Private Fund Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Act), which was signed by the President and became law on July 21, 2010, will significantly increase federal regulation and oversight of private investment funds and their managers.

Title IV of the Act, the Private Fund Investment Advisers Registration Act of 2010, amends the Investment Advisers Act of 1940 (Advisers Act) to impose US Securities and Exchange Commission (SEC) registration, reporting, and record keeping obligations on investment advisers to "private funds" (which include hedge funds, private equity funds, and other private funds) that have assets under management in the United States of $150 million or more, subject to certain limited exemptions.

The Act specifies records to be maintained by advisers to private funds and grants broad authority to the SEC to require reports by, and conduct inspections of, private fund advisers. Information obtained by the SEC may be shared with the Financial Stability Oversight Council (FSOC) to assist in determining whether to designate a private investment fund or its investment adviser as "systemically significant" and therefore subject to supervision by the Board of Governors of the Federal Reserve System (Federal Reserve), capital requirements, risk controls, pre-packaged liquidation plan requirements, the orderly liquidation authority of the Federal Deposit Insurance Corporation (FDIC), and other significant and pervasive regulatory requirements that will apply to financial companies so designated under Titles I and II of the Act.

The effective date of Title IV is one year after enactment of the Act except as otherwise provided, but an investment adviser to a private fund is permitted to register under the Advisers Act during the one-year transition period, subject to SEC rules.

The provisions in Title IV, and other provisions of the Act that affect private funds and their advisers, are discussed in this advisory.

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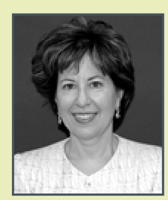

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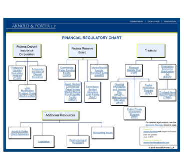

Financial Regulatory Chart

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Title IV. The Private Fund Investment Advisers Registration Act

Amendments to Impose Advisers Act Requirements on Advisers to Private Funds

Advisers to "private funds"[1] will become subject to Advisers Act regulation under the Act through an amendment that eliminates the current exemption in Section 203(b)(3) of the Advisers Act for investment advisers who, during the course of the preceding 12 months, had fewer than 15 clients (with a fund counting as a single client), and who do not hold themselves out to the public as an investment adviser nor act as an investment adviser to a registered investment company or a business development company. The elimination of the "private adviser" exemption from registration applies to investment advisers with less than 15 clients generally and not just to private fund advisers. Newly registered advisers will become subject to existing Advisers Act disclosure, record-keeping, custody, antifraud, and compliance requirements, as well as the additional requirements for private fund advisers discussed below.

Exemptions from Advisers Act Registration

In general, most advisers to hedge funds and private equity funds will be required to register with the SEC as investment advisers. However, the Act carves out a series of exemptions from the registration requirements of the Advisers Act, based upon assets under management or type of private fund.

- ***Registration Exemption for Investment Advisers with under $150 Million in US Assets under Management that Act as Advisers Solely to Private Funds.*** The Act directs the SEC to create an exemption from registration for any investment adviser that acts solely as an investment adviser to private funds and that has assets under management in the United States of less than $150 million. (However, as discussed below, investment advisers that have clients *other than* private funds would be subject to SEC or state registration requirements based upon other asset thresholds.) The SEC must require advisers to such "mid-sized" funds to maintain records and provide the SEC with annual or other reports as determined by the SEC.[2]
- ***Registration Exemption for Investment Advisers that Act as Advisers Solely to Venture Capital Funds.*** The Act exempts from registration an investment adviser that acts as an investment adviser solely to one or more "venture capital funds" (to be defined by SEC rule not later than one year after enactment). The SEC must require such advisers to maintain records and provide to the SEC annual or other reports.
- ***Exemption for Investment Advisers to Small Business Investment Companies.*** Investment advisers, other than those that are regulated or have elected to be regulated as business development companies, who solely advise small business investment companies (SBIC) are exempt from Advisers Act registration.[3]
- ***Exemption for Investment Advisers to Family Offices.*** The Act amends the definition of an "investment adviser" to exclude any "family office," as defined by SEC rule, regulation, or order. Any SEC rule, regulation, or order defining the term "family office" must be consistent with prior SEC exemptive orders and must recognize the range of organizational, management, and employment structures and arrangements employed by family offices. In addition, under a grandfathering provision, the definition of "family office" must not exclude any person who was not registered or required to be registered under the Advisers Act on January 1, 2010 solely because such person provides investment advice to, and was engaged before January 1, 2010 in providing investment advice to, certain enumerated categories of investors.[4] A family office that would not be a family office but for the grandfathering provision is deemed to be an investment adviser for purposes of the antifraud provisions in paragraphs (1), (2), and (4) of Section 206 of the Advisers Act. These provisions are designed to eliminate the need for individual case-by-case SEC exemptive orders for family offices.[5]
- ***Limited Exemption for Foreign Private Advisers.*** The Act exempts any investment adviser that is a "foreign private adviser" from Advisers Act registration. The term "foreign private adviser" refers to any investment adviser

