . ." A discussion of the definition of "family office" and the operation of Rule 202(a)(11)(G)-1 is beyond the scope of this Client Alert. *See* Release IA-3220, adopted June 22, 2011.

[2] Section 203(b)(3) of the Advisers Act in its present form exempts from registration an adviser who, during the course of the preceding 12 months, has had fewer than 15 clients and neither holds himself out generally to the public as an investment adviser nor acts as an investment adviser to any investment company registered under the Investment Company Act of 1940 or a "business development company," as defined by the Investment Company Act of 1940.

[3] New Section 202(a)(29) of the Advisers Act defines the term "private fund" to mean "an issuer that would be an investment company, as defined in section 3 of the Investment Company Act of 1940 . . . but for section 3(c)(1) or 3(c)(7) of that Act." Section 203(b)(3) has been relied upon advisers without regard to where they have maintained their principle office and place of business, provided that they would otherwise be subject to the Advisers Act.

[4] It is uncertain what effect the extension of the registration deadline by the SEC will have on counterparties to agreements with advisers in instances in which advisers that have relied upon the Private Adviser Exemption have made compliance representations to the effect that they are in material compliance with all applicable laws, rules and regulations.

(A) [have] no place of business in the United States . . .

(B) [have], in total, fewer than 15 clients and investors in the United States in private funds advised by the investment adviser . . .

(C) [have] aggregate assets under management attributable to clients in the United States and investors in the United States in private funds advised by the investment adviser of less than $25,000,000 . . . and

(D) neither (i) [hold themselves] out generally to the public in the United States as an investment adviser; nor (ii) [act] as – (I) an investment adviser to any [registered investment company]; or (II) a [business development company] (each, a "Foreign Private Adviser").

The Exemptions Release sets forth three new rules under the Advisers Act that implement these exemptions: Rule 203(l)-1, Rule 203(m)-1 and Rule 202(a)(30)-1, respectively, discussed in detail below. Four overriding considerations should be noted. First, an adviser that qualifies for any of the exemptions may nevertheless elect to register with the SEC, if otherwise qualified to do so.[5] Second, Venture Capital Fund Advisers and Private Fund Advisers will be required to maintain records, file an amended version of Form ADV, and be subject to examination by the SEC. (For this reason, these advisers are, collectively, referred to in the Releases and herein as "Exempt Reporting Advisers.") Third, the Instructions for amended Form ADV, Part 1A, sets forth a new methodology for determining assets under management ("AUM") for purposes of the new rules. Under the new methodology, an adviser must include, among other things, assets managed for family members, proprietary assets, assets managed without receiving compensation, and assets of non-U.S. clients.[6] Fourth, in response to industry concerns, the SEC stated that: "[n]othing in the rules we are today adopting in [the Exemptions] Release is intended to withdraw any prior statement of the [SEC] or the views of the staff as expressed in the *Unibanco* letters."[7]

A. Venture Capital Fund Adviser Exemption

1. Overview

Section 203(l) of the Advisers Act exempts Venture Capital Fund Advisers from registration. Rule 203(l)-1, generally, defines a "Venture Capital Fund" as any Private Fund that:

(1) Represents to investors and potential investors that it pursues a venture capital strategy;

(2) Immediately after the acquisition of any asset . . . holds no more than 20 percent of the amount of the fund's aggregate capital contributions and uncalled committed capital in assets (other than short-term holdings) that are not qualifying investments . . .;

(3) Does not borrow or otherwise incur leverage, other than limited short-term borrowing, in excess of 15 percent of the private fund's aggregate capital contributions and uncalled committed capital . . .;

[5] Such an adviser might choose to register with the SEC if it determines that the regulatory burden of being registered with the SEC would be less than the regulatory burden of being subject to registration and regulation by one or more states.

[6] AUM calculated pursuant to this standard is referred to in the Releases as "regulatory assets under management." *See* amended Form ADV, Instructions for Part1A, instr. 5.b.

[7] The SEC characterized these letters as providing "assurances that it would not recommend enforcement action of the substantive provisions of the Advisers Act with respect to a non-U.S. adviser's relationships with its non-U.S. clients [or] if a non-U.S. advisory affiliate of a registered adviser, often termed a 'participating affiliate,' shares personnel with, and provides certain services through, the registered adviser affiliate, without such affiliate registering under the Advisers Act." *See* Exemptions Release, Section. II.D.

(4) Only issues securities the terms of which do not provide a holder with any right, except in extraordinary circumstances, to withdraw, redeem or require the repurchase of such securities . . . ; and

(5) Is not registered under . . . the Investment Company Act of 1940 . . . and has not elected to be treated as a business development company under [such] Act.[8]

2. Notable Changes from the Proposed Rule

There are several notable differences between Rule 203(l)-1 as adopted and as proposed, the most significant of which is the addition of the 20 percent "basket" for non-qualifying investments (the "Non-Qualifying Basket"). This provision was adopted by the SEC as a means to address several legitimate concerns presented by the proposed version of Rule 203(l)-1.

A primary concern was that without a basket exception a Venture Capital Fund Adviser could inadvertently lose its exemption because of the detailed, strict requirements a Venture Capital Fund must satisfy. For example, under Rule 203(1)-l, as proposed, Venture Capital Funds could own *only* equity securities that were issued by "Qualified Portfolio Companies," eighty percent of which was required to be acquired directly from such companies, or cash, "cash equivalents"[9], and U.S. Treasuries with a remaining maturity of 60 days or less.

Another concern was that without a basket exception, and an expansion of the assets a Venture Capital Fund would be permitted to own, a Venture Capital Fund would not be able to participate in the reorganization of the capital structure of a portfolio company and acquire securities in connection with the acquisition or merger of a Qualifying Portfolio Company by another company. Rule 203(l)-1, as adopted, in addition to creating the Non-Qualifying Basket, addressed this concern by expanding the scope of permissible investments by a Venture Capital Fund and creating the term "Qualifying Investment" to read in its entirety as follows:

(i) An equity security issued by a qualifying portfolio company that has been acquired directly by the private fund from the qualifying portfolio company;

(ii) Any equity security issued by a qualifying portfolio company in exchange for an equity security issued by the qualifying portfolio company [described in clause (i)]; or

(iii) Any equity security issued by a company of which a qualified portfolio company is a majority-owned subsidiary as defined in section 2(a)(24) of the [Investment Company Act of 1940], or a predecessor, and is acquired by the private fund in exchange for an *equity* security described in [clauses (i) or (ii)].

