Proskauer

Proskauer's Hedge Start: When Is SEC Registration Necessary?

May 6, 2024

An initial question faced by any manager launching a hedge fund is whether or not registration as an investment adviser with the U.S. Securities and Exchange Commission (SEC) under the Investment Advisers Act of 1940, as amended (Advisers Act), will be required.

$100 Million Threshold

In general, an investment adviser with less than $100 million in "regulatory assets under management" (RAUM) must register with the relevant state authority in each state in which the adviser operates. Investment advisers with more than $100 million must register with the SEC.

- RAUM is generally defined as total assets under management (without deducting any liabilities).

$25 Million Threshold

An investment adviser in New York is subject to a lower $25 million threshold. Accordingly, an investment adviser in New York must register with the SEC if it has at least $25 million in RAUM, unless an exemption applies.

Exemptions from Registration

There are two exemptions from registration with the SEC that are often available to hedge fund advisers:

- **Private Fund Adviser Exemption**: An adviser is exempt from SEC registration as a "private fund adviser" if its only clients are one or more "private funds" with aggregate total RAUM of less than $150 million.
    - In order to qualify for the "private fund adviser exemption," a fund manager cannot manage any separate managed accounts for a coient that is not a "private fund."

    - An investment adviser with its principal office and place of business outside the United States is exempt under the "private fund adviser exemption" if it does not manage any separate managed accounts for any U.S. persons, and if private funds that it manages from an office in the United States in aggregate have less than $150 million in RAUM.
    - An adviser relying on the "private fund adviser exemption" must file certain information with the SEC on Form ADV Part 1 as an "exempt reporting adviser." The information filed, which includes information about the ownership of the investment adviser, is publicly available through the internet.

- **Foreign Private Adviser Exemption:** An investment adviser with no place of business in the United States is exempt as a "foreign private adviser" if it has less than 15 clients and investors in the United States, and if it manages less than $25 million in aggregate RAUM for U.S. clients and investors (in each case including U.S. investors in a U.S. or non-U.S. private fund).
    - However, an investment adviser that wishes to rely on the "foreign private adviser exemption" may not hold itself out generally to the public in the United States as an investment adviser, and may not act as investment adviser to a registered investment company or a registered business development company.

How to Register with the SEC

Application for registration as an investment adviser is submitted to the SEC on Form ADV, which can be found here. Parts 1 and 2 of Form ADV are filed electronically with the SEC through the Investment Adviser Regulatory Depository (IARD) system maintained by FINRA, where they are available to the public.

- Part 1 of Form ADV is an online "fill-in-the-blank" form that requires certain basic information relating to the investment adviser, such as the adviser's jurisdiction of incorporation and principal place of business, details concerning the ownership and control of the adviser, and basic business information about the adviser and its clients, and whether the adviser or an affiliate has been involved in any material civil, criminal or administrative legal proceedings.
- Parts 2A and 2B of Form ADV (often referred to as an adviser's "brochure") require fairly detailed narrative, plain-language disclosures relating to the adviser's operations, business practices, risk factors and potential conflicts of interest, including a description of the nature of the adviser's services and fees or other compensation charged, and any affiliations with other entities in the financial

services industry.

Once the applicant has submitted the necessary forms, the SEC will usually approvae the registration within 45 days.

Consequences of SEC Registration

SEC rules establish numerous substantive requirements governing the operation of a registered investment adviser and any private funds that it manages. In particular, a registered adviser must adopt a code of ethics and written policies and procedures (usually referred to as a compliance manual) reasonably designed to prevent violations of the federal securities laws, and appoint a chief compliance officer (CCO) responsible for administering the policies and procedures.

- Although the SEC does not require that an adviser's compliance policies and procedures contain specific elements, it has indicated that it expects that written policies and procedures would address, at a minimum:
    - portfolio management procedures;
    - proprietary trading of the adviser and its affiliates and personal trading by the adviser's employees;
    - regulatory issues, including procedures to ensure the accuracy of disclosures made to clients, investors and regulators;
    - safeguarding of client funds and assets;
    - establishment and maintenance of required books and records;
    - advertising and marketing practices;
    - procedures to value client holdings and assess fees based on those valuations;
    - safeguards for the privacy protection of client records and information;
    - disaster recovery and business continuity plans;
    - insider trading safeguards;
    - cybersecurity policies and protection of client data; and
    - anti-money laundering efforts.

The Takeaway:

SEC registration as an investment adviser can frequently be avoided during the early stages of a fund manager’s existence, which can significantly simplify a new manager’s compliance obligations. But SEC registration is inevitable as a new manager’s business grows and can easily be managed with the advice and assistance of appropriate compliance experts.

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