Investment Advisers Act Compliance Developments in 2012*

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Introduction

The next year will see major developments in the area of investment adviser regulation in the United States. By the end of the first quarter of 2012, the industry will have to deal with significant shifts in advisory firms' registrations with the US Securities and Exchange Commission or the states themselves, changes to the filings made by those already registered with the SEC, new kinds of public reports made by those relying on new exemptions from registration, and the effects of other recent or forthcoming initiatives. The main driver of these changes has been the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which removed a commonly relied-upon exemption from SEC registration under the Investment Advisers Act of 1940 and, together with new SEC rules,[1] added other exemptions. However, regulatory changes have erupted from a number of other sources as well.

Advisers Act registration requires dedicated efforts, public transparency, and initial and ongoing expenses. Even the new exemptions described below will require some investment of resources, if to a lesser degree.

So what can an investment adviser do to get in front of all these changes? A firm might consider the following roadmap:

Organizational review. What is the expected Advisers Act status of each investment adviser in your organization?

SEC action plan. To better fit within the new rules, how can relationships or organizational ties be adjusted? What filings need to be done, by when, and who will spearhead the effort?

Compliance updates. What new issues need to be addressed?

An investment adviser's organizational review

A family of businesses might consider a three-step process for conducting its organizational review. The process would involve determining, first, which entities in the group are investment advisers; second, whether each is fully exempt, must make reports, or should register; and third, whether the relationships or arrangements among certain affiliated investment advisers are such that they should be "collapsed" and their businesses combined for purposes of making these determinations. This analysis would have been less comprehensive in the past, because the breadth of formerly available exemptions would have made it easier to quickly conclude that few or no registrations are required.

Is the firm an "investment adviser"?

The first step in an Advisers Act organizational review is to determine which entities are "investment advisers" in the first place. An investment adviser is defined under the Advisers Act as, with certain exceptions:

> …any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, 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….

Most investment advisers have no doubt that they meet that definition. Others are a closer call. As a key part of the definition pertains to being in the business of advising on "securities," firms that advise solely with respect to commodities, real estate or other non-securities generally should not be considered "investment advisers." Before reaching a final determination, however, a firm should conduct a careful analysis of the assets on which it advises and how it has held itself out.

Also, as noted above, there are some exceptions – US banks, insurance companies and broker-dealers are examples of businesses that may be excepted from that definition under certain circumstances. As part of the organizational review's first step, then, a group of affiliated businesses would consider which of its entities can avail themselves of an exception. The answer is not always obvious. For example, a non-US bank may find itself outside of the exceptions. As mandated by Dodd-Frank, the SEC also adopted a rule to except "family offices" from being deemed investment advisers.[2] This new family office definition has a number of parts and may require complex analysis.[3] If a family office's facts do not fit within the rule's provisions, the circumstances could call for restructuring, a discussion with the SEC staff, seeking an exemptive order from the SEC, registration, or other measures.

If the firm is an investment adviser, must it register or report?

The second step in an organizational review is to determine the status of each investment adviser in the corporate structure as fully exempt, exempt-but-reporting, or required to be registered. Again, this is because Dodd-Frank removed a significant exemption from registration and added several new, but more limited, exemptions. Even a currently SEC-registered adviser should consider whether it remains eligible to be registered under the new rules (because certain smaller firms will be barred from SEC registration), and whether the status of its registered or unregistered affiliates are affected by the rulemaking.

Elimination of the "private adviser" exemption

Many hedge fund and private equity fund managers, among others, long relied on the so-called "private adviser" or "fourteen-or-fewer clients" exemption.

Under this provision, in Section 203(b)(3) of the Advisers Act, an exemption from SEC registration was available for

> any investment adviser who during the course of the preceding twelve months has had fewer than fifteen clients and who neither holds himself out generally to the public as an investment adviser nor acts as an investment adviser to any [SEC-regulated investment company].