who: (1) has no place of business in the United States; (2) has, in total, fewer than 15 clients and investors in the United States in private funds advised by the investment adviser; (3) has aggregate assets under management attributable to US clients and US investors in private funds advised by the investment adviser of less than $25 million (or such higher amount as the SEC may, by rule, deem appropriate); and (4) neither holds itself out generally to the public in the United States as an investment adviser, nor acts as an investment adviser to any investment company registered under the Investment Company Act or to a company that has elected to be a business development company. Because this exemption has several conditions, many foreign advisers may be required to register with the SEC. Foreign advisers that do not fall within the exemption but nevertheless have a limited number of US investors or assets under management in the US and limited US contacts may wish to evaluate whether to discontinue providing services to US clients.

- ***Elimination of Intrastate Exemption for Private Fund Advisers.*** Investment advisers to private funds will no longer be permitted to rely on the intrastate exemption from Investment Adviser Act registration applicable to advisers whose clients reside in the state in which such adviser maintains its principal place of business.[6]

Federal and State Jurisdiction

At the present time, investment advisers with assets under management of less than $25 million are generally not permitted to register with the SEC, but are instead subject to state registration. The Act effectively raises this threshold to $100 million in most cases by providing that an adviser with assets under management of greater than $25 million and up to $100 million (or a higher amount set by SEC rule) that is required to be registered and subject to examination under the laws of the state in which it has its principal office and place of business may not register with the SEC. However, if the investment adviser would be required to register with 15 or more states, then the adviser is permitted to register with the SEC. In addition, as has previously been the case, SEC registration is required if the adviser acts as an investment adviser to a registered investment company or a business development company.

This provision applies generally and is not limited to advisers to private funds. The increase in the statutory assets under management threshold may require many mid-sized investment advisers to register with the states rather than the SEC.

Record-Keeping, Reporting, and Registration Requirements

The Act gives the SEC authority to require advisers to private funds to maintain records and file reports with the SEC. These requirements, which will be further established by SEC rule, must include, for each private fund managed by the adviser, a description of:

- The amount of assets under management;
- Use of leverage, including off-balance sheet leverage;
- Counterparty credit risk exposure;
- Trading and investment positions;
- Valuation policies and practices;
- Types of assets held;
- Side arrangements or side letters;
- Trading practices; and
- Other information that the SEC, in consultation with the FSOC, determines is necessary or appropriate in the public interest or for the assessment of systemic risk.

The SEC may establish different reporting requirements for different classes of fund advisers, based upon the type or size of private fund being advised. The records of a private fund maintained by a registered private fund adviser are subject to periodic, special, and other examinations by the SEC.

Although the Act does not include specific requirements for disclosure to investors in private funds, there appears to be nothing prohibiting the SEC from requiring additional disclosures to investors and prospective investors pursuant to its authority under Sections 204, 206(4), and 211(a) of the Advisers Act.

Information Sharing

The SEC must make available to the FSOC all reports and records filed with or provided to the SEC by a registered private fund adviser for the purpose of assessing systemic risk of a private fund. These reports will be used in connection with the FSOC's determination of whether to designate a private investment fund as "systemically significant" and therefore subject to Federal Reserve supervision. Private funds that are so designated may be subject to heightened prudential standards, including capital requirements, risk controls, pre-packaged liquidation plan requirements, the FDIC's orderly liquidation authority, and other significant and pervasive regulatory requirements that will apply to financial companies so designated under Titles I and II of the Act.

