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The Impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act on Real Estate Investment Advisers and Real Estate Funds Exemptions: Part 2 of 2

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The Investment Advisers Act of 1940 (Advisers Act) requires "investment advisers" within the meaning of the Advisers Act with assets under management in excess of the floor for Advisers Act registration to register with the Securities and Exchange Commission (SEC) unless an exemption from registration applies. At present, many real estate investment advisers rely upon the registration exemption provided by Section 203(b)(3) of the Advisers Act. Section 203(b)(3) currently exempts from registration certain investment advisers having fewer than 15 clients in any 12-month period if certain conditions are met. In applying the numerical limit in Section 203(b)(3), the SEC generally permitted investment advisers to count as a single "client" any fund they advise, but the SEC does not require such funds to count the individual investors as separate clients. Accordingly, private fund

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managers have been able to rely upon the private advisers exemption in Section 203(b)(3) and advise a substantial number of separate funds (not more than 14 in any 12-month period) without becoming subject to SEC registration.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) strikes Section 203(b)(3) in its entirety and replaces it with a provision that provides that the Advisers Act will not apply to "any investment adviser that is a foreign private adviser."[1] However, US investment advisers (nonforeign) will no longer be able to rely upon Section 203(b)(3), and certain foreign investment advisers will not fall within the definition of "foreign private adviser." As a result, real estate investment advisers falling within the definition of "investment adviser" under the Advisers Act and with assets under management in excess of the applicable floor for Advisers Act registration may become subject to the registration requirements under the Advisers Act, unless otherwise exempt.

The concept of "covered mid-sized investment adviser" is central to understanding the applicable Advisers Act floors. The Dodd-Frank Act generally defines a covered mid-sized investment adviser as an investment adviser with between $25 million and $100 million in assets under management, and that is subject to registration and examinations as an investment adviser with the state in which it maintains its principal office and place of business.[2] Investment advisers with a principal place of business in Wyoming, New York or Minnesota, or outside the United States, would not be considered subject to registration and examinations in the state where they maintain their principal office and place of business, and therefore would not be covered mid-sized investment advisers.[3] The SEC will maintain a list of states that do not subject advisers registered with them to examination on the SEC's website, and such list will be available to advisers using the IARD to register or amend their registration forms.

Following the enactment of the Dodd-Frank Act, new section 203A(a)(2)(A) of the Advisers Act provides that no covered mid-sized investment adviser shall register federally unless: (1) the adviser advises a registered investment company; (2) the investment adviser advises an electing "business development company;" or (3) the adviser is required to register with 15 or more states. Non-covered mid-sized investment advisers are not subject to this prohibition. Until January 1, 2012, the prohibition of section 203A(a)(2) will not apply to an investment adviser registered with the SEC on July 21, 2011.[4]

Mid-sized advisers that are no longer eligible for SEC registration under section 203A(A)(2) of the Advisers Act, and are not otherwise exempted by Rule 203A-2 from such prohibition, must withdraw their registrations with the SEC after filing their Form ADV amendments by filing Form ADV-W no later than June 28, 2012.[5] Mid-sized advisers registered with the SEC as of July 21, 2011 must remain registered with the SEC (unless an exemption from SEC registration is available) until January 1, 2012, which is the date by which the SEC expects the programming of the IARD will be completed.[6]

Until July 21, 2011, when the amendments to section 203A(a)(2) take effect, advisers applying for registration with the SEC that qualify as covered mid-sized advisers under section 203A(a)(2) of the Advisers Act may register with either the SEC or the appropriate state securities authority. Thereafter, all such advisers are prohibited from registering with the SEC and must register with the state securities authorities.

The amendments do not affect section 203A of the Advisers Act, which still provides that no investment adviser that is regulated or required to be regulated as an investment adviser in the state in which it maintains its principal office and place of business shall register under section 203, unless the investment adviser has assets under management of not less than $25 million, or is an investment adviser to an investment company registered under the Investment Company Act.