Rule 203(l)-1 also created the term "Short-Term Holdings" to refer to shares of registered money market funds that are regulated under Rule 2a-7 of the Investment Company Act of 1940 (the "Company Act"), in addition to cash, cash equivalents and U.S. Treasuries with a maturity of 60 days or less, that are excluded from the calculation of the amount of assets held in the Non-Qualifying Basket. Investments held in longer term or higher yielding debt must fit within the Non-Qualifying Basket.

The final version of Rule 203(l)-1 also eliminated from the definition of Qualifying Portfolio Company the element that would have prohibited a Qualifying Portfolio Company from "redeem[ing], exchang[ing] or repurchase[ing] any securities of the company, or distribut[ing] to pre-existing security holders cash or other company assets, directly or indirectly, in connection with the [Private Fund]'s investment in such company."[10] The Exemptions Release states that, "because the [Non-Qualifying Basket] does not exclude secondary market transactions (or other buyouts of existing

[8] The complete text of Rule 203(l)-1 is attached hereto as Appendix A.

[9] The term "cash equivalents" is defined in Rule 2a51-1(b)(7)(i) under the Investment Company Act of 1940.

[10] Proposed Rule 203(l)-1(c)(4)(iii).

security holders), it would be inconsistent to define a [Venture Capital Fund] as a fund that does not participate in a buyout."[11]

In addition, Rule 203(l)-1 eliminated the managerial assistance requirement from the proposed definition of Venture Capital Fund[12]. Commenters persuaded the SEC that the managerial assistance criterion is not a unique characteristic of the relationship between Venture Capital Fund Advisers and portfolio companies, would be difficult to apply, and would be unnecessarily prescriptive.

The final notable distinction between the final and proposed versions of Rule 203(l)-1 is the modification of the leverage criterion of the definition of Qualifying Portfolio Company. In addition to the requirement that a Qualifying Portfolio Company not borrow or issue debt obligations in connection with an investment in the company, the final rule added the requirement that the company not distribute the proceeds of such borrowing or issuance to the Venture Capital Fund in exchange for its investment. In this context, it should be noted that under Rule 203(l)-1 a Venture Capital Fund is able to provide debt financing to a Qualifying Portfolio Company, provided that the financing meets the definition of "equity security" under Section 3(a)(11) of the Securities Exchange Act of 1934 (the "Exchange Act") or is part of the Non-Qualifying Basket.[13]

3. Interpretative Guidance

The Exemptions Release provides the following helpful explanatory comments and interpretative guidance regarding the exemption for Venture Capital Fund Advisers:

(a) In formulating the definition of "Venture Capital Fund," the SEC considered, but did not adopt, the State of California's definition of "Venture Capital Operating Company."[14] The SEC concluded that the California definition is overly broad and would exempt advisers to various types of private equity and other Private Funds that the Dodd-Frank Act did not contemplate would be exempted from registration.

(b) The definition of Qualifying Portfolio Company is not limited to companies that are, and remain, non-reporting companies under the Exchange Act. The definition, as adopted, focuses upon the status of the company at the time of a Venture Capital Fund investment. A Qualifying Investment will not lose its status as such if it becomes a reporting company.

(c) A Venture Capital Fund may use a wholly-owned intermediate holding company formed solely for *bona fide* tax, legal, or regulatory reasons to hold its investment in a Qualifying Portfolio Company.

(d) The "15 percent permissible leverage limit" is restricted to borrowings, guarantees, and other indebtedness with non-renewable terms of no longer than 120 days. This 120-day term limit does not apply, however,

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[11] Exemptions Release, Section II.A.3.b.

[12] As proposed, the definition of Venture Capital Fund required that the fund: "(i) Has an arrangement whereby the fund or the investment adviser offers to provide, and if accepted so provide, significant guidance and counsel concerning the management, operations or business objectives and policies of the qualifying portfolio company; or (ii) Controls the qualifying portfolio company . . . ."

[13] Exemptions Release, Section II.A.3.b.

[14] Rule 260.204.9(b)(3) of the California Cod of Regulations provides that: "An entity is a 'venture capital company' if, on at least one occasion during the annual period commencing with the date of its initial capitalization, and on a least one occasion during each annual period thereafter, at least fifty percent (50%) of its assets (other than short-term investments pending long-term commitment of distribution to investors), valued at cost, are venture capital investments, defined in subsection (b)(4) or derivative investments described in subsection (b)(5)."; *see also* CAL. CODE REGS. tit. 10, §260.204.9(b)(4) (2002) ("A 'venture capital investment' is an acquisition of securities in an operating company as to which the investment adviser, the entity advised by the investment adviser, or an affiliated person of either has or obtains management rights as defined in subsection (b)(6).").

to any guarantee made by a Venture Capital Fund of the obligations of a Qualifying Portfolio Company up to the value of the Venture Capital Fund investment in such company.

(e) The "represents itself as pursuing a venture capital strategy" element of the definition of Venture Capital Fund prohibits an adviser to classify a hedge fund, multi-strategy fund or other type of fund as a "Venture Capital Fund" because at a point in time such fund might otherwise satisfy all of the requirements of a Venture Capital Fund. Moreover, a Venture Capital Fund Adviser cannot include the performance of a Venture Capital Fund in a hedge fund database or index.[15]

(f) "Non-U.S. advisers[16]" may not disregard their non-U.S. activities when assessing their ability to qualify as a Venture Capital Fund Adviser[17]. No adviser may rely upon this exemption unless it solely advises Venture Capital Funds.

B. Private Fund Adviser Exemption

1. Overview

Section 203(m) of the Advisers Act exempts Private Fund Advisers from registration. Rule 203(m)-1 implements this exemption by defining various terms, such as "assets under management" and "principal office and place of business," and delineating the requirements that must be satisfied by U.S. and non-U.S.-based advisers seeking to rely on this exemption.[18] The SEC adopted Rule 203(m)-1 substantially as proposed.

Under Rule 203(m)-1, an adviser will be required to employ the new methodology for calculating AUM set forth in Instruction 5.b. of the Instructions for Part 1A of amended Form ADV. Under this new methodology an adviser must include in its calculation of AUM, among other things, assets that it manages without compensation.[19] In addition, an adviser cannot exclude the proportion of its AUM purchased with borrowed funds. These changes will cause many advisers who would otherwise qualify as Private Fund Advisers to exceed the $150 million limit requirement.

2. Notable Changes from the Proposed Rule

The final Rule incorporates several substantive differences to address concerns relating to the fluctuations that could occur in the amount of AUM of an adviser due to market conditions or other factors. First, Private Fund Advisers will not be required to calculate AUM more frequently than annually, rather than quarterly. Second, if an adviser reports in its annual updating amendment to its Form ADV that it has more than $150 million of AUM, such adviser will have a transition period of up to 90 days in which to apply for registration with the SEC. During this transition period, such adviser may continue to rely upon the exemption available to Private Fund Advisers.