Protection of Confidential and Proprietary Information

Because records and reports of a private fund are deemed to be records and reports of its registered adviser, the SEC and the FSOC will have access to a private fund's records. However, the Act protects confidential and proprietary information included in reports and records filed with or provided to the SEC by a registered private fund adviser in the following ways:

- The SEC may not be compelled to disclose any report or information required to be filed with the SEC by a private fund adviser, except upon the request of a federal department or agency, any self-regulatory organization (SRO) within the scope of its jurisdiction, or Congress, or to comply with a court order.
- The FSOC and any department, agency, or SRO that receives reports and other information from the SEC under the Act must keep it confidential, and such reports and information are exempt from disclosure under the Freedom of Information Act (FOIA).
- The Act provides enhanced protection for "proprietary information"[7] of a private fund adviser ascertained by the SEC from any report required to be filed with the SEC. This information is subject to the same limitations on public disclosure as any facts ascertained during an investment adviser examination under Section 210(b) of the Advisers Act.[8]

Confidential Client Information

Section 210(c) of the Advisers Act currently protects the confidential information of investment advisers' clients from unwarranted government intrusion by providing that the SEC is not authorized to require any investment adviser to disclose the identity, investments, or affairs of any client of the adviser, except insofar as the disclosure may be necessary or appropriate in a particular proceeding or investigation having as its object the enforcement of Adviser Act provisions. The Act modifies Section 210(c) by permitting the SEC to require any investment adviser to disclose the identity, investments, or affairs of any client "insofar as such disclosure may be necessary or appropriate in a particular proceeding or investigation…*or for purposes of assessment of potential systemic risk*." (emphasis added)

Custody of Adviser Client Accounts

The Act requires registered investment advisers to take such steps to safeguard client assets over which the adviser has custody, including verification of such assets by an independent public accountant, as the SEC may prescribe by rule. The SEC recently adopted amendments to Advisers Act custody and recordkeeping rules, effective March 12, 2010.[9]

Definition of the Term "Client"

The Act clarifies that the SEC's rulemaking authority under Section 211(a) of the Advisers Act includes authority to issue, amend, and rescind SEC rules and regulations defining "technical, trade and other terms." However, the SEC may not define the term "client" for purposes of the antifraud provisions of paragraphs (1) and (2) of Section 206 of the Advisers Act to include an investor in a private fund managed by an investment adviser if the private fund has entered into an advisory contract with the adviser. This provision is intended to avoid potential conflicts between the fiduciary duty an adviser owes to a private fund and to the individual investors in the fund (if those investors were defined as clients of the adviser). The Act recognizes that actions in the best interest of the fund may not always be in the best interests of each individual investor. However, the SEC has authority to define the term "client" to include an investor in a private fund for purposes of other sections of the Advisers Act.

Joint SEC/CFTC Rulemaking

The SEC and the US Commodity Futures Trading Commission (CFTC) must, after consultation with the FSOC, but not later than 12 months after enactment, jointly promulgate rules to establish the form and content of reports to be filed by private fund advisers with the SEC and with the CFTC by investment advisers that are registered both under the Advisers Act and the Commodity Exchange Act.

Adjustment to the "Accredited Investor" Standard

During the four-year period that begins on the date of enactment of the Act, the net worth standard for a natural person to qualify as an "accredited investor"[10] under the Securities Act of 1933 (Securities Act) is $1 million, *excluding* the value of the primary residence of the natural person.[11] Prior to enactment of the Act, individual investors could include their primary residence in the net worth calculation. This change, which is effective immediately, will make it harder for many individual investors to qualify as an accredited investor. Four years after enactment of the Act, the SEC must increase the net worth standard for individual investors to more than $1 million. The change in the definition of an accredited investor applies generally and not only to private funds, and private funds and other issuers should review their offering documents accordingly. The SEC must conduct periodic reviews of the definition.[12]

Adjustment to the Qualified Client Standard

Rule 205-3 under the Advisers Act provides an exemption from the prohibition on incentive fees for "qualified clients" (as defined in the rule).[13] The Act amends Section 205(e)[14] of the Advisers Act to require the SEC to make an inflation adjustment if the SEC uses a dollar amount test, such as a net asset threshold, as a factor in any SEC rule under Section 205(e). The SEC must issue an order not later than one year after the date of enactment, and every five years thereafter, to adjust for the effects of inflation on the test.