Currently, rule 203A-1(a)(2) generally provides that if the state where the adviser maintains its principal office and place of business has enacted an investment adviser statute, the adviser may register with the SEC if it has assets under management of at least $25 million but less than $30 million. The SEC amended the rule to eliminate the current buffer for advisers that have assets under management between $25 million and $30 million that permits these advisers to remain regulated by the states. The SEC replaced it with a similar buffer for mid-sized advisers. Rule 203A-1(a) provides, following the revisions to the rule, if the adviser is a "covered mid-sized investment adviser," unless the adviser advises a registered investment company or the adviser advises an electing "business development company," the adviser may, but will not be required to register with the SEC, if it has assets under management of at least $100 million but less than $110 million, and it need not withdraw its registration unless it has less than $90 million of assets under management.[7] Advisers may begin relying on the SEC amendment to the buffer in rule 203A-1 60 days after publication in the Federal Register. In addition, the SEC decided that eligibility for registration be determined annually as part of an adviser's annual updating amendment, allowing an adviser to avoid the need to change registration status based on fluctuations that occur during the course of the year.

Based on these principles, one can derive several conclusions regarding how the new floors will affect investment adviser registration.

Small investment advisers with under $25 million in assets under management will generally be prohibited from registering with the SEC, unless the state in which they maintain their principal office and place of business has not enacted an investment adviser statute (*e.g.*, Wyoming or a foreign country), or unless they act as an investment adviser to a registered investment company, in which cases they must register with the SEC under the Advisers Act, unless otherwise exempt.[8]

Non-covered mid-sized investment advisers with between $25 million and $100 million in assets under management will generally be required to register with the SEC, unless an exemption applies.[9] As discussed above, the Dodd-Frank Act generally defines a "covered mid-sized investment adviser" as an investment adviser with between $25 and $100 million in assets under management, and that is subject to registration and examinations as an investment adviser with the state in which it maintains its principal office and place of business.[10] As discussed above, the SEC noted that advisers with their principal office and place of business in Minnesota, New York and Wyoming with assets under management between $25 million and $100 million must register with the SEC, unless otherwise exempt. Presumably, non-US investment advisers with assets under management between $25 million and $100 million with their principal office and place of business in a foreign country would also have to register.

Covered mid-sized investment advisers with between $25 million and $100 million in assets under management will generally be prohibited from registering with the SEC unless (i) they advise a registered investment company or a company which has elected to be a "business development company," in which case they are required to register under the Advisers Act, unless otherwise exempt;[11] or (ii) they are required to register with 15 or more states, in which case they will be permitted to register under the Advisers Act.[12] If the covered mid-sized investment adviser has between $100 million and $110 million in assets under management, it will be permitted, but not required, to register with the SEC.[13]

Investment advisers with more than $110 million in assets under management will generally be required to register with the SEC, unless an exemption applies.[14]

As a result, the minimum assets under management threshold for SEC registration for most US investment advisers that do not manage registered investment companies or business development companies will be $100 million in general, and $25 million for advisers that would either (i) not be subject to registration and examination in the state in which they maintain their respective principal offices and places of business or (ii) otherwise be required to register with 15 or more states. It should be noted that non-US investment advisers with their principal office and place of business in a foreign country falling within the definition of "investment adviser" that use US jurisdictional means, since they are not subject to state law regulation or examination, will generally be required to register with the SEC at any size, unless otherwise exempt.