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[15] Exemptions Release, Section II.A.7.

[16] For this purpose, a "non-U.S. adviser" is an adviser which does not have a principal office and place of business in the United States. Exemptions Release, Section II.A.9.

[17] By contrast, a non-U.S. adviser is not required to take into account its non-U.S. activities for purposes of determining its qualification as a Private Fund Adviser. *See* Rule 203(m)-1(b)(2); Exemptions Release, Section II.B.3.

[18] The complete text of Rule 203(m)-1 is attached hereto as Appendix B.

[19] In the Exemptions Release, the SEC states that: "[a]lthough a person is not an 'investment adviser' for purposes of the Advisers Act unless it receives compensation for providing advice to others, once a person meets that definition (by receiving compensation from *any* client to which it provides advice), the person is an adviser, and the Advisers Act applies to the relationship between the adviser and any of its clients (whether or not the adviser receives compensation from them). *See* Exemptions Release, Section II.B.2.a.

3. Interpretive Guidance

The Exemptions Release provides the following helpful explanatory comments and interpretative guidance regarding the exemption for Private Fund Advisers:

(a) A non-U.S. adviser[20] can qualify as a Private Fund Adviser regardless of the size or nature of its activities outside of the United States, provided that each of its clients that is a "United States person[21]" is a "Qualifying Private Fund[22]" (a term that includes any fund that qualifies for an exclusion from the definition of "investment company" in addition to those exempted under Section 3(c)(1) or 3(c)(7) of the Company Act). For purposes of the exemption, non-U.S. advisers will be considered to have a place of business in the United States, and hence be managing assets that count towards the $150 million limit, if the adviser "regularly provides advisory services, solicits, meets with, or otherwise communicates with clients" in the United States.[23]

While noting that the foregoing determinations are inherently fact sensitive, the SEC stated that it would not consider providing research or conducting due diligence in the United States to cause an adviser to have "assets under management in the United States," if an adviser outside the United States "makes independent investment decisions and implements those decisions."[24]

(b) Rule 203(m)-1 contains a special provision that "requires an adviser relying upon the exemption to treat a discretionary or other fiduciary account as a United States person if the account is held for the benefit of a United States person by a non-U.S. fiduciary that is a [R]elated [P]erson[25] of the adviser." As explained by the SEC, the purpose of this provision is to prevent advisers from establishing discretionary accounts for the benefit of U.S. clients with an offshore affiliate and then delegating the management of such account to the U.S. adviser in order to exclude the value of the account for purposes of determining whether the $150 million AUM limit of a Private Fund Adviser has been satisfied.

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[20] Rule 203(m)-1 provides that for purposes of new Section 203(m), a "United States Investment Adviser" means "an investment adviser with its principal office and place of business in the United States," and a "non-United States Investment Adviser" means "an investment adviser with its principal office and place of business outside the United States."

[21] Rule 203(m)-1(d)(8) defines a "United States person," generally to mean any person who is a "U.S. person," as defined in Regulation S under the Securities Act of 1933.

[22] Rule 203(m)-1(d)(5) defines a "Qualifying Private Fund" to mean: "a private fund that is not registered under [the Company Act] and has not elected to be treated as a [BDC]."

[23] *See* Exemptions Release Section II.B.3; *see also* Rule 203(m)-1(d)(3).

[24] *Id.*

[25] The term "Related Person" is defined as, "Any *advisory affiliate* and any *person* that is under common *control* with your firm." *See* Rule 206(4)-2(d)(7) under the Advisers Act and amended Form ADV, Glossary, def. 37; *see also* amended Form ADV Glossary, def. 1 ("Affiliate: Your advisory affiliates are (1) all of your officers, partners, or directors (or any *person*) performing similar functions); (2) all *persons* directly or indirectly *controlling* or *controlled* by you; and (3) all of your current *employees* (other than *employees* performing only clerical, administrative, support or similar functions)"); amended Form ADV Glossary, def. 7 ("Control: The power, directly or indirectly, to direct the management or policies of a *person*, whether through ownership of securities, by contract, or otherwise."); amended Form ADV Glossary, def. 33 ("Person: A natural person (an individual) or a company. A company includes any partnership, corporation, trust, limited liability company, limited liability partnership, sole proprietorship, or other organization.").

(c) Non-U.S. advisers that rely on the exemption available to a Private Fund Adviser will remain subject to the antifraud provisions of the Advisers Act, the reporting obligations of an Exempt Reporting Adviser, and the oversight of the SEC. Unlike non-U.S. advisers, a U.S. adviser with assets managed at its non-U.S. offices will not be able to exclude such assets for the purposes of this exemption.

(d) An adviser cannot rely upon the exemption available to a Private Fund Adviser with respect to a portion of its business that qualifies under that exemption and rely upon another exemption with respect to another portion of its business.

C. Foreign Private Adviser Exemption

1. Overview

Section 203(b)(3) of the Advisers Act exempts Foreign Private Advisers from registration. Unlike Venture Capital Fund Advisers and Private Fund Advisers, Foreign Private Advisers are not be subject to the reporting or recordkeeping provisions of the Advisers Act or subject to SEC examination.

The final version of Rule 203(a)(30)-1, which defines the terms "client," "investor," "in the United States," "place of business," and "assets under management," was adopted substantially as proposed.[26]

2. Notable Changes from the Proposed Rule

Beneficial owners that are "Knowledgeable Employees," as defined in Rule 3c-5 under the Company Act, are no longer included in the definition of "investor." The SEC had proposed to include Knowledgeable Employees in this definition because of a concern that "excluding [K]nowledgeable [E]mployees from the definition would allow certain advisers to avoid registration" by relying on the exemption available to Foreign Private Advisers.

A revision was made to the note included in Rule 202(a)(30)-1 to clarify that: "A person who is in the United States may be treated as not being in the United States if such person was not in the United States at the time of becoming a client or, in the case of an investor in a private fund, *each time* the investor acquires securities issued by the fund." (emphasis added.)