Studies

Title IV of the Act requires the GAO to conduct studies and reports on custody rule costs, the criteria for accredited investors, and the feasibility of an SRO for private funds, and requires the SEC to conduct separate studies on short selling.

Other Provisions of Interest to Private Funds

Systemic Risk Regulation. Under Title I of the Act, the FSOC has authority to require nonbank financial companies, including private funds and their advisers, to be supervised by the Federal Reserve if the FSOC determines that material financial distress at the company, or the nature, scope, size, scale, concentration, interconnectedness and mix of its activities, could pose a threat to US financial stability. A private fund that becomes subject to Federal Reserve supervision in this manner may be subject to heightened prudential standards, including concentration limits, leverage limits, liquidity requirements, resolution plan, credit exposure report requirements, risk-based capital requirements, a contingent capital requirement, restrictions on management interlocks, and overall risk management requirements. Further information is available in our advisory, "Dodd-Frank Act Addresses Systemic Risk."[15]

Orderly Liquidation Authority. Title II of the Act provides orderly liquidation procedures in cases where authorities find that a nonbank financial company supervised by the Federal Reserve (which could include a private fund or adviser) is in default or danger of default and that, among other things, its failure and resolution would otherwise have serious adverse effects on US financial stability. In such a case, the FDIC would be appointed as receiver with the task of liquidating the company in an orderly manner, under new statutory provisions similar to the receivership provisions in the Federal Deposit Insurance Act.

To carry out these functions, Title II creates an "Orderly Liquidation Fund" (OLF), to be funded by FDIC obligations issued to the Treasury and then repaid with proceeds from the liquidated firm's assets. If necessary, however, assessments could be charged to "eligible financial companies," including, potentially, private funds and advisers supervised by the Federal Reserve, and any bank holding company with total consolidated assets of $50 billion or more. Assessments will be imposed on a graduated basis, with financial companies having greater assets and risk being assessed at a higher rate. Further information on Title II is available in our advisory, "Dodd-Frank Act Creates New Resolution Process for Systemically Significant Institutions."[16]

Over-the-Counter Derivatives Regulation. Under Title VII of the Act, new capital, margin, registration, recordkeeping, and related requirements will be imposed on "swap dealers" and "major swap participants." Private funds could fall within the definition of a "major swap participant" and in some cases a "swap dealer." In brief, a "swap dealer" is any person holding itself out as a dealer in swaps, who makes a market in swaps, who regularly enters into swaps as an ordinary course of business for its own account, or engages in any activity causing the person to be commonly known as a dealer or market maker. A "major swap participant" is (i) a person who maintains a substantial position in swaps (excluding any held to mitigate commercial risk); (ii) a person whose outstanding swaps create substantial counterparty exposure that could have serious adverse effects on financial stability; or (iii) a highly leveraged financial entity that is not subject to capital requirements under banking rules and that maintains a substantial position in outstanding swaps in categories determined by regulators.

Title VII establishes SEC authority over security-based swaps, and CFTC authority over others. Title VII specifies requirements for exchange trading (or trading on a swap execution facility) and centralized clearing for swaps meeting specified criteria. The CFTC and SEC will, in general, review clearing standards and determine whether a given type of swap must be cleared and/or traded on such an exchange or facility. Regulators also are authorized to establish position limits with respect to certain swap transactions, as deemed appropriate. Private funds that participate in derivatives trades may not be able to take large positions in certain swaps if the regulators decide to establish more restrictive position limits. Further information regarding the Act's impact on derivatives trading is available in our advisory, "Dodd-Frank Wall Street Reform and Consumer Protection Act to Significantly Impact Derivatives Trading of Banks."[17]

Other Provisions. Titles VII and IX include a number of other provisions of interest to private fund advisers and other investment advisers.