If a mid-sized adviser is prohibited from registering with the SEC, the SEC noted that it would be possible for a mid-sized investment adviser to receive an order permitting the adviser to register with the SEC.[15]

Part 1 of this article appeared in the February 2011 issue of *The Investment Lawyer*, and explained how real estate investment advisers could potentially structure their operations so that they are not "investment advisers" within the meaning of the Advisers Act, and also potentially within the meaning of state law. This type of structuring would theoretically prevent real estate investment advisers from having to register with the SEC and with the states, and would also likely in many cases prevent real estate investment advisers from being subject to SEC and state regulation. However, the downside of this type of structuring is that it would place limitations on the types of investments an investment adviser's clients may make. Real estate investment advisers generally become "investment advisers" when they advise about "securities." Many types of real estate investments have a "securities" aspect to them, as discussed in Part 1 of this article. Further, this analysis depends upon the resolution of complex fact specific securities questions and also an analysis of state-by-state law. Counsel should be consulted.

In Part 2 of this article, we analyze the adviser registration and exemption implications for real estate investment advisers under Title IV (Regulation of Advisers to Hedge Funds and Others) of the Dodd-Frank Act (Title IV) in the event a real estate investment adviser does not structure its operations so that it is not an "investment adviser" under the Advisers Act. Then, we consider the implications of an investment adviser registering under federal versus state law. In addition, we consider the impact of investment adviser registration or exemption under the Advisers Act on certain obligations of an investment adviser under the Advisers Act. On June 22, 2011, the SEC extended until March 30, 2012 the compliance deadline for advisers currently relying on the "private advisers" exemption contained in Section 203(b)(3) of the Advisers Act.

The Impact of Title IV on Advisers Act Registration and Exemptions

The Dodd-Frank Act will not necessarily require an investment adviser to register with the SEC. Although the Dodd-Frank Act narrowed the Section 203(b)(1)[16] and Section 203(b)(3) exemptions,[17] it generally raised the floor on Advisers Act registration for most investment advisers[18] and added certain new exemptions to the Advisers Act. Most importantly, with respect to the case of real estate investment advisers, the Dodd-Frank Act added the "private funds" Advisers Act exemption, which provides that the SEC will exempt from registration any investment adviser of "private funds," if such investment adviser acts solely as an adviser to private funds and has assets under management in the United States of less than $150 million.[19] In addition, the Dodd-Frank Act adds an exclusion from the definition of "investment adviser" in Section 202(a)(11) that will apply to any family office, as defined by rule, regulation or order of the SEC.[20] On June 22, 2011, the SEC published releases that provide more details on these exemptions.[21] We will also be authoring further articles that describe these exemptions in more detail.[22]

Narrowing Section 203(b)(1) and Section 203(b)(3) will generally shift the adviser's regulatory compliance burden from state law to federal law with respect to those investment advisers that exceed the applicable federal thresholds for Advisers Act registration and do not choose or are not able to rely upon any of the revised applicable Advisers Act exemptions.

State Versus Advisers Act Registration

Investment advisers that register with the SEC will not be subject to state registration. If an investment adviser does not register with the SEC, it may be required to register as an investment adviser under applicable state law, but some states provide exemptions to investment advisers that are exempt under the Advisers Act. California, for example, is currently considering granting an analogous exemption with respect to the section 203(m) exemption if the investment adviser has more than $100 million in assets under management, and an analogous section 203(l) exemption. In the event a state does not grant such an exemption, if an investment adviser is eligible for SEC registration (but SEC registration is not required), many investment advisers will choose to register with the SEC rather than register with the applicable state authorities because state registration can be more onerous as it may require registration in multiple states and compliance with certain state rules regarding investment advisers and investment adviser representatives.

Compliance Obligations of Registered Investment Advisers

Advisers that were previously exempt under the Advisers Act prior to the Dodd-Frank Act were only subject to certain Advisers Act rules, such as the antifraud provision in section 206 and the supervision requirements in section 203(e)(6). To the extent an investment adviser registers with the SEC, it will become subject to the full scope of the Advisers Act (including, without limitation, the above discussed obligations of unregistered investment advisers). Below, we summarize a few of the most important compliance obligations of registered investment advisers, but counsel should be consulted for more details.

