

Investment Funds Alert

SEC Clarifies Mechanics for Transition to State Registration

July 21, 2011

The Securities and Exchange Commission (SEC) recently adopted rules to clarify the operation of the new minimum threshold of eligibility for SEC registration for investment advisers that was added to the Investment Advisers Act of 1940 (the “Advisers Act”) by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). The new minimum threshold is \$100 million in assets under management (AUM). In order to give advisers currently registered under the Advisers Act time to become registered in the relevant state or states while retaining their SEC registration, the SEC provided a temporary exemption from the new \$100 million in AUM minimum threshold for currently registered investment advisers until January 1, 2012. Investment advisers that do not satisfy the new \$100 million¹ threshold will be required to deregister with the SEC by June 28, 2012. The \$100 million minimum threshold will be determined using a revised AUM calculation to avoid opportunities for regulatory arbitrage.

Prior to the effectiveness of Title IV of the Dodd-Frank Act, investment advisers with less than \$25 million of assets under management were not eligible for registration with the SEC. The Dodd-Frank Act modified this provision by making ineligible for SEC registration any investment adviser that (i) is required to be registered as an investment adviser with the securities commissioner of the state in which it maintains its principal office and place of business and, if registered, would be subject to examination and (ii) has AUM of less than \$100 million or such higher amount as may be set by the SEC (such investment adviser a “State-Regulated Adviser”), unless the investment adviser is an adviser to an investment company registered under the Company Act or a company that has elected to be a business development company pursuant to the Company Act and has not withdrawn the election. The new rules clarify the mechanics of this new exclusion from SEC authority and answer several open questions.

When will an investment adviser that is registered with the SEC be required to transition from federal to state registration?

Irrespective of when its fiscal year ends, each SEC-registered investment adviser that is registered on January 1, 2012, will be required to file an amendment to its Form ADV no later than March 30, 2012, reporting the market value of its regulatory AUM (as described below) determined within 90 days prior to the filing (the “Transition ADV”). If the adviser has less than the required amount of regulatory AUM as reported in that filing, the registered investment adviser will be required to file Form ADV-W withdrawing its registration with the SEC no later than June 28, 2012 (180 days after the end of the fiscal year).² An investment adviser that is currently registered with the SEC may not transition to state registration even if it has less than \$90 million in regulatory AUM (unless an exemption is available) until January 1, 2012.

After July 21, 2011, may a State-Regulated Adviser that is registered with a state securities commission choose to register with the SEC?

¹ The \$100 million in AUM will be determined through the annual amendment process.

² Investment advisers that expect to have to transition to state registration may wish to dual-register with a state prior to June 28, 2012, in order to accommodate state investment adviser registration timelines and avoid gaps in registration.



No, the SEC delayed the increase in the AUM threshold for State-Regulated Advisers only for investment advisers that are registered on July 21, 2011. After July 21, 2011, State-Regulated Advisers will be prohibited from registering with the SEC.

In which states are investment advisers subject to the \$25 million threshold because they are not required to register or are not subject to inspection?

New York does not inspect its investment advisers. Investment advisers in New York are, therefore, subject to the lower \$25 million in regulatory AUM threshold for registration.³ Wyoming does not have an investment advisory statute, so investment advisers in Wyoming must register with the SEC unless otherwise exempt if they provide advice as to securities even if they do not have any regulatory AUM.

An investment adviser's regulatory AUM may fluctuate above and below \$100 million on a regular basis. Will an investment adviser have to register and deregister with the SEC multiple times a year?

No, an investment adviser is required to measure its regulatory AUM after its annual updating amendment to its Form ADV. If an adviser's regulatory AUM decreases during the year, it would not be required to transition from SEC to state registration until its next annual updating amendment. As with the current rules, the new rules will require transition from SEC registration to state registration within 180 days after the end of the investment adviser's fiscal year.

The Dodd-Frank Act allowed the SEC to adopt a higher threshold for transition to state registration. Did the SEC increase the registration threshold to allow for a range of AUM that permits voluntary registration?

Yes, a State-Regulated Adviser is permitted to register with the SEC once the investment adviser has at least \$100 million in regulatory AUM and is required to register with the SEC once it has \$110 million or more in regulatory AUM. An SEC-registered investment adviser will not be required to deregister with the SEC unless it has less than \$90 million in AUM.

