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INVESTMENT FUNDS UPDATE

SEC Issues Much Anticipated Investment Adviser "Umbrella" Registration Guidance

On January 18, 2012, the Division of Investment Management of the Securities and Exchange Commission (the "SEC") issued a no-action letter[1] (the "Letter") in response to a letter submitted by the Subcommittee on Hedge Funds of the Federal Regulation of Securities Committee of the Business Law Section of the American Bar Association (the "Request Letter"). The Letter confirms certain conditions under which a related investment adviser of a registered investment adviser (a "Filing Adviser") may rely on the Filing Adviser's registration under the Investment Advisers Act of 1940 (the "Advisers Act") rather than file its own separate Form ADV.

The Letter addresses the use of the umbrella theory of registration, subject to specified conditions, in two general situations:

- the use of certain special purpose vehicles (each, an "SPV") acting as a general partner or managing member of a private fund (*i.e.*, a fund that relies on the exclusion from the definition of "investment company" provided by Section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940 (the "Company Act")); and
- groups of related advisers (other than SPVs) to private funds and certain separately managed accounts ("SMAs"), where the Filing Adviser and the related advisers are in a control relationship and conduct a single advisory business subject to a unified compliance program.

Background

Historically, certain related advisers of Filing Advisers have not filed their own separate Form ADV, relying instead on the Filing Adviser's registration based on an "umbrella theory." The Letter affirms and expands upon positions expressed by the SEC staff in a December 8, 2005 letter addressed to the American Bar Association's Subcommittee on Private Investment Entities (the "2005 Letter").[2]

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[1] American Bar Association, Business Law Section, SEC No-Action Letter (Jan. 18, 2012), *available at* http://www.sec.gov/divisions/investment/noaction/2012/aba011812.htm.

[2] *See* American Bar Association Subcommittee on Private Investment Entities, SEC Staff Letter (Dec. 8, 2005) at Question and Answer G.1, *available at* http://www.sec.gov/divisions/investment/noaction/aba120805.htm. *See also* Glenwood Associates, Inc., SEC No-Action Letter (Aug. 6, 1992) and Thomson Advisory Group L.P. SEC No-Action Letter (Sept. 26, 1995), cited in the 2005 Letter.

The 2005 Letter permitted a special purpose vehicle formed for the purpose of serving as the general partner or managing member of a private fund and that has a registration obligation under the Advisers Act to rely on the Filing Adviser's registration, subject to certain conditions.

Certain Filing Advisers and their related entities also have relied on the umbrella theory in situations where the related entity was not a true SPV (*e.g.*, when the related entities are sister subsidiaries under common control but do not serve as general partners or managing members).

The Letter

The Request Letter was submitted in the wake of the repeal of the exemption from registration previously provided by Section 203(b)(3) of the Advisers Act and new rules and amendments adopted pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act.[3]

The Letter:

- affirms the guidance provided by the 2005 Letter in respect of SPVs;
- provides additional guidance in respect of SPVs; and
- expands the universe of affiliates of Filing Advisers who may rely on a Filing Adviser's registration ("Relying Advisers") beyond SPVs (*i.e.*, other than the general partners or managing members of private funds managed by a Filing Adviser).

SPVs

The Letter confirms the SEC staff's prior position on SPVs stated in the 2005 Letter. The Letter notes that reliance on the position is subject to the following conditions:

- all of the investment advisory activities of the SPV would be subject to the Advisers Act and the rules thereunder, and the SPV would be subject to examination by the SEC;
- the Filing Adviser would subject the SPV, its employees and persons acting on its behalf to the Filing Adviser's supervision and control (including the Filing Adviser's code of ethics as required by Rule 204A-1 under the Advisers Act and other written compliance policies and procedures (the "Compliance Manual") as required by Rule 206(4)-(7));[4]
- the SPV is established by the relevant registered investment adviser to act as a private fund's general partner or managing member; and
- the formation documents of the SPV designate the registered investment adviser to manage the private fund's assets.[5]

Further, the Letter confirms that a single registered adviser may have multiple SPVs,[6] and that each may rely on a single Filing Adviser's registration. The Letter also addresses situations where SPVs have directors who are independent of

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[3] *See Rules Implementing Amendments to the Investment Advisers Act of 1940*, Investment Advisers Act Release No. 3221 (June 22, 2011), *available at* http://www.sec.gov/rules/final/2011/ia-3221.pdf (the "Implementing Release").