As an adviser counted each fund (rather than, in most cases, the fund's investors) as the "client," a

private fund manager could launch up to fourteen funds, each having hundreds of investors and unlimited amounts of assets, without registering with the SEC. In addition, non-US firms generally would count only their US clients, so could have very large non-US businesses without concern for the rules.

Then, in the midst of the Madoff crisis and other controversies, it was asserted that the SEC did not have the authority to regulate such private advisers, or even to acquire basic census-like information. Dodd-Frank's investment adviser registration provisions followed and eliminated the private adviser exemption. Advisers that relied on that exemption as of July 20, 2011 now have until March 30, 2012 to register or rely on another exemption.

Foreign private adviser exemption

Dodd-Frank and the SEC's implementing rules establish a new full exemption, called the "foreign private adviser" exemption. As this is a complete exemption from SEC registration requirements, a foreign private adviser is free of SEC filing, recordkeeping, and formal compliance program requirements. As with all investment advisers (registered or not), however, a foreign private adviser theoretically would remain subject to the SEC's antifraud provisions and certain other rules under the Advisers Act – at least assuming there is nonetheless a sufficient jurisdictional "hook."

To qualify for this exemption, an adviser must satisfy all of the following conditions:

- Have no place of business in the United States
- Have 14 or fewer clients in the United States and investors in the United States in private funds advised by the adviser
- Have total assets under management of less than $25 million attributable to clients in the United States and investors in the United States in private funds advised by the adviser
- Not hold itself out generally to the public in the United States as an investment adviser
- Not advise an SEC-regulated investment company

In considering this exemption, a number of different interpretive issues might take center stage. As examples:

When does a US presence become a "place of business"? The SEC provided guidance but many scenarios could arise that require consideration.

Now that a firm must count fund investors, a key question is who counts as an "investor"? The SEC provided fairly complex "look through" rules concerning funds under the new rules, so that an adviser's fund may need to look through a fund investing in it if that fund holds 10% of the outstanding voting securities of the adviser's fund, or if it puts 40% of its assets in the adviser's fund. Debt holders could be "investors" as well if the debt is construed as a security, but that determination can be a complex one driven by case law and regulatory guidance focused on particular fact patterns. Thus, again, careful analysis may be appropriate.

Advisers Act registration requires dedicated efforts, public transparency, and initial and ongoing expenses.

Who is a US client or US investor? These definitions are based primarily on the definition of "US person" as used in the SEC's Regulation S. That definition provides a list of categories of those who are US persons, supplemented by a list of those categories that exclude US persons. An analysis of the Regulation S definition will be critical for any foreign private adviser.

How are assets under management calculated for purposes of the $25 million threshold? The SEC provides detailed instructions with the intent of eliminating the choice of which assets to count, but even these instructions leave room for interpretation, especially in the area of non-discretionary investment advice.

At what point does a website, even if maintained outside of the United States, result in a firm holding itself out to the US public as an investment adviser? Given that a combination of factors can make a website appear more, or less, oriented to prospective clients in the United States, this is

fundamentally a question that depends on the site's specific facts.

These are just some of the key questions with which non-US firms are currently dealing. Foreign private advisers, almost by definition, will tend to have little or no US nexus and thus little US-oriented compliance infrastructure. Many of these firms will face a balancing act in deciding the extent of resources to dedicate to reach a careful conclusion regarding their US exempt status and how to maintain that exemption as they continue to operate their overseas businesses.

Private fund adviser exemption

For any US adviser, or any non-US adviser that is not eligible to be a foreign private adviser, this is the first of two categories of "exempt reporting advisers" – so called because they are exempt from SEC registration, but still subject to SEC reporting and recordkeeping requirements that we describe later in this article.

A "private fund adviser" is one that satisfies each of the following:

- Advises solely "qualifying private funds"
- Has assets under management of less than $150 million (for non-US advisers, this amount only includes those assets managed "from" in the United States)

Determining whether an adviser is eligible for this exemption thus requires a two-step process of client evaluation and asset calculation.