3. Interpretive Guidance

The Exemptions Release provides the following helpful explanatory comments and interpretative guidance regarding the exemption for Foreign Private Advisers:

(a) Rule 203(a)(30)-1 specifies that an adviser who provides advice to a legal organization is not required to count the owners of such legal organization as "clients" solely because the adviser, on behalf of the such legal organization, offers, promotes, or sells interests in such legal organization to the owners, or reports periodically to the owners as a group solely with respect to the performance of or plans for the legal organization's assets or similar matters.[27]

(b) The SEC indicated that there is no presumption that a non-U.S. adviser has a place of business in the United States solely because it is affiliated with a U.S. adviser. "A non-U.S. adviser might be deemed to have a place of business in the United States, however, if the non-U.S. adviser's personnel regularly conduct activities at an affiliate's place of business in the United States."[28]

(c) The SEC indicated that "if an adviser reasonably believes that an investor is not 'in the United States,' the adviser may treat the investor as not being 'in the United States.'" However, although these terms are

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[26] The complete text of Rule 202(a)(30)-1 is attached hereto as Appendix C.

[27] *See* Rule 202(a)(30)-1(b)(2).

[28] *See* Exemptions Release, Section II.C.4.

generally defined by incorporating the definition of "United States person" and "United States" under Regulation S, a "discretionary account or similar account that is held for the benefit of a United States person by a dealer or other professional fiduciary is a United States person if the dealer or professional fiduciary is a related person of the investment adviser . . . and is not organized, incorporated, or (if an individual) resident in the United States."[29]

III. THE IMPLEMENTING RELEASE

In addition to repealing the Private Adviser Exemption and creating the three narrow exemptions discussed above, Title IV of the Dodd-Frank Act requires: (i) new recordkeeping and reporting requirements to be imposed on both registered advisers and Exempt Reporting Advisers; and (ii) the reallocation of the primary regulatory responsibility for the oversight of investment advisers with $25 million to $100 million of AUM ("Mid-Size Advisers") from the SEC to applicable state authorities.

A. Reporting and Recordkeeping

1. Overview

As amended, Section 204 of the Advisers Act provides the SEC with authority to require registered advisers to maintain such records and file such reports with the SEC regarding the Private Funds advised by them as the SEC "by rule, may prescribe as necessary and appropriate in the public interest and for the protection of investors, or the assessment of systemic risk." Also, under new Sections 203(l) and 203(m) of the Advisers Act, Exempt Reporting Advisers, *i.e.,* Venture Capital Fund Advisers and Private Fund Advisers, respectively, must "maintain such records and provide to the [SEC] such . . . reports as the [SEC] determines necessary or appropriate in the public interest or the protection of investors."[30]

Under Section 204(b)(3) of the Advisers Act, the records required to be maintained by a registered adviser and subject to inspection by the SEC include for each Private Fund advised by the adviser a description of:

(A) [AUM] and use of leverage, including off-balance sheet leverage;
(B) counterparty credit risk exposure;
(C) trading and investment positions;
(D) valuation policies and practices;
(E) types of assets held;
(F) side arrangements or side letters;
(G) trading practices; and
(H) such other information as the [SEC] (in consultation with the [Financial Stability Oversight Council]) determines is necessary and appropriate in the public interest and for protection of investors or for the assessment of systemic risk . . . .

New Rule 204-4 under the Advisers Act requires Exempt Reporting Advisers to complete and file reports on Form ADV with respect to such Items as are specified in the Instructions thereto. These Items are described in the Section III.A.5., below.

2. Amendments to Form ADV

The SEC has adopted several amendments to Form ADV to implement the new requirements for registered advisers and Exempt Reporting Advisers. Amended Form ADV requires an adviser to provide the SEC with additional

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[29] *See* Rule 203(m)-1(d)(8) and Exemption Release, Section II.C.3.

[30] Section 404 of the Dodd-Frank Act.

information concerning three general areas of its operations: (i) the Private Funds it advises; (ii) data regarding its advisory business, including the types of its clients, its employees, its advisory activities, and its business practices that may present significant conflicts of interest; and (iii) its non-advisory activities and its financial industry affiliations.

(a) Private Fund Information

(i) Item 7.B.: Private Fund Reporting

Amendments to Item 7.B. of Part 1A and Schedule D of Form ADV expand the information an adviser must report to the SEC regarding each Private Fund it advises, other than a fund advised by a Related Person: (i) the jurisdiction under which the fund is organized; (ii) other persons involved in the management of the fund; (iii) whether the fund is part of a master-feeder arrangement or is a fund of funds; (iv) the regulatory status of the fund; (v) whether the fund is subject to the jurisdiction of a non-U.S. regulator; (vi) whether the fund relies upon an exemption from registration under the Securities Act of 1933 (the "Securities Act"); (vi) the type of investment strategy the fund employs; (vii) whether the fund invests in securities of registered investment companies; and (viii) the gross asset value of the fund.[31]

To avoid multiple reporting for each Private Fund: (i) only one adviser must report the full scope of information for each Private Fund, even if there are other advisers to the same fund, such as sub-advisers[32]; (ii) an adviser managing a master-feeder arrangement may complete a single Section 7.B.(1) for the master-fund and all of the feeder funds, if these funds would otherwise report substantially identical information[33]; and (iii) an adviser with a principal office and place of business outside of the United States is not required to complete Schedule D for any Private Fund that during its last fiscal year was not a "United States person"[34], was not offered in the United States, and was not beneficially owned by any United States person.[35]

(b) Advisory Business Data

(i) Item 1.O.: Reporting $1 Billion in Assets

New Item 1.O. requires an adviser to indicate whether it has "$1 billion or more in total assets shown on the [its] balance sheet as of the last day of the most recent fiscal year."[36] (This calculation is not based on AUM.) This information will be used to identify advisers possibly subject to SEC rules, jointly adopted with other federal agencies, pursuant to Section 956 of the Dodd-Frank Act[37] that

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[31] *See generally* amended Form ADV, Part 1A, Section 7.B.(1)A. of Schedule D.

[32] Implementing Release, Section II.C.1.

[33] *See* amended Form ADV, Instructions for Part 1A, instr. 6.d.

[34] The term "United States person" is defined as "any person that is a U.S. person as defined under [Regulation S], except that any discretionary account or similar account that is held for the benefit of a United States person by a dealer or other professional fiduciary is a United States person if the dealer or professional fiduciary is a related person of the investment adviser relying on this section and is not organized, incorporated, or (if an individual) resident in the United States." *See* Rule 203(m)-1(d)(8).

[35] *See* amended Form ADV, Instructions for Part 1A, instr. 6.a.

[36] *See* amended Form ADV, Part 1A, Item 1.O.; amended Form ADV, Instructions to Part 1A, instr. 1.b.

[37] These proposed rules, set forth in Release No. 34-64140, dated March 31, 2011, are scheduled to be adopted between August and December 2011. Implementing Dodd-Frank Wall Street Reform and Consumer Protection Act – Upcoming Activity, SECURITIES AND EXCHANGE COMMISSION, http://www.sec.gov/spotlight/dodd-frank/dfactivity-upcoming.shtml#05-07-11.

address certain excessive incentive-based compensation arrangements. The final amended Form ADV and the proposed rule under Section 956 of the Dodd-Frank Act leave open to interpretation questions as to how certain assets, such as investment management agreements, should be valued for purposes of this calculation.