- **Short Sale Reporting and Disclosure.** Title IX of the Act directs the SEC to issue rules for public disclosure of aggregate short sale data for individual securities on a no-less-than-monthly basis. The disclosure must include the name of the issuer and the title, class, CUSIP number, and any additional information determined by the SEC. The Act prohibits manipulative short sales and directs the SEC to issue rules to ensure appropriate enforcement remedies are available for violations of this prohibition. It also requires broker-dealers to notify customers that they may elect not to allow their fully paid securities to be used in connection with short sales, and that the broker may receive compensation if the shares are so used.[18]
- **Whistleblower Incentives and Protections.** Title IX authorizes the SEC to pay bounties of up to 10 percent to 30 percent of funds collected to whistleblowers in SEC enforcement actions that result in monetary sanctions exceeding $1 million. It also prohibits employer discrimination against whistleblowers and gives employees a private right of action against employers who retaliate against them.
- **Broader SEC Enforcement Powers.** The Act increases the jurisdictional scope and causes of action that the SEC can bring, as well as the remedies that can be imposed. Title IX:
  - — Amends the Securities Act, Exchange Act, and Investment Company Act to provide that in an enforcement action by the SEC, persons may be held liable for knowingly or recklessly providing substantial assistance to another person in violation of the securities laws. The Advisers Act is amended to provide for such liability for persons that knowingly or recklessly aid, abet, counsel, command, induce, or procure a violation.
  - — Permits the SEC to impose civil monetary penalties in administrative cease-and-desist proceedings against any person found to have violated securities laws. Previously, civil penalties could be imposed in administrative actions only against regulated entities (such as broker-dealers, investment advisers, and mutual funds) and associated persons.

— Extends the jurisdiction of US courts in actions or proceedings brought or instituted by the SEC or the United States alleging a violation of the antifraud provisions of the federal securities laws to cover (i) securities transactions outside the United States, where conduct within the United States constitutes "significant steps in furtherance of the violation;" or (ii) conduct occurring outside the United States that has a "foreseeable substantial effect" within the United States.

— Clarifies that controlling person liability under Section 20(a) of the Exchange Act applies in SEC enforcement actions, not only in private actions.

— Amends the Exchange Act and the Advisers Act to give the SEC authority to bar offenders from associating with a broad range of SEC-regulated entities (e.g., investment advisers, brokers, dealers, municipal securities dealers, municipal advisers, transfer agents, and nationally recognized statistical rating organizations). Previously, offenders barred for securities law violations in one type of regulated entity could find work in another part of the securities industry.

— Gives the SEC authority to subpoena witnesses located anywhere in the United States in civil actions filed in federal court.[19]

— Gives SEC staff 180 days after giving a Wells Notice to any person to file an enforcement action against such person or provide notice to the Director of the Division of Enforcement of its intent to not file an action. In addition, gives the SEC staff 180 days after completing an onsite examination or receiving all requested records, whichever is later, to request corrective action or provide written notice that the examination has concluded. Both deadlines are subject to additional 180-day extensions by the SEC in complex cases with notice to (and for the subsequent extensions, approval of) the SEC.

- **Broader CFTC Enforcement Powers.** Title VII of the Act significantly increases the enforcement powers of the CFTC:

— The Act broadens the CFTC's enforcement authority with regard to commodity futures contracts and swaps by including fraud liability provisions that parallel Section 10(b) of the Exchange Act with respect to securities. Specifically, the Act achieves this by amending Section 4b of the Commodity Exchange Act and adding language that prohibits derivatives participants from: employing any device, scheme, or artifice to defraud; making any untrue statement of material fact or omitting any statement of material fact necessary in order to make the statements made misleading; or engaging in any act, practice or course of business which operates as a fraud or deceit upon any person.

— The Act also provides the CFTC with enforcement authority over market participants that engage in "disruptive practices." The Act defines such disruptive practices to include: activities violating bids or offers; intentional or reckless disregard for the orderly execution of transactions during the closing period of a market; and "spoofing" (bidding or offering with the intent to cancel the bid or offer before execution).

— The Act also expands the CFTC's anti-manipulation authority, and broadens the types of activities that are considered manipulation. For instance, it reduces the scienter requirement for manipulation in the reporting context by changing the standard of such conduct to include acting in *reckless* disregard of the fact that such report is false, misleading, or inaccurate.