First, a firm's client base must be evaluated. A "qualifying private fund" is any issuer that would be an investment company but for an exception in Section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940 (the "Investment Company Act"), the common exclusions for hedge funds and private equity funds. The SEC rule clarifies that an issuer generally also could rely on an additional exception under the Investment Company Act without losing its qualifying private fund status. The SEC provides guidance on when a non-US fund (which must rely on Section 3(c)(1) or 3(c)(7) with respect to any US offering) is a qualifying private fund. To rely on this exemption, a US adviser must have only qualifying private funds as clients – even a single separate account agreement with a non-fund, for example, would make this exemption unavailable. A non-US adviser need only consider its US clients, so it could have any number of non-US clients that are not funds, but may not have even a single separate account agreement with a non-fund that is a US person.

Note about "single investor" funds

A key issue that the SEC's rule release discusses is whether a single investor fund, sometimes called a fund-of-one, is a private fund. The SEC took the position that, if the fund is formed for the sole purpose of helping the adviser avoid registration, the adviser is effectively doing indirectly what it cannot do directly, in violation of Section 208(d) of the Advisers Act. As the SEC, in adopting the rulemaking, discussed this question in some detail, and has previously provided guidance concerning the invocation of Section 208(d), an adviser of any single investor funds that rely on Section 3(c)(1) or 3(c)(7) should consider this issue carefully.

Second, the adviser must calculate its assets under management. For this purpose, the SEC's rulemaking includes a new "regulatory assets under management" concept along with detailed instructions for calculating that figure. An adviser should be aware that the asset figure may differ from the one that the adviser has historically used. Non-US advisers should consider whether any US personnel manage assets from the United States, or provide solely (for example) research and diligence, which the SEC indicates may not count as "managing."

Venture capital fund adviser exemption

An adviser solely of venture capital funds is the second of the two categories of "exempt reporting advisers." As with the previous exemption, these advisers are subject to SEC reporting and recordkeeping rules but are not required to register, and are not subject to compliance with most parts of the Advisers Act.

Each fund advised by a venture capital fund adviser must be a private fund that holds itself out as pursuing a venture capital strategy. Each such fund – except for certain grandfathered funds described below – must meet all of the following tests:

Have appropriate portfolio composition	No more than 20% in non-qualifying investments (other than short-term holdings) Qualifying investments are generally equity securities, acquired directly from the issuer rather than in a secondary market, in non-public operating companies that do not incur leverage in connection with the private fund's investment. (This is merely a general description; the SEC's definitions under this rule must be parsed carefully to be sure an investment is a qualifying investment.)
Not use leverage except as permitted	The rule generally prohibits leverage other than limited short-term borrowing and certain guarantees of qualifying portfolio company obligations by the fund
Lock in investors	No redemption or similar liquidity rights except in extraordinary circumstances
Have appropriate regulatory status	Not be an SEC-regulated investment company

Unlike a private fund adviser, a venture capital fund adviser is not subject to any maximum amount of assets under management. Also unlike private fund advisers, however, a non-US adviser must consider even its non-US client base to determine whether it advises only venture capital funds.

Note about grandfathering

For purposes of the venture capital fund adviser exemption, a private fund that holds itself out as pursuing a venture capital strategy, has sold securities prior to December 31, 2010, and has not sold any securities after July 21, 2011 (even if not all capital commitments were called by then) is "grandfathered" – meaning the fund need not meet the other qualification tests required of newer funds.

The fund need not have used the term "venture capital" but must have described the totality of its investment strategy to prospective investors in a manner consistent with common industry understandings of a venture capital fund.

Registration – with a State or with the SEC?

If none of the above exemptions is available for an investment adviser, it must consider whether to register with a state (for smaller and mid-sized US advisers) or with the SEC (for larger or non-US advisers).