(ii) Item 5: Employees, Clients and Advisory Activities

Under amendments to Item 5 of Part 1A of Form ADV, an adviser is required to report: (i) a numerical approximation instead of a range of how many of its employees are registered as investment adviser representatives or are licensed insurance agents[38]; (ii) the number and types of clients it serves[39]; (iii) the types of advisory services it provides, including portfolio management for pooled investment vehicles other than registered investment companies[40]; and (iv) whether it provides investment advice only with respect to "limited types of investments."[41]

(iii) Item 8: Participation in Client Transactions

Three amendments to Item 8 of Form ADV require an adviser to report information regarding its transactions with its clients. First, if an adviser indicates on its Form ADV that it has discretionary authority to determine the brokers or dealers to execute client transactions or that it recommends brokers or dealers to clients, the adviser must report whether any of such brokers or dealers are Related Persons of the adviser.[42] Second, if an adviser indicates on its Form ADV that it receives "soft dollar" benefits, it must report whether all such benefits qualify for the safe harbor under Section 28(e) of the Exchange Act.[43] Finally, an adviser must report whether it or its Related Persons receive direct or indirect compensation for client referrals.[44]

(iv) Item 9: Custody

An amendment to the scope of Item 9 requires an adviser to disclose the total number of persons that act as qualified custodians for advisory clients in connection with the services provided by the adviser in addition to the disclosure of information regarding an adviser or a Related Person acting as a custodian.[45]

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[38] The numerical approximation requirement applies to existing questions of Item 5 as well. *See* amended Form ADV, Part 1A, Item 5.B.

[39] *See* amended Form ADV, Part 1A, Item 5.C. and 5.D.

[40] *See* amended Form ADV, Part 1A, Item 5.G.

[41] "Limited types of investments" is not defined in the Implementing Release, amended Form ADV, Part 1A, Item 5.J, *or* amended Form ADV, Part 2A, Item 4.B.

[42] *See* amended Form ADV, Part 1A, Items 8.C.3., 8.D., 8.E., and 8.F.

[43] *See* amended Form ADV, Part 1A, Item 8.G.2.

[44] *See* amended Form ADV, Part 1A, Items 8.H. and 8.I.

[45] *See* amended Form ADV, Part 1A, Item 9.F.; *see also Custody of Funds or Securities of Clients by Investment Advisers*, Investment Advisers Act Release No. 2968 (Dec. 30, 2009).

(c) Non-Advisory Activities and Financial Industry Affiliations

(i) Items 6 and 7: Other Business Activities and Financial Industry Affiliations

Amendments to Items 6 and 7 of Part 1A, and their corresponding sections in Schedule D, require an adviser to report: (i) whether the adviser or a Related Person is a trust company, registered municipal adviser, registered security-based swap dealer, or major security-based swap participant, in addition to those financial services businesses previously listed[46]**;** (ii) whether the adviser is engaged in another financial service under a different name[47]; (iii) whether the adviser is primarily engaged in another business and, if so, to provide a description of such activities[48]; (iv) whether a Related Person of the adviser is an accountant, accounting firm, lawyer, or law firm; (v) identifying information for any type of Related Person listed in Item 7.A., including additional details regarding the relationship between the adviser and the Related Person[49]; and (vi) whether a Related Person of the adviser is a sponsor, general partner, or managing member of a pooled investment vehicle.[50]

3. Notable Changes from the Proposed Amended Form ADV

In response to comments received, the SEC made several significant changes to the proposed amendments to Form ADV. Most important, the SEC did not adopt certain proposed amendments to Part A of Section 7.B.(1) of Schedule D that would have required the disclosure of certain competitively sensitive information of a Private Fund, *i.e.*: (i) its net assets, which would have revealed its leverage strategy; (ii) its assets and liabilities by class and categorization in the fair value hierarchy established under GAAP, which could have revealed, for example, the value of private companies held by a Venture Capital Fund that makes a limited number of investments; and (iii) the percentage of the Private Fund owned by certain types of beneficial owners, which would have enabled the reverse engineering of investor identities.

The Implementing Release narrows the proposed definition of "hedge fund" used in the Instructions to Part 1A of amended Form ADV and used for classification purposes by Part A of Section 7.B.(1) of Schedule D.[51] First, securitized asset funds are explicitly excluded from the definition of "hedge fund." Second, the Implementing Release amends the definition of "hedge fund" to describe more accurately the type of incentive fees received by hedge funds that distinguish hedge funds from other types of Private Funds.[52] Finally, the definition includes an exception for a "*de*

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[46] *See* amended Form ADV, Part 1A, Items 6.A. and 7.A.

[47] *See* amended Form ADV, Part 1A, Section 6.A. of Schedule D.

[48] *See* amended Form ADV, Part 1A, Section 6.B.(2) and 6.B.(3) of Schedule D.

[49] *See* amended Form ADV, Part 1A, Section 7.A. of Schedule D. Such additional details include: whether the Related Person is registered with a non-U.S. financial regulatory authority, whether the Related Person and the adviser share employees or the same physical location, and, if the adviser is reporting a Related Person as an investment adviser, whether the Related Person is exempt from registration.

[50] *See* amended Form ADV, Part 1A, Item 7.A.

[51] *See* amended Form ADV, Instructions to Part 1A, Section 6(e); *see also* amended Form ADV, Part 1A, Section 7.B.(1)A of Schedule D, question 10. A Private Fund may be classified as a "hedge fund," a "liquidity fund," a "private equity fund," a "real estate fund," a "securitized asset fund," a "venture capital fund," or "other." The term "private fund" as used in amended Form ADV has the same meaning as the term used in Section 202(a)(29) under the Advisers Act. *See* amended Form ADV, Glossary of Terms. "Venture capital fund" as used in amended Form ADV uses the definition set forth in Rule 203(l)-1 under the Advisers Act. *See* amended Form ADV, Instructions for Part 1A.

[52] The definition of "hedge fund" now requires that performance fees or allocations calculated by taking into account unrealized gains must be paid to the adviser of a fund, rather than simply accrued on the financial statements of such fund. In addition,

minimis" amount of short selling so as to avoid the classification of a fund that employs traditional foreign exchange risk and interest rate exposure hedging strategies as a hedge fund.