Filing of Form ADV. Registered investment advisers (RIAs) must make periodic public filings with the SEC on Form ADV. Form ADV is divided into several parts. In particular, Part 2A (brochure), as recently revised by the SEC, provides a narrative disclosure of, without limitation, fees and expenses, incentive fees and side-by-side management, investment strategies and methods of analysis, material risk factors and conflicts of interest, financial industry affiliations, codes of ethics, brokerage practices, a review of accounts, client referrals, custody, discretionary authority and the voting of client securities.

The SEC recently adopted a number of amendments to Form ADV that will improve its ability to oversee investment advisers. As amended, Form ADV requires RIAs to provide the SEC with additional information about three areas of their operations. First, the SEC required RIAs to provide additional information about private funds they advise.[23] Second, the SEC expanded the data RIAs must provide the SEC about their advisory business (including data about the types of clients they have, their employees, and their advisory activities), as well as about their business practices that may present significant conflicts of interest (such as the use of affiliated brokers, soft dollar arrangements, and compensation for client referrals). Third, the SEC required additional information about an RIA's non-advisory activities and their financial industry affiliations.

Record Keeping Obligations. Under Rule 204-2 promulgated under the Advisers Act, RIAs are obligated to maintain an array of records. Additional requirements apply where the RIA has custody or possession of securities or funds of any client, or where the RIA has voting authority with respect to client securities. Subject to exceptions, records must be maintained for at least five years from the end of the fiscal year during which the last entry was made on such record.[24]

The SEC adopted amendments to rule 204-2 under the Advisers Act, the "books and records" rule. The amendments, among other things, update the rule's "grandfathering provision" for RIAs that are currently exempt from registration under the "private adviser" exemption, but will be required to register after the "private advisers" exemption is eliminated. The amendment clarifies that these RIAs are not obligated to keep certain performance-related records for any period when they were not registered with the SEC; however, to the extent that these RIAs preserved these performance-related records even though they were not required to keep them, they must continue to preserve them.[25]

Examinations. Prior to the Dodd-Frank Act, all records of any investment adviser were subject to examinations by the SEC.[26] The Dodd-Frank Act requires the SEC to conduct periodic examinations of all records of private funds maintained by an RIA.[27]

Compliance Programs. Each investment adviser has a duty under the Advisers Act to supervise the activities of persons who act on its behalf with a view to preventing violations.[28] This means that investment advisers should establish compliance programs where (A) there are established procedures and a system for applying such procedures, to prevent and detect, as practicable, any such violation; and (B) such persons have reasonably discharged their duties and obligations under such procedures and system.

Under Rule 206(4)-7, an RIA is also required to adopt and implement written policies and procedures reasonably designed to prevent violation by the RIA and its supervised persons of the Advisers Act and related SEC rules. The RIA must review, at least annually, the adequacy of such policies and procedures and the effectiveness of their implementation. In addition, the RIA must designate a supervised person to be responsible for administering such policies and the procedures and to perform various tests to determine potential violations.

According to the SEC, an RIA's compliance policies and procedures should address a number of issues to the extent they are relevant to the RIA's operations, including: portfolio management and trading processes; proprietary trading; personal trading by supervised persons; accurate disclosure to investors, clients and regulators; safeguarding client assets from conversion or inappropriate use; maintenance of required records; marketing advisory services; valuation of client assets; safeguarding privacy of client records; and business continuity plans.

Code of Ethics. RIAs must comply with Rule 204A-1 and maintain a written code of ethics. The written code of ethics must, at a minimum, include: standards of business conduct that the RIA requires of its supervised persons, which standard must reflect its fiduciary obligations; provisions requiring supervised persons to comply with applicable securities laws; provisions requiring the review of personal securities transactions and holdings of access persons; provisions requiring supervised persons to report any violation of the code of ethics; and provisions requiring the distribution of the RIA's code of ethics and amendments.