Historically, investment advisers have registered with the SEC, rather than with states, upon reaching the level of $25-$35 million in assets under management. That threshold has now changed. (Non-US advisers are not subject to the threshold, and advisers of any SEC-regulated investment company are required to register with the SEC regardless of size.)

Smaller advisers, having less than $25 million in assets under management, generally are prohibited from registering with the SEC. Mid-sized advisers, having $25-$100 million in assets under management, also generally may not register with the SEC, as long as their principal office and place of business is located in a state that requires them to register and makes them subject to inspection. To date, all states have undertaken to regulate and inspect advisers except Wyoming and New York, which means the SEC registration threshold in those two states remains at $25 million, and in all other states is $100 million. Larger advisers, generally over $100 million in assets under management, must register with the SEC unless an exemption is available.

Note about state registration

State registration is sometimes more onerous than SEC registration. States typically require the same kinds of registration statements as the SEC, may review and (unlike the SEC) comment on investment management agreements, and may require advisory personnel to pass tests such as certain Financial Industry Regulatory Authority (FINRA) "series" examinations, among other differences. An adviser also could have to register in up to 14 states and juggle the different regulatory requirements of each.

Must the firm be "collapsed" with one or more affiliates?

The third step in performing a group's organizational review is determining whether the businesses of affiliated investment advisers are so intertwined that they should be effectively combined or "collapsed" when considering whether the exemptions discussed above are available.

Many global firms, and even some smaller advisers, have numerous investment advisory entities formed for various business, tax or regulatory purposes. As these organizations determine the regulatory status of each affiliated adviser, it is possible that some entities within the same group will have to register, some will be exempt reporting advisers, and some will be fully exempt foreign private advisers.

Such different treatment of related parties, however, could potentially draw SEC scrutiny, depending on the circumstances. For example, the SEC staff, in a 1981 position cited approvingly by the SEC in its recent rulemaking, said that the SEC may consider whether an unregistered company that creates a registered subsidiary is doing indirectly through the subsidiary what the unregistered parent may not do directly, which is prohibited under Section 208(d) of the Advisers Act. In that instance, the SEC staff said: "If the subsidiary has an existence independent of the parent and functions independently of the parent, the mere fact of creation and continued ownership by the parent would not constitute a violation of section 208(d)." In outlining what is generally viewed as a safe harbor (rather than a requirement), the SEC staff gave, as evidence of a subsidiary's independent existence and functions, that the subsidiary

> (1) is adequately capitalized, (2) has a buffer, such as a board of directors a majority of whose members are independent of the parent, between the subsidiary's personnel and the parent, (3) has employees, officers, and directors, who if engaged in providing advice in the day-to-day business of the subsidiary entity, are not otherwise engaged in an investment advisory business of the parent, (4) itself makes the decisions as to what investment advice is to be communicated to, or is to be used on behalf of, its clients and has and uses sources of investment information not limited to its parent, and (5) keeps its investment advice confidential until communicated to its clients.[4]

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This third step can, therefore, require careful judgment in deciding whether to revisit any of the conclusions regarding the registration or exemption status reached on an adviser-by-adviser basis. Irritatingly, this is not to say that a multi-entity firm that is viewed as "collapsed" can simply rely on a single SEC registration. Instead, being collapsed may mean the worst of both worlds, with different entities tainting each other for purposes of the exemptions analysis but nonetheless required, when registering, to maintain multiple, entity-by-entity registrations.

Note about fund general partners

A structure that the SEC staff specifically addresses is the general partner of a fund formed as a limited partnership. A single SEC-registered adviser might sponsor many funds, each having a separate general partner that, often, is owned by the adviser or under common control with it. The general partner is, in many cases, formed as a separate legal entity for liability, governance or tax reasons. As the SEC does not have a strong interest in requiring numerous separate registrations of those general partners, its staff has advised that an adviser need not register each general partner, so long as, in short, each is treated by the firm as if it were subject to the full Advisers Act in the same way as its SEC-registered affiliate.