- **Miscellaneous Provisions.** Title IX also:

— Authorizes the SEC to require earlier filing of beneficial ownership reports required by Section 13(d) of the Exchange Act (current law requires reporting "within ten days of acquisition") and eliminates requirements to send related notices to the issuer and exchanges. A similar accelerated time frame would be allowed for "short swing" reporting under Exchange Act Section 16.

— Requires the SEC to issue rules within one year after enactment of the Act to disqualify felons and other "bad actors" from participating in exempt offerings of securities made under Rule 506 of Regulation D.

— Requires persons who have custody or use of securities, deposits or credits of a registered investment company or of clients of registered investment advisers to comply with recordkeeping requirements as the SEC may prescribe and subjects such records to examinations.

— Gives the SEC authority to prohibit or impose conditions or limitations on the use of mandatory pre-dispute arbitration agreements with customers of brokers, dealers, municipal securities dealers and investment advisers.

We hope that you have found this advisory useful. If you have additional questions, please contact your Arnold & Porter attorney or:

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(Endnotes)

1 The Act defines a "private fund" as an issuer that would be an investment company under the Investment Company Act of 1940 (Investment Company Act) but for the exceptions provided in Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act. Section 3(c)(1) excludes from the definition of investment company any issuer whose outstanding securities (other than short-term paper) are beneficially owned by not more than 100 investors and which is not making a public offering. Section 3(c)(7) excludes from the definition of investment company any issuer whose outstanding securities are owned exclusively by persons who, at the time of acquisition of such securities, are "qualified purchasers," and which is not making a public offering. The term "qualified purchasers" is defined in Section 2(a)(51) of the Investment Company Act and includes institutions with $25 million or more in investments and individuals and family companies with $5 million or more in investments.

2 In prescribing regulations for advisers to such "mid-sized" private funds, the SEC must take into account the size, governance, and investment strategy of the funds to determine whether they pose systemic risk, and must provide for registration and examination procedures for the advisers of these funds that reflect the level of systemic risk posed by the funds.

3 The exemption applies to investment advisers who solely advise small business investment companies that are licensed under the Small Business Investment Act of 1958; entities that have received from the Small Business Administration notice to proceed to qualify for a license, which notice or license has not been revoked; or applicants affiliated with one or more licensed small business investment companies that have applied for another license, which application remains pending.

4 The enumerated categories of investors include:

(A) Natural persons who, at the time of their applicable investment, are officers, directors, or employees of the family office who:

(i) have invested with the family office before January 1, 2010; and

(ii) are accredited investors, as defined in Regulation D under the Securities Act or, as the SEC may prescribe by rule, the successors-in-interest thereto;

(B) Any company owned exclusively and controlled by members of the family of the family office, or as the SEC may prescribe by rule;

(C) Any investment adviser registered under the Advisers Act that provides investment advice to the family office and who identifies investment opportunities to the family office, and invests in such transactions on substantially the same terms as the family office invests, but does not invest in other funds advised by the family office, and whose assets as to which the family office directly or indirectly provides investment advice represent, in the aggregate, not more than 5 percent of the value of the total assets as to which the family office provides investment advice.

5 Many high net worth families operate offices to manage the personal and financial affairs of family members. For smaller families, the old "fewer than 15" clients exemption in Section 203 of the Advisers Act, and SEC rules which defined relatives living in a single household as one "client" for this purpose, have provided an exemption from Advisers Act registration for these "family offices." Since the 1940s, however, the SEC has issued individual orders exempting from the Advisers Act certain family offices on a case-by-case basis (typically offices of larger, multi-generational families). The SEC in the past took the view that it did not have statutory authority to grant these exemptions by rule of general applicability, but only by individual orders.

6 Section 203(b)(1) of the Advisers Act exempts from registration any investment adviser all of whose clients are residents of the State within which such investment adviser maintains his or its principal office and place of business, and who does not furnish advice or issue analyses or reports with respect to securities listed or admitted to unlisted trading privileges on any national securities exchange.