In addition, Section 7.A. of Schedule D requires an adviser to complete a separate entry for each Related Person the adviser lists in Item 7.A of Part 1A of amended Form ADV. The Implementing Release revises Item 7.A, however, to not require an adviser to complete an additional Section 7.A. of Schedule D for a Related Person if: (i) the adviser has no business dealings with the Related Person in connection with the advisory services it provides to clients; (ii) the adviser does not conduct shared operations with the Related Person; (iii) the adviser does not refer clients or business to the Related Person, and the Related Person does not refer prospective clients or business to the adviser; (iv) the adviser does not share supervised persons or premises with the Related Person; and (v) the adviser has no reason to believe that its relationship with the Related Person otherwise creates a conflict of interest with its clients.[53]

Finally, under the proposed amended Form ADV, an adviser was required to report under Item 5.D. the approximate percentages of its regulatory AUM[54] by client type in broad ranges and an approximate amount of regulatory AUM attributable to each type of client. The Implementing Release modifies Item 5.D. in order that an adviser is only required to provide the approximate percentages of its AUM by client type.

4. Implementation of the New Registration Requirements

Pursuant to new Rule 203-1, an adviser entitled to rely upon the Private Adviser Exemption until July 21, 2011 may delay registering with the SEC until March 30, 2012.[55] The SEC recommended that, as a practical matter, in order to be registered, effective March 30, 2012, an adviser should file its Form ADV with the SEC no later than February 14, 2012.[56]

Also, pursuant to new Rule 203A-5, every investment adviser registered with the SEC on January 1, 2012 must file an amendment to its Form ADV no later than March 30, 2012 and "shall determine its assets under management based on the current market value of the assets as determined within 90 days prior to the date of filing the Form ADV," rather than 30 days, as proposed. Such filing must provide the information required under amended Form ADV.[57]

5. Exempt Reporting Advisers

(a) Reporting and Recordkeeping

New Rule 204-4 requires Exempt Reporting Advisers to submit and periodically update information on an amended version of Form ADV with respect to seven Items: (i) Item 1 (Identifying Information); (ii) Item 2.B. (SEC Reporting by Exempt Reporting Advisers); (iii) Item 3 (Form of Organization); (iv) Item 6 (Other Business Activities); (v) Item 7 (Financial Industry Affiliation and Private Fund Reporting); (vi) Item 10 (Control Persons); and (vii) Item 11 (Disciplinary History). Exempt Reporting Advisers are also required to complete those sections of Schedules A, B, C, and D that correspond to such Items. The content of the

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performance fees and allocations must not account for unrealized gains solely for the purpose of reducing such fees or allocations to reflect net unrealized losses. *See* amended Form ADV, Instructions to Part 1A, Section 6(e)(2)(a).

[53] *See* amended Form ADV, Part 1A, Item 7.A.

[54] *See* supra Part II.B.2.

[55] *See* Rule 203-1(e).

[56] *See* section 203(c)(2) of the Advisers Act; *see also* Implementing Release, Section III.B.2.

[57] *See* Rule 203A-5(b); *see also* Implementing Release, Section II.A.1.

information required to be provided does not differ from that required of registered advisers and the filings will be publicly available on the SEC's website.

(b) SEC Examination

In addition to reporting requirements, Exempt Reporting Advisers are subject to SEC examination. This results from the fact that Section 204(a) of the Advisers Act provides the SEC with the authority to conduct "reasonable periodic, special, or other examinations" of investment advisers unless "specifically exempted from registration pursuant to [S]ection 203(b) of [the Advisers Act]." Venture Capital Fund Advisers and Private Fund Advisers, unlike Foreign Private Advisers, are not within this category.[58] In the exercise of its discretionary authority, the SEC has indicated that Exempt Reporting Advisers will not be subject to routine examinations. Rather, the SEC states in the Implementing Release that it "will conduct cause examinations where there are indications of wrongdoing, *e.g.*, those examinations prompted by tips, complaints, and referrals."[59]

(c) Implementation of the New Reporting Requirements

Exempt Reporting Advisers must file their first reports on Form ADV between January 1 and March 30, 2012 (rather than by August 20, 2011, as proposed), and must update their Form ADV at least annually. Information an Exempt Reporting Adviser provides under Items 1, 3, and 11 must be updated promptly, if such information becomes inaccurate in any way, and information it provides under Item 10 must be updated promptly, if it becomes materially inaccurate. It should be noted that the SEC has announced that it plans to reconsider the disclosure requirements imposed on Exempt Reporting Advisers after reviewing the Form ADV submissions of all such advisers made by March 30, 2012 and will thereafter determine whether the newly adopted requirements are appropriate.[60]

6. Interpretive Guidance

The Implementing Release provides the following helpful explanatory comment and interpretative guidance:

The public disclosure of certain information required by Section 7.B.(1) of Schedule D, *e.g.,* the minimum investment commitment required of an investor and other terms under which an individual may invest in a fund, "would not, in and of itself," jeopardize the reliance of a Private Fund on the non-public offering exemption from Section 5 of the Securities Act provided by Section 4(2) thereof or the safe harbor for offshore offerings provided by Regulation S thereunder.[61]

B. Registration of Mid-Size Advisers

1. Overview

Section 410 of the Dodd-Frank Act generally raised the minimum AUM required in order for an investment adviser to be eligible to register with the SEC from $25 million to $100 million. However, in order to be subject to this new AUM requirement, an adviser is required to be registered as an investment adviser in the state "in which it maintains its principal place of business and, if registered, [to] *be subject to examination as an investment adviser by any such commissioner, agency*

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[58] *See* Implementing Release, at n.188.

[59] *Id.*

[60] SEC Open Meeting, June 22, 2011.

[61] Implementing Release, Section II.C.1

or office . . . ." (emphasis added).[62] As of the date of the Implementing Release, Mid-Size Advisers maintaining their principal place of business in Wyoming, New York or Minnesota will continue to be subject to SEC registration requirements because Wyoming does not regulate investment advisers and New York and Minnesota did not respond to a request by the SEC to advise whether they administer an examination program.[63] The new minimum AUM requirement does not apply to: (i) an adviser to a registered investment company or a BDC; (ii) an adviser that would be required to register with 15 or more states; or (iii) an adviser with a principal office and place of business outside the United States.[64]

2. Transition of Advisers to State Registration

If an adviser is no longer eligible to be registered with the SEC[65], under Rule 203A-5(c)(1) the adviser will have until June 28, 2012 to withdraw its SEC registration and register with the state in which it has its principal office and place of business. A Mid-Size Adviser may register with the SEC until July 21, 2011, when the amendments to Section 203A(a)(2) of the Advisers Act take effect, after which a Mid-Size Adviser will be required to register with its applicable state authority.