Another consideration for investment advisers within larger groups is the use of so-called "participating affiliates." Under SEC staff guidance, which the recent rulemaking expressly did not withdraw, some registered advisers have been able to benefit from the support and resources of unregistered (generally non-US) affiliates without

subjecting the entire businesses of those affiliates to SEC scrutiny.[5] The exact contours of this guidance under the SEC's new rulemaking (such as, for example, how it may apply to either an adviser or its affiliate if one or both are exempt reporting advisers) remain subject to further interpretation or guidance.

Other case-specific issues are almost certain to arise as larger organizations work through their organizational review. For that reason, now that the SEC's rules are final, the earlier the review can be started and completed, the better.

SEC Action Plan

Leadership. The appropriate person or group to direct the compliance effort will depend on the firm. A key consideration in choosing the leaders of the process, however, is their authority and resources, as they should be capable of demanding attention from both senior and day-to-day operational personnel and to incur necessary expenses.

Changes to the business. To address the Advisers Act changes described above, advisers may find it appropriate to modify certain of their businesses, client relationships or service provider arrangements. Examples of questions faced by some advisers may include:

- Should a non-US adviser close a US place of business or remove portfolio managers from the United States?
- Should a private fund adviser terminate separate account relationships with non-funds?
- Should certain client relationships be housed in a different part of a single group's network of affiliates, so as to consolidate US client relationships within a registered adviser?

Upon registering, an adviser may find it necessary to enter into new relationships with qualified custodians, accounting firms, recordkeepers, counsel, and other providers of services to the adviser or the funds it manages. The time needed to engage these parties should be built into time allocated to register with the SEC.

Filings (or not). An investment adviser also should decide soon what filings it must make and by when.

- A fully exempt foreign private adviser need not make any SEC filings under the Advisers Act. Nor must any company excluded from the definition of investment adviser, including family offices as defined under the new rules. Such firms are also not subject to SEC recordkeeping requirements.
- An investment adviser that, on July 20, 2011, relied on the "fourteen-or-fewer clients" exemption has until March 30, 2012 to be registered with the SEC. As the SEC is entitled to a 45 day review of a filing on Form ADV, the SEC's registration statement form for investment advisers, a firm should make its initial Form ADV filing by February 14, 2012. It is prudent for a newly registering firm to have its compliance program ready by the time of its initial filing of Form ADV, because the SEC's review often does not take all 45 days.
- An exempt reporting adviser – whether a private fund adviser or venture capital fund adviser – must make its first reports to the SEC by March 30, 2012. These reports consist of a portion of Part 1 of Form ADV. Some details about this reporting requirement are provided below. These advisers also will be subject to yet to be announced recordkeeping rules.
- An investment adviser that will withdraw from SEC registration and instead register with one or more states must complete that withdrawal and registration process by June 28, 2012. As state registration may be burdensome or unpredictable from a timing standpoint, a firm should seek to build in sufficient time for that process.
- Other deadlines could apply depending on the circumstances, and compliance personnel should focus early on determining which deadlines apply for which entities in their group.

Compliance Updates

Firms, whether currently registered with the SEC or dealing with the SEC for the first time, will find that various compliance issues vie for their attention.

Family offices

To maintain their full exclusion from the definition of investment adviser, and avoid the application of the Advisers Act to their activities, family offices must be vigilant in operating within the parameters of the SEC's family offices rule.

Foreign private advisers

Foreign private advisers must actively seek to maintain their fully exempt status. For example, the firm should monitor any US person investments in its funds or separate accounts, including any increases due to capital appreciation, to be sure the totals do not approach $25 million. Compliance personnel should be alerted before any place of business is opened in the United States.

As noted above, foreign private advisers are free of filing obligations but are subject to SEC antifraud provisions. They, and all other investment advisers whether registered or not, also are subject to the SEC's "pay to play" rules that regulate political contributions to certain state and local officials or candidates in the United States. Outside of the Advisers Act, state legislatures and pension plans also have been adopting stringent requirements under lobbyist/placement agent laws for investment managers or placement agents that seek to influence decisions on asset managers for those state plans.