Custody. Under Rule 206(4)-2, RIAs may become subject to the SEC's custody rule. The custody rule requires that an RIA with "custody" of client funds or securities maintain those funds and securities with a "qualified custodian." "Custody" is broadly interpreted not just to include actual possession, but virtually any authority to obtain possession of funds and securities.

In the event an RIA is subject to the custody rule, it will generally be subject to notice, account statement and surprise examinations requirements in rule 206(4)-2(a)(2), (3) and (4) respectively.[29] Rule 206(4)-2(b)(4) exempts an RIA from notice, account statement and surprise examination requirements with respect to any fund that (i) annually distributes audited financial statements prepared in accordance with GAAP to all investors within 120 days of the end of its fiscal year; (ii) is audited by an independent public accountant registered with, and subject to regular inspection as of the commencement of the professional engagement period, and as of each calendar year-end, by the Public Company Account Oversight Board (PCAOB); and (iii) upon liquidation distributes its audited financial statements prepared in accordance with GAAP to all investors promptly after the completion of the audit.[30] There are also other exemptions and nuances in the custody rule. Counsel should be consulted.

Principal Transactions. Section 206(3) of the Advisers Act provides that it is unlawful for an investment adviser acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction. For RIAs, these transactions will be subject to SEC review.

As the principal transactions rule applies to affiliates of the RIA, each RIA will need to consider affiliate transactions across its entire organization. Compliance with Section 206(3) may require obtaining client consent prior to the transaction's execution or obtaining client consent after the transaction's execution but before its settlement.

Advertising Rules. The SEC regulates advertising by RIAs which, for fund managers, will apply to firm websites, private placement memoranda (PPMs) and certain other written communications. Under specific rules, the SEC generally limits or restricts:

(i) advertisements that refer to testimonials or past profitable investment recommendations;
(ii) any representation that a graph or formula can guide the investor as to which securities to buy or sell;
(iii) statements that services will be provided free of charge unless it is entirely free and without any condition or obligation; and
(iv) certain advertising practices relating to the disclosure of performance information, which the SEC considers misleading.

Restrictions on Performance Fees. The Advisers Act prohibits an RIA from charging "clients"[31] performance-based compensation (for example, carried interest), except with respect to fee arrangements with clients that are "qualified clients." Qualified clients are generally defined to include natural persons or companies that have at least $750,000 under management with the adviser and natural persons or companies that the adviser reasonably believes either have a net worth of more than $1,500,000 at the time the contract is entered into or are "qualified purchasers" (as defined in the 1940 Act).[32]

Pay to Play. Rule 206(4)-5 applies to RIAs. There is a two-year time out, subject to certain exemptions, on an RIA's ability to provide advisory services to a government entity after a contribution to an official of the government entity is made by the investment adviser or any covered associate of the investment adviser (including a person who becomes a covered associate within two years after the contribution is made). "Covered associates" include managing members of an LLC, officer level employees of the investment adviser as well as employees who solicit a government entity or who supervise such solicitors.[33] In addition, a covered associate could include a political action committee (PAC) controlled by the investment adviser or by officer level employees of the investment adviser as well as by employees who solicit a government entity or who supervise such solicitors.[34]

An RIA and its covered associates cannot directly or indirectly pay any person to solicit a government entity for investment advisory services on behalf of the investment adviser unless the person hired is a "regulated person" or an officer or employee of the investment adviser.[35] "Regulated persons" generally include broker-dealers that are registered with the SEC and under a national securities association, provided that the rules of the association prohibit members from engaging in distribution or solicitation activities if certain political contributions have been made.[36] In addition, for broker-dealers, (A) the rules of the association must prohibit members from engaging in distribution or solicitation activities if certain political contributions have been made; and (B) the SEC, by order, must find that such rules impose substantially equivalent or more stringent restrictions on broker-dealers than Rule 206(4)-5 imposes on investment advisers and that such rules are consistent with the objectives of Rule 206(4)-5.[37] The SEC amended the rule to add municipal advisors to the categories of registered entities – referred to as "regulated persons" – excepted from the rule's prohibition on advisers paying third parties to solicit government entities.[38] To qualify as a "municipal advisor" (and thereby a "regulated person"), a solicitor must be registered under section 15B of the Exchange Act and subject to pay to play rules adopted by the Municipal Securities Rulemaking Board (MSRB).[39] Notably, for municipal advisors to qualify as "regulated persons," the SEC must find that applicable MSRB pay to play rules: (i) impose substantially equivalent or more stringent restrictions on municipal advisors than the pay to play rule imposes on investment advisers; and (ii) are consistent with the objectives of the pay to play rule.[40]