[4] The SPV, all of its employees and the persons acting on its behalf would be deemed to be "persons associated with" the Filing Adviser. *See* Section 202(a)(17) of the Advisers Act.

[5] These explicit conditions may limit more general applications of the umbrella theory previously employed by investment advisers in respect of their SPVs in reliance on the 2005 Letter.

[6] For example, a single adviser to multiple private funds may establish separate general partners for each of its private funds to limit liability or allocate compensation in a specific manner.

the registered adviser or a related SPV.[7] The Letter states that the fact that such independent directors would not be subject to the supervision or control of the Filing Adviser (as would be required by the 2005 Letter), will not require an SPV to register separately, assuming the other conditions are met.

Of note, the Letter also states that the SPV is itself a registered investment adviser, despite the fact that it relies on the Filing Adviser's registration.[8] Conversely, the Letter does not purport to affect the status of an SPV that has no registration obligation under the Advisers Act because it is not acting as an investment adviser.

Relying Advisers Other Than SPVs

The Letter also provides guidance on the ability of a related advisory entity other than an SPV to rely on a Filing Adviser's registration as a Relying Adviser. Such related entities may be formed in other jurisdictions to provide support for persons located in those jurisdictions or for tax reasons. Further, a Filing Adviser may form related entities to advise different private funds based on different investment objectives or strategies or for liability insulation or income sharing purposes.

Conditions. The Letter states that Relying Advisers may rely on the Filing Adviser's registration and do not need to register separately provided that:

- the Relying Adviser is controlled by or under common control with the Filing Adviser; and
- the Relying Adviser, together with the Filing Adviser, "collectively conduct a single advisory business."

Relief is subject to the following conditions:

- The Filing Adviser and each Relying Adviser may advise only private funds and SMAs that pursue investment objectives and strategies that are substantially similar or otherwise related to those private funds. Further, the clients for such SMAs must be (i) qualified clients as defined in Rule 205-3 under the Advisers Act and (ii) otherwise eligible to invest in the private funds advised by the Filing Adviser or the Relying Adviser.
- Each Relying Adviser, its employees and persons acting on its behalf "are persons associated with" the Filing Adviser and must be subject to the Filing Adviser's supervision and control.
- The Filing Adviser must have its principal office and place of business in the United States. The Filing Adviser and each Relying Adviser (regardless of its location) will be subject to the full panoply of Advisers Act requirements, even in respect of non-U.S. clients.
- The Filing Adviser and each Relying Adviser must be subject to a single code of ethics and a single Compliance Manual, in both cases administered by a single chief compliance officer.[9]
- The Filing Adviser must disclose in its Form ADV that it and any Relying Advisers are filing a single Form ADV and must identify each Relying Adviser by completing a separate Section 1.B., Schedule D for each Relying Adviser including the notation "(relying adviser)". Section 1.B. asks for names under which the Filing Adviser does business and requires the Filing Adviser to "[l]ist on Section 1.B. of Schedule D any additional names under which you conduct your advisory business."

[7] For example, an SPV may have independent directors to represent the interests of investors in a private fund or satisfy certain legal obligations in respect of certain conflicted transactions.

[8] *See* the Letter at note 3.

[9] Such single code of ethics and single Compliance Manual may take into account different obligations imposed on certain Relying Advisers in particular jurisdictions. *See* the Letter at note 11.

The Letter does not provide explicit guidance on what other facts may suggest that a related entity may be conducting a different business than the Filing Adviser but does indicate that a Filing Adviser and a related entity may be conducting a single advisory business if they:

- use the same or similar names; and/or
- hold themselves out to current and prospective private fund investors and advisory clients as conducting a single advisory business because, for example, they share personnel and resources. It is unclear what additional facts may cause a related entity to be deemed to be conducting a different business than the Filing Adviser.

Implications for Relying Advisers. Relying Advisers are deemed to be registered investment advisers subject to all of the provisions of the Advisers Act and rules and regulations thereunder.[10] Therefore, the single Form ADV must include information about both the Filing Adviser and each Relying Adviser (such as disciplinary information for the Relying Adviser's employees and ownership information for each Relying Adviser).

Furthermore, the Letter confirms that Filing Advisers must include information related to each of their Relying Advisers when filing other mandated reports and filings (such as Form PF).

Limitations on Relief

The relief granted by the Letter has limitations that are significant for advisers who have relied, or intend to rely, on the umbrella theory.