Exempt reporting advisers

To maintain their status, exempt reporting advisers must avoid entering into separate account agreements with non-funds and monitor their assets under management. A non-US manager may have many different kinds of non-US clients, but should monitor whether any investment personnel in the United States jeopardize the firm's meeting the under-$150 million threshold.

Exempt reporting advisers will make annual public filings with the SEC on a portion of Part 1 of Form ADV. These filings are updated annually and upon certain material events; consequently, compliance personnel may find it useful to create a compliance calendar. (Exempt reporting advisers need not prepare the narrative Form ADV Part 2 or brochure supplements.) In addition to basic identifying information, the reporting items include, among other things, the following:

- Identities of the adviser's direct and indirect owners
- Disciplinary information about the adviser and certain of its affiliates
- Identifying information about various categories of the adviser's affiliates
- Detailed fund-by-fund information.

Exempt reporting advisers remain subject to Advisers Act antifraud provisions. As their exempt reporting status may not technically preempt state law, these advisers also could be subject to full or partial state investment advisory regulation, the prospects for which should be monitored. These advisers also are subject to the same SEC "pay to play" prohibitions and state lobbyist/placement agent regimes as described above for foreign private advisers.

State-registered advisers

Registration requirements will differ among states, but generally state registrants must file the full Form ADV. Advisers formerly registered with the SEC should keep in mind that certain items applicable to state registrants, such as the length of time for which disciplinary information is to be provided, differ from those applicable to SEC registrants. An adviser that withdraws its SEC registration may need to reassess its management of certain US retirement plan assets, as it would no longer be eligible to be a "qualified professional asset manager" under US Department of Labor regulations. Many state-registered advisers also must confirm that their personnel are appropriately licensed and have passed the FINRA or other exams noted above.

These advisers would be subject to SEC antifraud rules, "pay to play" requirements, and state lobbyist/placement agent regulations, and may be subject to substantive state regulation of investment advisers as well.

SEC-registered advisers

SEC registrants should continue to monitor their eligibility to serve as such, particularly in light of the higher registration threshold (generally $100 million, rather than $25 million as before) that separates state from federal registrants. A filing in early 2012, even for advisers having a fiscal year that calls for a later annual update of Form ADV, must be made by currently-registered advisers to confirm the level of assets under management, and thus the advisers' eligibility to remain registered.

Registered advisers are newly accustomed to the amended Part 2 that came into effect in 2011, but changes that the SEC recently made to Part 1 will require advisers to focus attention on their responses to amended items. For example, an adviser will have

to provide over 25 items of information about each private fund that it manages. Information about related persons also may be greatly expanded for advisers having a large network of affiliates. The 2012 annual update filing will, for most advisers, be the first to include information about changes in a new "Material Changes" item of Form ADV Part 2.

SEC-registered advisers also are expected to become subject in 2012 to filings on Form PF (which stands for "private fund"). There will be separate reporting for each private fund (and in some instances, each class of each fund) managed by the adviser. A registered adviser will provide several dozen items of information on an annual basis or, for larger advisers, on a quarterly basis. Unlike the fund-by-fund reporting that has been added for Form ADV, the Form PF reporting would be kept confidential by the US government. Compliance personnel of registered advisers should familiarize themselves with this filing once the rules adopting it are final, and firms will need to liaise with fund service providers like custodians, administrators and prime brokers to compile the detailed information.

Other recent or forthcoming developments

Besides dealing with registrations or exemptions, investment advisers should keep up-to-date on other US regulatory developments that may affect their businesses in 2012 and beyond.

