Foreign Investment Advisers: Traps for the Unwary in the Proposed SEC Rules.

December 13, 2010

On November 19, 2010, the Securities and Exchange Commission (the "SEC") proposed rules implementing the new exemption for foreign private advisers from SEC registration introduced by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). The new exemption will become effective on July 21, 2011. It relies in substantial part on the SEC's current position with respect to the registration requirements for foreign investment advisers, but expands the universe of foreign investment advisers required to register with the SEC by including the number of investors and the assets under management in private funds managed by foreign investment advisers in determining their eligibility to rely on the exemption. The proposed SEC rules implementing the private adviser exemption further expand the number of foreign investment advisers that will in the future be required to register with the SEC.

As amended by Dodd-Frank, Section 202(b)(3) of the Investment Advisers Act of 1940, as amended (the "Advisers Act") exempts a foreign investment adviser from SEC registration if the foreign adviser

(a) has no place of business in the United States,

(b) has, in total, fewer than 15 clients in the United States and investors in the United States in private funds advised by the foreign adviser,

(c) has aggregate assets under management attributable to clients in the United States and investors in the United States in private funds advised by the foreign investment adviser of less than $25 million (or such higher number as the SEC may deem appropriate), and

(d) neither holds itself out publicly in the United States as an investment adviser, nor acts as an investment adviser to an investment company registered under the Investment Company Act or a business development company pursuant to Section 54 of the Investment Company Act.

No Place of Business in the United States

Pursuant to the proposing release, the SEC intends to rely on the criteria set forth in Section 222 of the Advisers Act to determine whether a foreign adviser has a place of business in the United States. Pursuant to Rule 222-1, the physical location of the executive office of the investment adviser from which the officers, partners, or managers of the investment adviser direct, control, and coordinate the activities of the investment adviser determines whether an investment adviser has a place of business in the United States.

Clients or Investors in the United States

To determine whether clients or investors are deemed to be in the United States, the SEC generally relies on the definitions of U.S. person and United States under Regulation S with one significant exception: Discretionary accounts held by a non-U.S. securities dealer or professional fiduciary for the benefit of a U.S. person is treated as a client in the United States if the dealer or professional fiduciary is related to the foreign investment adviser relying on the exception. However, a foreign investment adviser may treat a U.S. client or investor as not being in the United States if such client was not in the United States at the time of becoming a client or investor in a private fund.

The proposed limitation of the types of discretionary accounts that qualify as non-US clients will have an impact on foreign advisers that are part of group that includes a foreign bank, broker, fiduciary company or similar financial service provider.

Number of Clients and Investors

Proposed SEC Rule 202(a)(30)-1(a) and (b) provide a *safe harbor* based on SEC Rule 203(b)-1 for purposes of determining a foreign adviser's single U.S. clients. Pursuant to this rule, minor children, relatives who live in a client's home, accounts or trusts where the client or any of the foregoing persons are the primary beneficiaries constitute one client. Legal organizations with identical owners may also be treated as a single client if the adviser provides investment advice based on the investment objectives of the organization and not its members. The foreign adviser may attribute multiple accounts of the foregoing beneficiaries to the same client. However, a foreign adviser must include U.S. persons for whom it provides investment advice *without compensation* in determining the number of its U.S. clients.

Proposed SEC Rule 202(a)(30)-1(c) defines an *investor* in a private fund as any person who would be included in determining the number of beneficial owners of a private fund pursuant to Section 3(c)(1) of the Investment Company Act of 1940, as amended (the "Investment Company Act") or in determining whether a private fund pursuant to Section 3(c)(7) of the Investment Company Act is owned exclusively by qualified purchasers pursuant to Section 2(a)(51) of the Investment Company Act. In addition, the investment adviser must count certain executives and investment professionals as well as holders of short term-term paper as investors in a private fund.

Pursuant Section 3(c)(1) of the Investment Company Act, beneficial ownership of voting securities of a private fund held by another private fund that owns 10% or more of the outstanding voting securities of the private fund in which it is invested is attributed to the holders of the investor fund's securities. Accordingly, it seems that the SEC requires a foreign adviser to look through these funds to determine whether U.S. investors hold any securities in a private fund advised by such foreign adviser.

For purposes of Section 3(c)(7), a foreign private adviser may be required to look through private funds to determine beneficial ownership as well as through companies that hold a controlling interest in the private fund relying on Section 3(c)(7).

According to the adopting release, the SEC purposely narrowed the scope of the exemption to increase the number of foreign advisers that will be required to register with the SEC.

Assets under Management

Assets under management must be determined by reference to "regulatory assets under management under Item 5 of Form ADV.

Holding Out Generally to the Public in the United States as an Investment Adviser

In the proposed rules, the SEC clarifies that a foreign investment adviser would not be deemed to hold itself out generally to the public in the United States as an investment solely because the adviser participates in the private placement of securities of a private fund in the United States.

Foreign Advisers to Private Funds or Venture Capital Funds

Instead of relying on the exemption for foreign private advisers, foreign investment adviser to private funds or venture capital funds may instead rely on the exemptions from Advisers Act registration provided for advisers to private funds and venture capital funds. For a discussion of the proposed SEC rules for these advisers please refer to our client information "Proposed SEC Rules for Venture Capital Funds and Private Fund Advisers."

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This summary is intended to provide general information only on the matters presented. It is not a comprehensive analysis of these matters and should not be relied upon as legal advice. If you have any questions about the matters covered in this publication, please contact:

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