7 "Proprietary information" includes sensitive, non-public information regarding the investment adviser's investment or trading strategies, analytical or research methodologies, trading data, computer hardware or software containing intellectual property, and any additional information that the SEC determines to be proprietary.

8 Section 210(b) of the Advisers Act generally prohibits the SEC and its staff from disclosing the existence of any examination under the Advisers Act or the results of or any facts ascertained during any such examination.

9 *See* Release IA-2968, Custody of Funds or Securities of Clients by Investment Advisers, Dec. 30, 2009, *available at:* http://www.sec.gov/rules/final/2009/ia-2968.pdf.

10 The term "accredited investor," as defined in Rule 501(a) of Regulation D under the Securities Act for purposes of certain exempt offerings, includes:

- Individuals who have a net worth, or joint worth with their spouse, above $1 million, or have income above $200,000 in each of the last two years (or joint income with their spouse above $300,000) and a reasonable expectation of reaching the same income level in the year of investment; or are directors, executive officers or general partners of the issuer of the securities or its general partner; and
- Certain institutional investors, including: banks; savings and loan associations; registered brokers, dealers and investment companies; licensed small business investment companies; corporations, partnerships, limited liability companies and business trusts with more than $5 million in assets; and qualified employee benefit plans and trusts with more than $5 million in assets.

11 The SEC has issued an interpretation that the amount of any associated mortgage and other indebtedness secured by the primary residence up to its fair market value may be excluded in determining an individual's net worth. Any excess liability should be deducted from the investor's net worth. *See* Compliance Disclosure and Interpretation (CDI) 179.01 (or identical CDI 255.47).

12 The SEC may undertake an initial review of the definition of an "accredited investor," as the term applies to natural persons, to determine whether the definition, excluding the requirement relating to the net worth standard described above, should be adjusted or modified, and following completion of the review, may make adjustments to the definition (except as to the net worth standard requirement) after notice and comment rulemaking. The SEC is required to conduct a review, not earlier than four years after enactment and not less frequently than every four years thereafter, of the definition of "accredited investor" in its entirety as defined in Rule 215 of the Securities Act. Upon completion of this review, the SEC may make adjustments to the definition of "accredited investor" as defined in Rule 215 after notice and comment rulemaking. (The Act does not require a review of the definition of an "accredited investor" in Rule 501(a) of Regulation D every four years. Rather, this review is only required with respect to the definition of an "accredited investor" for purposes of Rule 215, which affects the Section 4(6) exemption from registration under the Securities Act.)

13 Rule 205-3 generally defines a "qualified client" as one of the following:

(1) A natural person or company that has $750,000 under the management of the adviser; or

(2) A natural person or company whom the adviser reasonably believes has (a) a net worth of more than $1.5 million; or (b) is a "qualified purchaser" as defined in Section 2(a)(51) of the Investment Company Act; or

(3) An executive officer, director, trustee, or general partner of the adviser, or an employee that participates in the investment activities of the adviser with at least 12 months investment experience.

14 Section 205(e) of the Advisers Act permits the SEC to exempt any person or transaction from the Advisers Act limitations on incentive fees set forth in Section 205(a)(1) if the SEC determines such person does not need this protection on the basis of financial sophistication, net worth, knowledge of and experience in financial matters, and certain other factors.

15 *Available at:* http://www.arnoldporter.com/public_document.cfm?id=16151&key=17B3.

16 *Available at:* http://www.arnoldporter.com/public_document.cfm?id=16155&key=12F3.

17 *Available at:* http://www.arnoldporter.com/public_document.cfm?id=16138&key=26I2.

18 In addition to the rulemaking on short sale reporting and disclosure, the SEC is required to conduct a study of the feasibility, benefits and costs of requiring reporting of short sale positions to the public, or alternatively, only to the SEC and the Financial Industry Regulatory Authority. A separate study is required on the state of short selling, with consideration given to the impact of recent rule changes and failures to deliver.

19 Previously, the applicable federal rule of civil procedure placed a geographical limit on how far a witness could be required to travel, which meant that juries in federal court cases often watched videotaped depositions rather than live testimony. However, nationwide service of process will now be available to defendants in SEC federal court cases as well. The SEC currently has nationwide subpoena authority in administrative proceedings.