Client Alert

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CURRENT ISSUES RELEVANT TO OUR CLIENTS JANUARY 30, 2012

SEC Issues Guidance on Investment Adviser Registration Issues

The staff of the Securities and Exchange Commission (the "SEC") recently provided guidance on various issues regarding investment adviser registration under the Investment Advisers Act of 1940 (the "Advisers Act"). The SEC staff issued the guidance in response to a request by the American Bar Association, Business Law Section. The SEC staff previously commented on many of the same issues in a letter addressed to the American Bar Association's Subcommittee on Private Investment Entities in 2005 in connection with the SEC's 2004 rules that sought to require hedge fund managers to register under the Advisers Act. The current guidance clarifies certain matters in light of recent changes under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). The original request and the SEC staff's response are available at http://www.sec.gov/divisions/investment/noaction/2012/aba011812.htm. The 2005 SEC guidance is available at http://www.sec.gov/divisions/investment/noaction/aba120805.htm.

Background: Advisers Act Registration Obligations for Certain Related Persons

Section 203(a) of the Advisers Act generally provides that it is unlawful for an investment adviser to engage in business without registering under the Act unless an exemption is available. Section 202(a)(11) of the Advisers Act defines the term "investment adviser" broadly to include any person who for compensation provides advice as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities. This definition is sufficiently broad to not only include an investment adviser entity but also its employees. However, the SEC and its staff have generally not required natural persons associated with a registered adviser to register separately solely as a result of their activities as associated persons.

In 2005 the staff took a similar approach with respect to special purpose vehicles ("SPVs") created by registered advisers to act as the general partner or managing member to a private fund. In the 2005 guidance, the staff stated that it would not recommend enforcement action against a registered adviser and an SPV if the SPV does not separately register as an investment adviser, subject to the following representations and undertakings:

- The investment adviser to a private fund establishes the SPV to act as the private fund's general partner or managing member;
- The SPV's formation documents designate the investment adviser to manage the private fund's assets;
- All of the investment advisory activities of the SPV are subject to the Advisers Act and the rules thereunder, and the SPV is subject to examination by the SEC; and
- The registered adviser subjects the SPV, its employees, and the persons acting on its behalf to the registered adviser's supervision and control and, therefore, the SPV, all of its employees, and the persons acting on its behalf are "persons associated with" the registered adviser (as defined in Section 202(a)(17) of the Advisers Act).

Subject to these conditions, the SPV would effectively look to and rely upon the registered adviser's registration with the SEC in not submitting a separate Form ADV.

2012 Staff Letter: Updating the Staff's Views on SPV Registration in Light of the Dodd-Frank Act

The staff received inquiries about whether the 2005 staff letter continues to represent the position of the staff along with other questions about positions expressed in that letter in light of the Dodd-Frank Act's repeal of the exemption previously provided by Section 203(b)(3) of the Advisers Act. While the staff did not respond to all questions, the staff presented the following no-action guidance:

- The staff confirmed that the 2005 letter continues to represent the staff's position;
- The position expressed in the 2005 staff letter is not limited to a registered adviser with a single SPV (i.e., it could apply to a registered adviser with multiple SPVs);
- The staff would not recommend enforcement action to the SEC under Section 203(a) or 208(d) of the Advisers Act against a registered adviser and its SPV(s) if the SPV does not separately register as an investment adviser with the SEC and if the registered adviser and SPV(s) meet all of the conditions in the 2005 staff letter, except that the only persons acting on an SPV's behalf that the registered adviser does not supervise and control, and thus are not "persons associated with" the registered adviser, are directors who are independent of the registered adviser; and
- Even though Form ADV was not designed to combine information about separately formed advisers conducting different advisory businesses, the staff would not recommend action to the SEC under Section 203(a) or 208(d) of the Advisers Act against an investment adviser that files a single Form ADV (the "filing adviser") on behalf of itself and each other adviser that is controlled by or under common control with the filing adviser that is registering through a single registration with the filing adviser (each, a "relying adviser") where the filing adviser and each relying adviser collectively conduct a single advisory business. The staff would view one or more advisers to be conducting a single advisory businesses for this purpose if:
    - The filing adviser and each relying adviser advise only private funds and separate account clients that are qualified clients (under Advisers Act Rule 205-3) and are otherwise eligible to invest in the private funds advised by the filing adviser or a relying adviser and whose accounts pursue investment objectives and strategies that are substantially similar or otherwise related to those private funds;
    - Each relying adviser, its employees, and the person acting on its behalf are subject to the filing adviser's supervision and control, and therefore each relying adviser, its employees, and the persons acting on its behalf are "persons associated with" the filing adviser;
    - The filing adviser has its principal office and place of business in the US, and therefore all substantive provisions of the Advisers Act and rules thereunder apply to the filing adviser's and each relying adviser's dealings with each of its clients, regardless of whether any client or the filing adviser or relying adviser providing the advice is a US person;
    - The advisory activities of each relying adviser are subject to the Advisers Act and rules thereunder, and each relying adviser is subject to examination by the SEC;
    - The filing adviser and each relying adviser operate under a single code of ethics and a single set of written policies and procedures adopted and implemented and administered by a single chief compliance officer in accordance with that rule; and
    - The filing adviser discloses in its Form ADV that it and its relying advisers are together filing a single Form ADV in reliance on the position expressed in this letter and identifies each relying adviser by completing a separate Section 1.B, Schedule D of Form ADV for each relying adviser and identifying it as such by including the notation "(relying adviser)".

What To Do Next?

Many private fund managers will be required to register as investment advisers with the SEC effective March 30, 2012. Those firms with multiple special purpose general partner or managing member entities should review the SEC staff's current guidance along with the 2005 guidance to determine the proper action to take with respect to

registration of each entity. Please contact us if we can be of assistance. For further information on investment adviser registration and related Dodd-Frank Act matters, please see our publication Dodd-Frank: Impact on Asset Management available at http://www.chapman.com/media/news/media.901.pdf.

If you would like to discuss any of the issues discussed in this Client Alert, please contact any attorney in our Investment Management Group or visit us online at chapman.com.

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