An RIA and its covered associates cannot coordinate, or solicit any person or PAC to make, any (A) contribution to an official of a government entity to which the investment adviser is providing or seeking to provide investment advisory services; or (B) payment to a political party of a state or locality where the investment adviser is providing or seeking to provide investment advisory services to a government entity.[41]

An RIA cannot do indirectly what would be illegal to do if done directly.[42] This prohibition generally prohibits the RIA from funneling payments through other parties, including, for example, consultants, attorneys, family members, friends or companies affiliated with the investment adviser as a means to circumvent the rule.

There are several record keeping requirements in connection with Rule 206(4)-5, as described in Rule 204-2(a)(18).

Compliance Obligations of Exempt Reporting Advisers

To the extent an investment adviser relies upon section 203(m) of the Advisers Act for an Advisers Act registration exemption (exempt reporting advisers), it will become subject, in addition to the compliance obligations of unregistered investment advisers discussed above, to the following Advisers Act requirements.

Form ADV. To implement new section 203(m) of the Advisers Act, the SEC adopted a new rule that requires exempt reporting advisers to submit to the SEC and to periodically update, reports that consist of a limited subset of items on Form ADV.[43] The SEC stated that these reports would both (i) provide the SEC with information as to whether these advisers or their activities might present sufficient concerns to warrant our further attention in order to protect their clients, investors, and other market participants, and (ii) provide the public with some basic information about these advisers and their businesses. The SEC determined, given its authority under section 210(a) to make reports of exempt reporting advisers publicly available. Exempt reporting advisers must file their first reports on Form ADV through IARD between January 1 and March 30, 2012.

Pay to Play Rule. The SEC amended rule 206(4)-5, the "pay to play" rule (discussed above), to address certain consequences arising from the Dodd-Frank Act's amendments to the Advisers Act and the Exchange Act. The SEC amended the scope of the SEC "pay to play" rule so that it applies both to exempt reporting advisers and foreign private advisers.[44] The rule currently applies to advisers either registered with the SEC or unregistered in reliance on the "private adviser" exemption under section 203(b)(3) of the Advisers Act.[45] The amendments prevent the unintended narrowing of the "pay to play" rule.

Examinations. The SEC indicated that it does not anticipate that the Staff will conduct compliance examinations of exempt reporting advisers on a regular basis. Nonetheless, the SEC has the authority under Section 204(a) of the Advisers Act to examine records of exempt reporting advisers and would do so if it receives indications of wrongdoing, for example, those examinations prompted by tips, complaints, and referrals.

NOTES

1. Dodd-Frank Act, Section 403.

2. Dodd-Frank Act, Section 410; Advisers Act, section 203A(a)(2)(B).

3. Form ADV, Part 1A, Items 2.A.(3), 2.A.(4).

4. Rule 203A-5(a).

5. Rule 203A-5(c)(1). During this period while an investment adviser is registered with both the SEC and one or more state securities authorities, the Advisers Act and applicable state law will apply to the investment adviser's activities. *Id*. If, prior to the effective date of the withdrawal from registration of an investment adviser on Form ADV-W, the SEC has instituted a proceeding pursuant to section 203(e) of the Advisers Act to suspend or revoke registration, or pursuant to section 203(h) to impose terms or conditions upon withdrawal, the withdrawal from registration shall not become effective except at such time and upon such terms and conditions as the SEC deems necessary or appropriate in the public interest or for the protection of investors. Rule 203A-5(c)(2).

