



MEMORANDUM

To: Clients of Tannenbaum Helpern Syracuse & Hirschtritt LLP

Re: Compliance and Filing Requirements for Fund Managers
that Are Registered Investment Advisers¹

Date: December 2004

This memorandum identifies the various compliance obligations and filing requirements under the Investment Advisers Act of 1940, as amended (the “Advisers Act”) and other statutes and the applicable deadlines that fund managers that are federally registered investment advisers (“RIAs”) must comply with in order to maintain good standing with the Securities and Exchange Commission (the “SEC”)².

I. Requirements for Registered Investment Advisers under the Advisers Act

This section sets forth the various requirements under the Advisers Act that are applicable to RIAs.

1. Uniform Application for Investment Adviser Registration (“Form ADV”) – Part I

A fund manager that elects to or is required to register as an RIA with the SEC does so by filing a registration statement on Form ADV.³ Form ADV consists of two sections: (i) Part I which generally requires disclosure about the RIA’s business address,

¹ This memorandum is general in nature and for educational purposes only, and should not be construed as legal advice which can only be made in response to a particular set of facts.

² A non-U.S. based hedge fund manager registered with the SEC that only operates a non-U.S. domiciled pooled investment vehicle is not subject to the substantive provisions of the Advisers Act. An offshore adviser that is registered or is contemplating registration should consult us to discuss the extent of compliance with the Advisers Act.

³ Note that under current law, it is permissible for an investment adviser to register with the SEC if it manages \$25 million or more of assets under management. It is mandatory for an investment adviser to register with the SEC if it manages U.S.\$30 million or more of assets under management absent an exemption from registration, e.g. Section 203(b)(3) of the Advisers Act. A U.S.-based hedge fund manager is required to register if the fund manager (i) operates a “private fund”; (ii) has fifteen or more clients; and (iii) has U.S.\$30 million or more of assets under management. See footnote 5 for a description of the term “private fund.”

ownership structure, past disciplinary events, and operations; and (ii) Part II which generally requires information about the RIA's investment style, fees, (including solicitation fees, if any), conflicts of interest, brokerage practices (including soft dollars, if any) and other information a potential client may find relevant in determining to hire the RIA's services. Part I of Form ADV is filed electronically through the Investment Adviser Registration Depository ("IARD")⁴ while Part II must be kept as part of the RIA's books and records.

A fund manager that is RIA because it operates a "private fund"⁵ must respond affirmatively that it advises a "private fund" in part 1.A, Item 7 of Form ADV. Moreover, such an RIA must complete Section 7.B. of Schedule D in Part I of Form ADV by disclosing the following for each "private fund" that it advises:

- The name of the private fund.
- The name of the general partner or manager of the private fund.
- Whether clients are solicited to invest in the private fund.
- The percentage of clients that have invested in the private fund.
- The minimum investment commitment required of a limited partner, member or other investor.
- The current value of the total assets of the private fund.

From time to time, RIAs are required to file certain amendments to Form ADV Part I through the IARD system as follows:

- A. Amendments are required to be filed promptly if:
- i. information provided in the most recent Form ADV in response to the following items in Part 1A becomes inaccurate in any way including:
 - identifying information, including name of firm, address, contact person, etc. (Item 1);
 - type of entity (i.e. LLC, LP, Corp. status) and/or state of organization or fiscal year information (Item 3);

⁴ The IARD is an electronic filing system for investment advisers that is sponsored by the SEC and the North American Securities Administration Association ("NASAA") and is administered by the National Association of Securities Dealers Inc. ("NASD").

⁵ According to Rule 203(b)(3)-2(d)(1) under the Advisers Act, a "private fund" is defined to mean a company:

- (i) that would be an investment company under Section 3(a) of the Investment Company Act of 1940, as amended (the "Company Act") but for the exception provided from that definition by either Section 3(c)(1) or Section 3(c)(7) of such Act;
- (ii) that permits owners to redeem any portion of their ownership interests within two years of the purchase of such interests; and
- (iii) interests in which are or have been offered based on the investment advisory skills, ability or expertise of the investment adviser.