Independent Qualification for Registration. The Filing Adviser and each Relying Adviser must not be prohibited from registering with the SEC by section 203A of the Advisers Act. Each related entity must independently qualify for registration (for example, an adviser seeking to qualify based on the regulatory assets under management ("RAUM") test must have RAUM of at least $100 million).[11] Alternatively, related entities may rely on an exemption from the prohibition on registration set forth in Section 203A of the Advisers Act, such as Advisers Act Rule 203A-2(b) which permits a related entity in a control relationship with a Filing Adviser to register if it has the same principal office and place of business as the Filing Adviser.

Private Funds Required. The relief is available only to those advisers that manage private funds. The Filing Adviser and the Relying Adviser also may manage SMAs, but those accounts must pursue investment objectives and strategies that are substantially similar or otherwise related to private funds advised by the Filing Adviser or another Relying Adviser. Thus, advisers that manage any registered investment companies may not rely on the relief. Further, to the extent that SMAs are advised by a Filing Adviser or its Relying Adviser, the clients for such SMAs must be "qualified clients" as defined in Advisers Act Rule 205-3 and may be required to meet other eligibility standards applicable to the private funds advised by the Filing Adviser and the Relying Adviser. For example, if a Relying Adviser manages a private fund that relies on Section 3(c)(7) of the Company Act, any SMA clients in accounts related to that fund will be required to be "qualified purchasers" as defined in the Company Act.

U.S. Principal Place of Business. The Filing Adviser must have its principal office and place of business in the United States. Furthermore, by relying on the U.S.-based Filing Adviser's registration, non-U.S. Relying Advisers become subject to the full requirements of the Advisers Act (as if they were located in the United States) including in respect of their activities relating to non-U.S. clients. As a result, non-U.S. Relying Advisers may not take advantage of "Adviser Lite" treatment that would limit the application of the Advisers Act in respect of their dealings with non-U.S. clients.[12] Adviser Lite treatment, however, would be applicable if the related non-U.S. entity filed its own registration.[13]

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[10] *See* the Letter at note 10.

[11] *See* the Letter at note 7.

[12] *See generally Registration Under the Advisers Act of Certain Hedge Fund Advisers*, Investment Advisers Act Release No. 2333 (December 2, 2004); ABA Subcommittee on Private Investment Entities, SEC No-Action Letter (August 10, 2006), *available at*

The SEC staff declined to respond to other situations where an adviser might rely on the registration of a related Filing Adviser, including if the Filing Adviser is outside of the United States. Also, the Letter does not provide any guidance with respect to the ability of exempt reporting advisers to rely on an umbrella theory for filing purposes.

If you have any questions regarding this update, please contact the Sidley lawyer with whom you usually work.

The Investment Funds Practice of Sidley Austin LLP

Sidley has a premier, global practice in structuring and advising investment funds and advisers. We advise clients in the formation and operation of all types of alternative investment vehicles, including hedge funds, fund-of-funds, commodity pools, venture capital and private equity funds, private real estate funds and other public and private pooled investment vehicles. We also represent clients with respect to more traditional investment funds, such as closed-end and open-end registered investment companies (*i.e.*, mutual funds) and exchange-traded funds (ETFs). Our advice covers the broad scope of legal and compliance issues that are faced by funds and their boards, as well as investment advisers to funds and other investment products and accounts, under the laws and regulations of the various jurisdictions in which they may operate. In particular, we advise our clients regarding complex federal and state laws and regulations governing securities, commodities, funds and advisers, including the Dodd-Frank Act, the Investment Company Act of 1940, the Investment Advisers Act of 1940, the Securities Act of 1933, the Securities Exchange Act of 1934, the Commodity Exchange Act, the USA PATRIOT Act and comparable laws in non-U.S. jurisdictions. Our practice group consists of approximately 120 lawyers in New York, Chicago, London, Hong Kong, Singapore, Shanghai, Tokyo, Los Angeles and San Francisco.

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http://www.sec.gov/divisions/investment/noaction/aba081006.pdf. *See also Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers,*" Investment Advisers Act Release No. 3222 (June 22, 2011) *available at* http://www.sec.gov/rules/final/2011/ia-3222.pdf at 128.

[13] The Letter states that the SEC staff was concerned that if non-U.S. advisers were permitted to be Filing Advisers, Relying Advisers located in the U.S. would take the position that they could operate under an Adviser Lite framework in respect of their non-U.S. clients. *See* the Letter at note 9.