6. Rule 203A-5(a).

7. Rule 203A-1(a)(1). This provision does not apply if the investment adviser is an investment adviser to a registered investment company or a BDC, or if the investment adviser is eligible for an exemption in Rule 203A-2. Rule 203A-1(a)(2). In addition, advisers that rely on amended rule 203A-2(c) to register with the SEC (because they expect to be eligible for registration within 120 days) cannot rely on the buffer and must have $100 million of assets under management within 120 days to remain registered with the SEC. *See* Form ADV; Instructions for Part 1A, instrs. 2.a., 2.g. *See also* amended rule 203A-1(a)(2)(ii); amended rule 203A-2(c).

8. Advisers Act, Section 203A(a)(1).

9. Rule 203A-1(a); Advisers Act, Section 202(a)(11); Dodd-Frank Act, Section 410.

10. Dodd-Frank Act, Section 410; Advisers Act, Section 203A(a)(2)(B). A mid-sized adviser that relies on an exemption from registration with its home state would not be considered to be "required to be registered" with

its home state. *See* Form ADV: Instructions for Part 1A, instr. 2.b.

11. Release No. IA-3221, *Rules Implementing Amendments to the Investment Advisers Act of 1940,* at n.106.

12. Section 203A(a)(2)(A) of the Advisers Act provides as follows: "No investment adviser described in subparagraph (B) shall register under section 203, unless the investment adviser is an adviser to an investment company registered under the Investment Company Act of 1940, or a company which has elected to be a business development company pursuant to section 54 of the Investment Company Act of 1940, and has not withdrawn the election, except that, if by effect of this paragraph an investment adviser would be required to register with 15 or more States, then the adviser may register under section 203."

13. Rule 203A-1(a).

14. Advisers Act, Section 203A; Section 202(a)(11); Rule 203A-1(a).

15. Form ADV, Part 1A, Item 2.A.(12).

16. House Bill, Section 5003; Senate Bill, Section 403. Prior to the enactment of the Dodd-Frank Act, Section 203(b)(1) of the Advisers Act, the intrastate advisers exemption, exempted from registration any investment adviser whose clients were residents of the state where such investment adviser maintained its principal office and place of business, and who did not furnish advice, analysis or reports with respect to securities listed or admitted to unlisted trading privileges on any national securities exchange. Under the Dodd-Frank Act, the intrastate exemption is retained, but investment advisers that advise any "private funds" may not rely upon the exemption in Section 203(b)(1) of the Advisers Act. "Private funds" under the Dodd-Frank Act include an investment fund that would be an investment company as defined in Section 3 of the Investment Company Act but for the exemptions in Section 3(c)(1) or Section 3(c)(7) thereof. Real estate investment advisers that desire to rely upon the intrastate advisers exemption may consider structuring their funds pursuant to Investment Company Act exemptions other than Section 3(c)(1) or Section 3(c)(7). This type of structuring involves complex securities considerations.

17. Dodd-Frank Act, Section 403. Prior to the enactment of the Dodd-Frank Act, Section 203(b)(3) exempted from registration investment advisers who during the course of the preceding twelve months had fewer than 15 clients and who did not hold themselves out to the public as investment advisers, and who also neither acted as an investment adviser to any registered investment company or "business development company." The Dodd-Frank Act strikes Section 203(b)(3) in its entirety and replaces it with a provision that provides that the Advisers Act will not apply to "any investment adviser that is a foreign private adviser."

18. Dodd-Frank Act, Section 410.

19. Dodd-Frank Act, Section 408.

20. Dodd-Frank Act, Section 409. The SEC has proposed to adopt Rule 202(a)(11)(G)-1 under the Advisers Act to implement the family offices exemption. This proposal is not yet final.

