Registration Exemptions for Investment Advisers under the Investment Advisers Act of 1940

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Any person or firm who acts as an investment adviser must register with the appropriate regulatory authority (as further discussed below, either the Securities and Exchange Commission (the "SEC") or the applicable state's securities regulator) or qualify for a registration exemption. An investment adviser is generally defined under the Investment Advisers Act of 1940 (the "Advisers Act") as any person or firm who, for compensation, engages in the business of advising others as to the value of securities, or as to the advisability of investing in, purchasing, or selling securities. Two commonly relied upon registration exemptions for investment advisers under the Advisers Act are the private fund adviser exemption and the venture capital fund adviser exemption, each of which is discussed in more detail below.

The Private Fund Adviser Exemption

An investment adviser is exempt from the requirement to register with the SEC under the private fund adviser exemption if it solely advises "private funds" and its total "regulatory assets under management" in the United States are less than $150 million.

A "private fund" is a pooled investment fund that satisfies the requirements of either Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act of 1940 (the "1940 Act"). To satisfy the requirements of Section 3(c)(1), a private fund must have fewer than 100 beneficial owners (all of whom must be an "accredited investor" under the Securities Act of 1933)[1] and must not make a public offering of its securities. To satisfy the requirements of Section 3(c)(7), all of the private fund's beneficial owners must be "qualified purchasers" and the fund must not make a public offering of its securities. A qualified purchaser is generally defined under the 1940 Act as a sophisticated investor that has a minimum amount of investable assets. For example, an individual that has more than $5 million of investments is a qualified purchaser, as is a company or other entity that has more than $25 million of investments.

An adviser's "regulatory assets under management" are the sum of the "regulatory assets" of the private funds that it manages. A private fund's "regulatory assets" are calculated as the sum of (a) the current market value of the fund's assets (or fair value of those assets where market value is unavailable) and (b) the additional amounts that its investors are contractually obligated to contribute to the fund.

The Venture Capital Fund Adviser Exemption

An investment adviser is exempt from the requirement to register with the SEC under the venture capital fund adviser exemption if the adviser solely advises "venture capital funds." A venture capital fund is a private fund that satisfies all of the criteria listed below.

- The fund that satisfies the requirements of either Section 3(c)(1) or Section 3(c)(7) of the 1940 Act (see above).

- The fund represents to investors and potential investors that it pursues a venture capital strategy.
- The fund invests at least 80% of its assets in "qualifying investments," which generally are equity securities of privately held companies (other than private funds) that are issued directly to the fund.
- The fund does not borrow or provide guarantees for more than 15 percent of its aggregate capital contributions and uncalled committed capital.
- Any borrowing by the fund is for a non-renewable term of 120 or fewer calendar days.
- The fund's governing documents prohibit investors from withdrawing or redeeming their interests except in extraordinary circumstances.

A Side-by-Side Comparison

The key characteristics of each exemption are summarized in the table below.

	Private Fund Adviser	Venture Capital Fund Adviser
Maximum assets under management:	$150 million	Unlimited
Permitted clients:	Private funds only	Private funds only
Permitted investment strategies:	Any	Venture capital only
Required to register with the SEC?	No	No

Federal v. State Registration

An investment adviser that does not qualify for a registration exemption under the Advisers Act must register with the appropriate regulatory authority. Unless it qualifies for an exemption, an adviser that has $100 million or more of regulatory assets under management must register with the SEC, while an adviser that has less than $25 million of regulatory assets under management must register with the securities regulator of the state in which it has its principle office, subject to certain state-specific exceptions and exemptions that are not discussed in this article. A non-exempt adviser that has $25 to $100 million of regulatory assets under management must register with the securities regulator of the state in which it has its principal office unless the adviser would not be "subject to examination" by that state's securities regulator (in which case the adviser must register with the SEC).[2]

Regulation of "Exempt" Investment Advisers

An investment adviser that qualifies for a registration exemption will be relieved of some of the more burdensome regulatory requirements that apply to SEC-registered advisers. Unlike an SEC-registered investment adviser, an exempt adviser is not subject to the SEC's rules regarding what an adviser may say in an advertisement, what records an adviser must retain, and what policies and procedures the adviser must implement to avoid violating its fiduciary and legal obligations. An exempt adviser, however, remains subject to a range of other regulations that are intended to protect investors. An exempt adviser, for example, remains subject to federal anti-fraud and pay-to-play regulations, must periodically report information about itself on part 1 of Form ADV, and remains subject to inspection by regulatory authorities. Exemption from registration therefore does not mean exemption from regulation.

For more information, please contact a member of our Private Investment Funds and Advisers Practice.

1. An accredited investor is generally defined under the Securities Act as someone who has: (i) annual income of at least $200,000 (or $300,000 if combined with a spouse's income); or (ii) net worth of $1 million or more, either individually or together with a

spouse, but excluding the value of a primary residence. Furthermore, if an investment adviser to a Section 3(c)(1) private fund charges the fund's investors a performance fee (*i.e.*, a fee charged by the adviser, in addition to a management fee, for generating positive returns), then all of the fund's investors must be "qualified clients" which is a higher threshold to meet than an accredited investor. A qualified client is generally defined under the Advisers Act as a sophisticated client that has: (i) at least $1.1 million in asset under management with the adviser; or (ii) has a net worth (together, in the case of a natural person, with assets held jointly with a spouse) that the adviser reasonably believes to be in excess of $2.2 million. [?]

2. For example, a non-exempt adviser with $25 to $100 million of regulatory assets under management and a principal office in either New York or Wyoming is not "subject to examination" and therefore must register with the SEC. [?]