3. Addition of "Buffer"

Rule 203A-1, as adopted, provides that a Mid-Size Adviser will remain eligible to maintain its status as an SEC or state registrant if its AUM remains within $10 million of the $100 million statutory threshold. As proposed, Rule 203A-1 did not provide such a buffer. This change was made to address concerns that advisers at or near $100 million of AUM could be required frequently to switch between state and federal registration due to fluctuations in the value of the assets they manage.[66] The SEC also amended Rule 203A-1 to eliminate a similar mechanism that had been provided for advisers with AUM that fluctuates between $25 and $30 million.

IV. CONCLUDING OBSERVATIONS

The adoption by the SEC of the complex final rules and rule amendments set forth in the Exemptions Release and the Implementing Release, arguably, is the most significant regulatory development for advisers to Private Funds since enactment of the Dodd-Frank Act. Nonetheless, the full scope and manner in which this action will impact the private fund management industry and individual advisers will only become known as further regulatory developments unfold during the remainder of 2011 and beyond. Also, it is important to bear in mind that the application of these rules and rule amendments to any particular set of circumstances is highly fact sensitive. Orrick will be closely monitoring regulatory developments and is available to address any questions that arise.

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[62] Section 410 of the Dodd-Frank Act.

[63] *See* Implementing Release, Section II.A.2; Implementing Release, Section II.A.7.b.

[64] Section 203A(a)(2(A) of the Advisers Act.

[65] See discussion in Section III.A.4, above.

[66] *See* Implementing Release, Section II.A.4.

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APPENDIX A

§ 275.203(l)-1 Venture capital fund defined.

(a) *Venture capital fund defined.* For purposes of section 203(l) of the Act (15 U.S.C. 80b-3(l)), a venture capital fund is any private fund that:

(1) Represents to investors and potential investors that it pursues a venture capital strategy;

(2) Immediately after the acquisition of any asset, other than qualifying investments or short-term holdings, holds no more than 20 percent of the amount of the fund's aggregate capital contributions and uncalled committed capital in assets (other than short-term holdings) that are not qualifying investments, valued at cost or fair value, consistently applied by the fund;

(3) Does not borrow, issue debt obligations, provide guarantees or otherwise incur leverage, in excess of 15 percent of the private fund's aggregate capital contributions and uncalled committed capital, and any such borrowing, indebtedness, guarantee or leverage is for a non-renewable term of no longer than 120 calendar days, except that any guarantee by the private fund of a qualifying portfolio company's obligations up to the amount of the value of the private fund's investment in the qualifying portfolio company is not subject to the 120 calendar day limit;

(4) Only issues securities the terms of which do not provide a holder with any right, except in extraordinary circumstances, to withdraw, redeem or require the repurchase of such securities but may entitle holders to receive distributions made to all holders pro rata; and

(5) Is not registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8), and has not elected to be treated as a business development company pursuant to section 54 of that Act (15 U.S.C. 80a-53).

(b) *Certain pre-existing venture capital funds.* For purposes of section 203(l) of the Act (15 U.S.C. 80b-3(l)) and in addition to any venture capital fund as set forth in paragraph (a) of this section, a venture capital fund also includes any private fund that:

(1) Has represented to investors and potential investors at the time of the offering of the private fund's Securities that it pursues a venture capital strategy;

(2) Prior to December 31, 2010, has sold securities to one or more investors that are not related persons, as defined in § 275.206(4)-2(d)(7), of any investment adviser of the private fund; and

(3) Does not sell any securities to (including accepting any committed capital from) any person after July 21, 2011.

(c) *Definitions.* For purposes of this section:

(1) *Committed capital* means any commitment pursuant to which a person is obligated to:

(i) Acquire an interest in the private fund; or

(ii) Make capital contributions to the private fund.

(2) *Equity security* has the same meaning as in section 3(a)(11) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(11)) and § 240.3a11-1 of this chapter.

(3) *Qualifying investment* means:

(i) An equity security issued by a qualifying portfolio company that has been acquired directly by the private fund from the qualifying portfolio company;

(ii) Any equity security issued by a qualifying portfolio company in exchange for an equity security issued by the qualifying portfolio company described in paragraph (c)(3)(i) of this section; or

(iii) Any equity security issued by a company of which a qualifying portfolio company is a majority-owned subsidiary, as defined in section 2(a)(24) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(24)), or a predecessor, and is acquired by the private fund in exchange for an *equity security* described in paragraph (c)(3)(i) or (c)(3)(ii) of this section.

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(4) *Qualifying portfolio company* means any company that:

(i) At the time of any investment by the private fund, is not reporting or foreign traded and does not control, is not controlled by or under common control with another company, directly or indirectly, that is reporting or foreign traded;

(ii) Does not borrow or issue debt obligations in connection with the private fund's investment in such company and distribute to the private fund the proceeds of such borrowing or issuance in exchange for the private fund's investment; and

(iii) Is not an investment company, a private fund, an issuer that would be an investment company but for the exemption provided by § 270.3a-7 of this chapter, or a commodity pool.

(5) *Reporting or foreign traded* means, with respect to a company, being subject to the reporting requirements under section 13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)), or having a security listed or traded on any exchange or organized market operating in a foreign jurisdiction.

(6) *Short-term holdings* means cash and cash equivalents, as defined in § 270.2a51-1(b)(7)(i) of this chapter, U.S. Treasuries with a remaining maturity of 60 days or less, and shares of an open-end management investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8) that is regulated as a money market fund under § 270.2a-7 of this chapter.

Note: For purposes of this section, an investment adviser may treat as a private fund any issuer formed under the laws of a jurisdiction other than the United States that has not offered or sold its securities in the United States or to U.S. persons in a manner inconsistent with being a private fund, provided that the adviser treats the issuer as a private fund under the Act (15 U.S.C. 80b) and the rules thereunder for all purposes.

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APPENDIX B

§ 275.203(m)-1 Private fund adviser exemption.

(a) *United States investment advisers.* For purposes of section 203(m) of the Act (15 U.S.C. 80b-3(m)), an investment adviser with its principal office and place of business in the United States is exempt from the requirement to register under section 203 of the Act if the investment adviser:

(1) Acts solely as an investment adviser to one or more qualifying private funds; and

(2) Manages private fund assets of less than $150 million.

(b) *Non-United States investment advisers.* For purposes of section 203(m) of the Act (15 U.S.C. 80b-3(m)), an investment adviser with its principal office and place of business outside of the United States is exempt from the requirement to register under section 203 of the Act if:

(1) The investment adviser has no client that is a United States person except for one or more qualifying private funds; and

(2) All assets managed by the investment adviser at a place of business in the United States are solely attributable to private fund assets, the total value of which is less than $150 million.

