A PRACTICAL GUIDE FOR FOREIGN ADVISERS: FOREIGN PRIVATE ADVISER EXEMPTION FROM REGISTRATION WITH THE SEC AS AN INVESTMENT ADVISER

By Bettina Eckerle, July 18, 2011

On June 22, 2011, the SEC replaced the current exemption for foreign private advisers from registration under the Investment Advisers Act of 1940 (the "Advisers Act") with a new one.

The web of defined terms in the new rules is intricate and stems from different set of rules, including the Investment Company Act of 1940 and Regulation S, so the analysis should be careful and commence as soon as possible to determine whether you qualify for this or any other exemption. We anticipate that many foreign advisers will not meet the criteria. Other possible exemptions are the private adviser and the venture capital fund exemptions. However, these exemptions would require the adviser to report to the SEC as exempt reporting adviser and to satisfy the requirements that the SEC indicated it will impose on record keeping. Please read the Practical Guides regarding the private adviser and the foreign adviser exemption and the rules governing exempt reporting advisers by the same author.

Under the new rules, a foreign private adviser is an investment adviser that:

- Has no "Place of Business" in the U.S.;
- Has, in total, fewer than 15 "Clients" and "Investors" in the U.S. in private funds advised by the adviser;
- Has less than $25 million of aggregate "Assets Under Management" attributable to such clients and investors – note that the Advisers Act authorizes the SEC to raise this $25 million threshold if it deems appropriate, and the SEC has indicated that it will evaluate whether it is appropriate to do so in the future; and
- Neither holds itself out generally to the public in the U.S. as an investment adviser nor advises mutual funds or business development companies under the Investment Company Act of 1940 (the "1940 Act").

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The new rules define the following terms for advisers that seek the protection of the "foreign private adviser" exemption and add a safe harbor and clarify the rules for "Client" counting:

Client. The new rules provide a safe harbor for purposes of counting clients for purposes of the definition. A foreign private adviser may deem the following to constitute a single "Client":

- A natural person and minor children regardless of whether they share the same principal residence, and relatives, spouse, spousal equivalent or relative of the spouse or spousal equivalent who have the same principal residence as the person, and accounts and trusts for which the person and/or the foregoing persons are the only primary beneficiaries;

- A partnership, limited liability company, corporation, trust or other legal organization (or more than one organization with identical ownership) to which the adviser provides advice based on the organization's investment objectives, rather than the individual objectives of the organization's owners.

- An adviser is not permitted to disregard a person as a "Client" because the adviser provides services for such person without compensation; and

- A general partner or managing member or similar person acting as an adviser to a partnership or limited liability company is required to count the partnership or limited liability company as a "Client."

- To avoid double counting, the SEC introduced two new rules:

  - An adviser is not required to count a private fund as a client if it counts an investor in the private fund as a client; and

  - An adviser is not required to count a person as an investor in a private fund if it counts the private fund as a "Client."

- These new definitions are non-exclusive safe harbors, and there may be other situations in which multiple persons constitute a single "Client."

Private Fund Investor. The SEC added a definition of "Investor" to the Advisers Act, harmonizing the new provisions with the 1940 Act.

- An "investor" in a private fund would be any person who would be taken into account when determining whether the fund came within the exclusions from the definition of "investment company" under Section 3(c)(1) or Section 3(c)(7) of the 1940 Act. One exception is that holders of short-term paper issued by a private fund would also count as "investors".

- Knowledgeable employees of an adviser do not count as investors.

- An investor in more than one fund managed by the adviser only counts once.

- An adviser is required to "look through" certain intermediate accounts such as nominee and similar arrangements. For examples, holders of interests in feeder funds in a master-feeder structure are counted, not just the feeder funds.

- Holders of both debt and equity must be counted.

In the U.S. This term is used in several contexts within the "foreign private adviser" exemption, including the definitions of "Assets under Management", "Clients", "Investors", "Place of Business" and "holding itself out as an investment adviser". The new term applies to all these contexts.

- "In the U.S." is treated as located in the "United States" as defined in Regulation S. An investor or client generally is treated as being "in the U.S." if that investor or client is a "U.S. person" for purposes of Regulation S, except with respect to certain discretionary or similar accounts that are held for the benefit of U.S. persons by certain non-U.S. dealers or other non-U.S. professional fiduciaries.

- If a person was not actually in the U.S. at the time the person became a "client" or, as an "investor" when it acquired securities in a private fund, that person may be treated for purposes of this rule as not being in the U.S.

- The SEC stated that if an adviser reasonably believes that an investor or client is not "in the U.S." at the time that they became an investor or client then the adviser can treat such investor or client as not being "in the U.S."

Place of Business. The "place of business" of an investment adviser is defined as:

- An office at which the adviser regularly provides investment advisory services, solicits, meets with, or otherwise communicates with clients; and

- Any other location that is held out to the general public as a location at which the adviser conducts any such activities.

An office at which an adviser regularly communicates with its clients, whether they are U.S. or non-U.S. persons or an office where an adviser regularly conducts research would qualify as a "place of business."

An office at which the adviser solely engages in administrative and back-office activities would not qualify as a "place of business," if such activities are not intrinsic to providing investment advisory services and do not involve communicating with clients.

Assets under Management. The SEC implemented a uniform method of calculating "Assets under Management" for use in several contexts under the Advisers Act. This method would also apply to the foreign private adviser exemption. Please refer to Item 5 of Form ADV.

For more details, see: http://www.sec.gov/rules/final/2011/ia-3222.pdf

Please place questions concerning the topics discussed in this memorandum to Bettina Eckerle at bettina.Eckerle@eckerlelawyers.com.