

posted - 05 Jul 2011

A practical outline

James Deeken of law firm Akin Gump Strauss Hauer & Feld discusses what SEC registration means for private equity fund managers.

On 22 June the US Securities and Exchange Commission adopted rules under the Dodd Frank Act to obligate a number of private equity fund managers to register as an investment advisor with the SEC. The registration requirements will require a shift for many private equity firms in the way they operate with respect to compliance policies, public disclosures and preparation for possible SEC in-office examinations.

Going from being an unregistered investment advisor to an SEC registered investment advisor will create three fundamental shifts in the way that private equity managers operate: (i) being subject to increased regulation under the Investment Advisers Act of 1940; (ii) making public disclosures in SEC filings and (iii) being subject to an increased likelihood of SEC examinations.

Each private equity manager registering with the SEC will be required to appoint a chief compliance officer, adopt comprehensive compliance policies and procedures specifically tailored to the compliance risks presented by their business operations and review such policies and procedures on an annual basis. Although a registered investment advisor will be required to comply with the full array of regulations under the Advisers Act, some of the requirements that will have a more practical impact are below:

Custody: A requirement that securities be maintained with a qualified bank or investment firm custodian, with a need to provide annual fund audited financial statements to fund investors within 120 days of fiscal year end or be subject to surprise audits to verify custody of securities and other requirements

Code of Ethics: A requirement that fund manager and others with access to information about investments of a manager fund pre-clear their personal participations in initial public offerings and private offerings of securities and report their personal trading

Marketing:

- Restrictions on materials that can be included in marketing materials;
- Restrictions on using select case studies of certain positions;
- Provisions for providing investors certain required disclosures and regulations regarding the use of placement agents

Fees: Requirements that (i) performance-based compensation can only be charged to certain “qualified clients” and (ii) management fees cannot be charged to investors for a period of six months or more in advance unless the investment advisor elects to file certain audited financial statements of the investment advisor with the SEC

Books and Records: Requirements regarding the records (including emails and instant messages) that must be maintained, the methods of retention and the duration of retention

Business Continuity Plans: Disaster recovery and business continuation policies and plans

Reporting to the SEC on Form PF: Under proposed SEC rules, requirements to report to the SEC, either on a periodic basis information about use of leverage and certain other investor and investment-related information

A number of other restrictions applicable to investment advisors generally, regardless of whether they are registered with the SEC or not, such restrictions on cross trades and political contributions to prospective governmental entity investors.

PE MANAGER

FOR PRIVATE FUND CFOs, COOs, AND COMPLIANCE OFFICERS

Each manager registering as an investment advisor will be required to file a comprehensive Form ADV that will be accessible to the general public on the SEC's website and will be required to update it on at least an annual basis. The Form ADV requires an investment adviser to disclose information such as disciplinary history, types of clients, compensation and fees, assets under management, officers, a summary of compliance policies, brokerage practices and a summary of the material risks involved in making an investment with the advisor. The main consequence is that some of the information about private equity managers that has been traditionally confined to private placement memorandums will now be made publicly available.

Registration with the SEC raises the profile of a manager with the SEC and increases the chances of examination. The SEC typically conducts three types of examinations: (i) cause—where there is reason to believe that an investment manager is violation of law; (ii) sweeps—where the SEC exams a broad base of managers fitting certain criteria and (iii) routine examinations. For routine examinations, the SEC will typically assign a risk rating to managers based on various factors, including past compliance history, the results of past examinations, outlier performance and trading strategy and exam those with higher risk ratings more frequently.

Private equity managers that will need to register with the SEC under Dodd Frank should begin to consider now the adoption of policies to comply with the Advisers Act, the preparation of SEC registration materials and preparedness for possible in-office examinations by the SEC.