(c) *Frequency of Calculations.* For purposes of this section, calculate private fund assets annually, in accordance with General Instruction 15 to Form ADV (§ 279.1 of this chapter).

(d) *Definitions.* For purposes of this section:

(1) *Assets under management* means the regulatory assets under management as determined under Item 5.F of Form ADV (§ 279.1 of this chapter).

(2) *Place of business* has the same meaning as in § 275.222-1(a).

(3) *Principal office and place of business* of an investment adviser means the executive office of the investment adviser from which the officers, partners, or managers of the investment adviser direct, control, and coordinate the activities of the investment adviser.

(4) *Private fund assets* Means the investment adviser's assets under management attributable to a qualifying private fund.

(5) *Qualifying private fund* means any private fund that is not registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8) and has not elected to be treated as a business development company pursuant to section 54 of that Act (15 U.S.C. 80a-53). For purposes of this section, an investment adviser may treat as a private fund an issuer that qualifies for an exclusion from the definition of an "investment company," as defined in section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3), in addition to those provided by section 3(c)(1) or 3(c)(7) of that Act (15 U.S.C. 80a-3(c)(1) or 15 U.S.C. 80a-3(c)(7)), provided that the investment adviser treats the issuer as a private fund under the Act (15 U.S.C. 80b) and the rules thereunder for all purposes.

(6) *Related person* has the same meaning as in § 275.206(4)-2(d)(7).

(7) *United States* has the same meaning as in § 230.902(l) of this chapter.

(8) *United States person* means any person that is a U.S. person as defined in § 230.902(k) of this chapter, except that any discretionary account or similar account that is held for the benefit of a United States person by a dealer or other professional fiduciary is a United States person if the dealer or professional fiduciary is a related person of the investment adviser relying on this section and is not organized, incorporated, or (if an individual) resident in the United States.

Note to paragraph (d)(8): A client will not be considered a United States person if the client was not a United States person at the time of becoming a client.

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APPENDIX C

§ 275.202(a)(30)-1 Foreign private advisers.

(a) *Client.* You may deem the following to be a single client for purposes of section 202(a)(30) of the Act (15 U.S.C. 80b-2(a)(30)):

(1) A natural person, and:

(i) Any minor child of the natural person;

(ii) Any relative, spouse, spousal equivalent, or relative of the spouse or of the spousal equivalent of the natural person who has the same principal residence;

(iii) All accounts of which the natural person and/or the persons referred to in this paragraph (a)(1) are the only primary beneficiaries; and

(iv) All trusts of which the natural person and/or the persons referred to in this paragraph (a)(1) are the only primary beneficiaries;

(2) (i) A corporation, general partnership, limited partnership, limited liability company, trust (other than a trust referred to in paragraph (a)(1)(iv) of this section), or other legal organization (any of which are referred to hereinafter as a "legal organization") to which you provide investment advice based on its investment objectives rather than the individual investment objectives of its shareholders, partners, limited partners, members, or beneficiaries (any of which are referred to hereinafter as an "owner"); and

(ii) Two or more legal organizations referred to in paragraph (a)(2)(i) of this section that have identical owners.

(b) *Special rules regarding clients.* For purposes of this section:

(1) You must count an owner as a client if you provide investment advisory services to the owner separate and apart from the investment advisory services you provide to the legal organization, provided, however, that the determination that an owner is a client will not affect the applicability of this section with regard to any other owner;

(2) You are not required to count an owner as a client solely because you, on behalf of the legal organization, offer, promote, or sell interests in the legal organization to the owner, or report periodically to the owners as a group solely with respect to the performance of or plans for the legal organization's assets or similar matters;

(3) A limited partnership or limited liability company is a client of any general partner, managing member or other person acting as investment adviser to the partnership or limited liability company;

(4) You are not required to count a private fund as a client if you count any investor, as that term is defined in paragraph (c)(2) of this section, in that private fund as an investor in the United States in that private fund; and

(5) You are not required to count a person as an investor, as that term is defined in paragraph (c)(2) of this section, in a private fund you advise if you count such person as a client in the United States.

Note to paragraphs (a) and (b): These paragraphs are a safe harbor and are not intended to specify the exclusive method for determining who may be deemed a single client for purposes of section 202(a)(30) of the Act (15 U.S.C. 80b-2(a)(30)).

(c) *Definitions.* For purposes of section 202(a)(30) of the Act (15 U.S.C. 80b-2(a)(30)):

(1) *Assets under management* means the regulatory assets under management as determined under Item 5.F of Form ADV (§ 279.1 of this chapter).

(2) *Investor* means:

(i) Any person who would be included in determining the number of beneficial owners of the outstanding securities of a private fund under section 3(c)(1) of the Investment Company Act of 1940 (15 U.S.C. 80a-3(c)(1)), or whether the outstanding securities of a private fund are owned exclusively by qualified purchasers under section 3(c)(7) of that Act (15 U.S.C. 80a-3(c)(7)); and

(ii) Any beneficial owner of any outstanding short-term paper, as defined in section 2(a)(38) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(38)), issued by the private fund.

Note to paragraph (c)(2): You may treat as a single investor any person who is an investor in two or more private funds you advise.

(3) *In the United States* means with respect to:

(i) Any client or investor, any person who is a U.S. person as defined in § 230.902(k) of this chapter, except that any discretionary account or similar account that is held for the benefit of a person in the United States by a dealer or other professional fiduciary is in the United States if the dealer or professional fiduciary is a related person, as defined in § 275.206(4)-2(d)(7), of the investment adviser relying on this section and is not organized, incorporated, or (if an individual) resident in the United States.

Note to paragraph (c)(3)(i): A person who is in the United States may be treated as not being in the United States if such person was not in the United States at the time of becoming a client or, in the case of an investor in a private fund, each time the investor acquires securities issued by the fund.

(ii) Any place of business, *in the United States*, as that term is defined in § 230.902(l) of this chapter; and

(iii) The public, *in the United States*, as that term is defined in § 230.902(l) of this chapter.

(4) *Place of business* has the same meaning as in § 275.222-1(a).

(5) *Spousal equivalent* has the same meaning as in § 275.202(a)(11)(G)-1(d)(9).

(d) *Holding out.* If you are relying on this section, you shall not be deemed to be holding yourself out generally to the public in the United States as an investment adviser, within the meaning of section 202(a)(30) of the Act (15 U.S.C. 80b-2(a)(30)), solely because you participate in a non-public offering in the United States of securities issued by a private fund under the Securities Act of 1933 (15 U.S.C. 77a).