Qualified client modification. Registered advisers that charge performance fees generally must do so only with respect to "qualified clients" (whether they invest through a fund or an account). The SEC amended that standard so that a client's net worth (together with assets held jointly with the client's spouse) must exceed $2 million or the client must have at least $1 million under the management of the adviser (up from $1.5 million and $750,000, respectively). The standard may be further amended so that, as with the accredited investor standard for purposes of the SEC's Regulation D safe harbor for private placements, which was amended in 2010, a qualified client's net worth would exclude the value of a primary residence. Firms should update their fund offering documents and subscription agreements, and any other relevant documents, to include reference to this new standard.

Volcker Rule and other initiatives relating to banks or systemically important financial institutions. The Federal Reserve and other US (as well as non-US) banking authorities will be proposing or adopting various rules over the next months and years. These rules could significantly affect the future operations of investment advisers that have bank affiliates (as banks and affiliates may be prohibited from sponsoring funds), or that manage private funds having significant holdings by banks or bank affiliates (as banks and affiliates may be generally prohibited from investing in private funds).

Broker-dealers' standard of care. The SEC has been considering imposing a fiduciary duty or similar standard on broker-dealers. This new duty could change the dynamic between advisers and the broker-dealers that are service providers, intermediaries or counterparties for the advisers' clients.

Self-regulatory organization. The SEC has considered whether a self-regulatory organization (SRO) should be established with respect to investment advisers. A final conclusion has not yet been reached in that regard. Under an investment adviser SRO, certain rules, examination protocols and fees may be expected to change.

Commodity Futures Trading Commission rules and other matters relating to derivatives. Registered and unregistered investment advisers whose clients trade in futures or certain other derivatives should monitor any amendments to CFTC Rules 4.13 and 4.14. The CFTC has considered whether to narrow those rules' exemptions from registration as a commodity trading advisor or commodity pool operator. CFTC registration would entail significant substantive and procedural compliance. Many advisers also should monitor other derivatives-related developments, including those relating to the standardization and clearing of certain instruments such as swaps, and federal reporting obligations of certain participants in the derivatives markets.

Tax treatment of carried interest. US tax policy is in flux, but an item of particular interest to many fund managers is the tax treatment of carried interest (pursuant to which fund managers or their affiliates receive a performance-based allocation from a fund), which typically enjoys a lower capital gains rate rather than a higher ordinary income rate. Such a change in the economics of managing funds could have a significant impact on fund structures. If so, private fund documents may need significant revision. Although there is no assurance that this

proposed tax policy will become law, it is illustrative of the breadth of issues that an adviser's compliance or legal personnel must consider.

Conclusion

With the Advisers Act evolving as we look into 2012, investment advisers and their compliance and legal personnel have a great deal to think about – and from many perspectives. A careful organizational review can go a long way toward putting together the puzzle pieces in a coherent manner that considers the firm's client base, lines of business, geographic footprint, and its willingness to make organizational changes to limit or rationalize US regulatory exposure. Finally, while it may appear that the effect of these changes will fall disproportionately on firms that are not currently registered with the SEC, these developments mean that there is significant new work for firms that are currently registered as well.

ENDNOTES

* This publication is intended only as a general discussion of these issues. It should not be regarded as legal advice. The authors would be pleased to provide additional details or advice about specific situations if desired.

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1 See Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, Investment Advisers Act Release No. 3222 (June 22, 2011); Rules Implementing Amendments to the Investment Advisers Act of 1940, Investment Advisers Act Release No. 3221 (June 22, 2011); related amendments to SEC Form ADV.

2 See Family Offices, Investment Advisers Act Release No. 3220 (June 22, 2011).

3 In summary, the family office must have no clients other than "family clients" (as defined in the rule), must be wholly owned by family clients and be exclusively controlled (directly or indirectly) by one or more family members and/or family entities – all from a single family – and must not hold itself out to the public as an investment adviser. The family office rule and its definitions are complex, and any family office that seeks to rely on this rule should review its provisions carefully.

4 See Richard Ellis, Inc., SEC Staff No-Action Letter (Sept. 17, 1981).

5 See, e.g., União de Bancos de Brasileiros S.A., SEC Staff No-Action Letter (July 28, 1992) and related no-action letters.