21. Release No. IA-3220, *Family Offices;* Release No. IA-3221, *Rules Implementing Amendments to the Investment Advisers Act of 1940;* and Release No. IA-3222, *Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers with Less than $150 Million in Assets under Management, and Foreign Private Advisers.*

22. *See* Kenneth Muller, Jay Baris and Seth Chertok, "A Detailed Analysis of the June 22, 2011 Commission Releases and Rules under the Advisers Act," *Insights* (forthcoming).

23. Note that real estate funds relying upon Section 3(c)(5)(C) of the Investment Company Act and investment companies not relying upon Section 3(c)(1) or Section 3(c)(7) would not fall within the definition of "private funds" and therefore would not be subjected to "private funds" information requirements.

24. Rule 204-2(e)(1). The Dodd-Frank Act also adds a provision in Section 204(b) of the Advisers Act that would require RIAs to maintain records of "private funds" advised by the RIA. The Dodd-Frank Act prescribes certain categories of records and reports that must be maintained by private funds advised by an RIA and that will be subject to inspection by the SEC. Most of these requirements relate to the status of a fund's portfolio investments as well as to areas that are likely to involve conflicts of interests.

25. Rule 204-2(e)(3)(ii).

26. Advisers Act, Section 204(a).

27. Dodd-Frank Act, Section 404.

28. Advisers Act, Section 203(e)(6).

29. The notice requirement basically requires the RIA to notify investors about the qualified custodian, and in the event the RIA sends its own account statements, it requires the RIA to provide clients a statement urging the client to compare the account statements from the custodian with those from the RIA. Under the account statement requirement, the RIA must have a reasonable basis for believing that the qualified custodian sends an account statement, at least quarterly, to each of its clients. The surprise examination requirement requires that client funds and securities of which the RIA has custody be verified by a surprise examination at least once a year by an independent public accountant.

30. Complying with the custody rule may involve complex questions for real estate investment advisers about whether a real estate investment is a security. As discussed in Part 1 of this article, many types of real estate investments are securities. The custody rule also raises complex questions on how these securities will be custodied. Counsel should be consulted.

31. Following the *Goldstein* decision, "clients" would generally only include pooled investment vehicles in the fund context. However, Rule 205-3 provides that equity owners of a 3(c)(1) exempt fund under the Investment Company Act will be considered a "client" for such purposes. Equity owners of other types of exempt funds would not currently be considered as "clients" for such purposes.

32. The SEC has just proposed raising the $750,000 assets under management threshold to $1 million, and the $1,500,000 net worth test to $2 million. The SEC proposed to amend the net worth standard in the definition of "qualified client" to exclude the value of a natural person's primary residence and debt secured by the property. The amendment would only exclude the value of a natural person's primary residence and the amount of debt secured by the property that is no greater than the property's current market value. The debt above the market value would be considered a liability in calculating net worth.

33. Rule 206(4)-5(f)(2).

34. Rule 206(4)-5(f)(2).

35. Rule 206(4)-5(a)(2)(i).

36. Rule 206(4)-5(f)(9).

37. Rule 206(4)-5(f)(9)(ii).

38. Rule 206(4)-5(f)(9)(ii).

39. Rule 206(4)-5(f)(9)(iii).

40. Rule 206(4)-5(f)(9)(iii).

41. Rule 206(4)-5(a)(2)(iii).

42. Rule 206(4)-5(d).

43. Exempt reporting advisers must complete seven items of Form ADV: Items 1 (Identifying Information), 2.B. (SEC Reporting by Exempt Reporting Advisers), 3 (Form of Organization), 6 (Other Business Activities), 7 (Financial Industry Affiliations and Private Fund Reporting), 10 (Control Persons), and 11 (Disclosure Information). *See* Form ADV: General Instruction 3. Exempt reporting advisers must also complete corresponding sections of Schedules A, B, C, and D.

44. Rule 206(4)-5(a)(1).

45. Rule 206(4)-5(a).