If an investment adviser with less than \$100 million in regulatory AUM is able to take advantage of an exemption under the state investment adviser statute of the state of its principal office and place of business or related regulations, would the investment adviser escape registration at both the state and federal levels?

No, investment advisers that are exempt from state registration in the state of their principal place of business will not be considered to be "required to register" with that state's securities authority and, therefore, will be required to register with the SEC if they have more than \$25 million in regulatory AUM unless an exemption from SEC registration is otherwise available. A state-exempt investment adviser also will not be able to voluntarily register with the state securities authorities to avoid registration with the SEC.

If an investment adviser is not required to register with a state securities authority because of an exemption, would the investment adviser be required to register with the SEC as soon as it has reached \$25 million in regulatory AUM or would it be able to take advantage of the current \$5 million buffer and register at the \$30 million in AUM level?

In almost every state, an investment adviser will be required to register with the SEC after it has reached \$25 million in regulatory AUM. The final rules will eliminate the related \$5 million buffer and, therefore, require the registration of a state-exempt investment adviser with the SEC if the adviser has more than \$25 million in regulatory AUM, unless an exemption from registration is otherwise available.

³ The release originally stated that investment advisers in Minnesota also would be subject to the lower threshold, but Minnesota subsequently wrote to the SEC and informed the staff that it does inspect investment advisers registered in the state of Minnesota.

Changes to AUM Calculation

The rules discussed above require determinations of an investment adviser's "regulatory AUM." Regulatory AUM is a new term used to indicate the AUM of an investment adviser as determined in accordance with specified instructions to Part 1A of Form ADV (rather than for purposes of Part 2A of Form ADV). The calculation of regulatory AUM in the instructions to Part 1A of Form ADV is similar to that in previous versions, with a few changes for private funds and discretionary assets. Under both the current and the revised AUM definition, "AUM" is defined as the value of securities portfolios with respect to which the investment adviser provides continuous and regular supervisory or management services. The new regulatory AUM definition changes the accounts to be counted as "securities portfolios" and the value of those securities portfolios. To review the new definition of regulatory AUM, see instruction 5.F. available [here](#).

How will the changes to Form ADV affect the accounts that are determined to be "securities portfolios"?

The current definition of AUM allows, but does not require, investment advisers to include securities portfolios that are (i) proprietary and family assets, (ii) assets managed without compensation and (iii) assets of clients that are not United States persons.⁴ The amended Form ADV will require investment advisers to include those securities portfolios in regulatory AUM. The amended Form ADV will also require investment advisers to include all of the assets of private funds as a securities portfolio regardless of the nature of those assets and include any uncalled capital commitments in the value of that securities portfolio.

How will the amendments to Form ADV change the calculation of the value of the regulatory AUM?

As with the previous AUM calculation, an adviser will be required to calculate the AUM based on the current market value of the assets determined within 90 days prior to the filing of the relevant Form ADV. The revised Form ADV will define a private fund's AUM to be the current market value or, in the event that market quotations are unavailable, fair value of the private fund's assets. Any fair valuing will be in accordance with generally accepted accounting standards or another international accounting standard.

How will a sub-adviser's regulatory AUM be calculated?

A sub-adviser's regulatory AUM will only include that portion of the portfolio for which the sub-adviser provides continuous and regular supervisory or management services.

Will the assets be reduced for liabilities or debt?

No, the previous AUM calculation stated that securities purchased on margin should not be deducted. The new Form ADV will expand the exclusion to prohibit an adviser from subtracting any outstanding indebtedness and other accrued but unpaid liabilities that remain in a client's account and are managed by the adviser. Investment advisers could use the total value of assets in a double-entry balance sheet.

Related Alerts

On the same day that the SEC adopted the rules relating to transition to state registration of State-Regulated Advisers, the SEC also adopted rules relating to exemptions from investment adviser registration added by the Dodd-Frank Act and the exclusion to investment adviser status for family offices. For further information, please see our alerts titled, "[SEC Adopts Exemptions for Advisers to Certain Private Funds and Venture Capital Funds and Delays Registration](#)," "[SEC Adopts Rules Clarifying Registration Exemption for 'Foreign Private Advisers'](#)" and "[SEC Adopts Rules Defining Exclusion for Family Offices](#)."

⁴ Although a person is not an investment adviser for purposes of the Advisers Act unless it receives compensation for providing advice to others, once it meets that definition, the Advisers Act applies to the relationship between the adviser and any of its clients.

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