- changes to an RIA’s or related person’s custody of client assets (Item 9); and
 - disciplinary disclosure for the RIA (Item 11)
- ii. information provided in the most recent Form ADV in response to the following items in Part 1A becomes **materially** inaccurate in any way:
- succession to the business of another RIA (Item 4);
 - participation or interest in client transactions (including any proprietary or sales interest or changes in investment or brokerage discretion) (Item 8); and
 - direct and indirect control persons of the RIA (Item 10).
- B. With respect to any other changes to Part I of Form ADV, amendments are required to be filed annually within 90 days after the end of the RIA’s fiscal year.

2. Form ADV – Part II

Form ADV Part II shall be updated both annually and at any time information becomes materially inaccurate. While Form ADV Part II is not filed with the SEC, when changes are made an RIA must maintain the revised copy and all past copies of the Form ADV Part II that have been used for the past 5 years.

3. Written Disclosure (the “Brochure Requirement”)

RIAs are required to deliver a written disclosure statement to all “clients⁶” and all clients must sign and return to the RIA an acknowledgment that they have received such written disclosure statement. This requirement (known as the “Brochure Rule”) can be satisfied by either delivering a copy of the RIA’s most recent Part II of its Form ADV or a written document containing, at a minimum, the information required by Part II of Form ADV to all clients.

- A. If the client can terminate the contract without penalty within five business days after entering into the contract, the written disclosure statement may be delivered at the time of entering into the advisory contract; **otherwise**
- B. The written disclosure statement must be delivered at least 48 hours prior to entering into any written or oral investment advisory contract with such client or prospective client⁷.

⁶ For purposes of the Brochure Rule, the term “client” refers to all underlying investors in a pooled investment vehicle advised by the RIA.

⁷ For delivery to clients that are U.S. investment vehicles with underlying investors, the written disclosure statement should be included in offering documents to existing and potential investors of such clients.

RIAs must deliver or offer in writing to deliver upon written request, without charge, the annually updated Part II of Form ADV.

4. Custody

Pursuant to Rule 206(4)-2 under the Advisers Act, effective as of April 1, RIAs with custody⁸ of clients'⁹ assets must:

- (i) maintain its client's assets and securities with a qualified custodian in a separate account for each client under that client's name **or** in accounts that contain only its client's funds and securities, under the RIA's name as agent or trustee for the client,
- (ii) distribute a notice to each client regarding the qualified custodian's contact information and the manner in which the assets and securities are held, **AND**
- (iii) comply with one of the following:
 - A. The RIA must have a reasonable basis to believe that the qualified custodian is sending to each client, i.e., each beneficial owner (or the beneficial owner's designated nominee), in a fund account statements no less frequently than quarterly. The account statement must include: (i) the amount of funds the client has with the RIA, (ii) each security in the account as of the end of each period, and (iii) all transactions in the account during that period. (This can be sent by either the qualified custodian or the RIA; however, if the RIA elects to send the account statement directly to the client, the RIA must also undergo an annual surprise audit¹⁰); **OR**
 - B. If the RIA operates a pooled investment vehicle, then the RIA need not provide to clients the quarterly account statements, **PROVIDED THAT** the RIA distributes audited financial statements prepared in accordance with GAAP within 120 days of the fund's fiscal year-end, or in the case of a pooled investment vehicle that is a fund-of-funds,¹¹ the RIA is to distribute the audited financial statements prepared in

⁸ An RIA is deemed to have custody when (1) it has possession of client funds or securities, even briefly (not including inadvertent receipt if returned to sender within three business days); (2) it has authority to withdraw funds or securities or obtain possession of them or can direct a third party to do so; or (3) it acts in any capacity that gives it legal ownership of or access to, the client funds or securities (as when a related person is the general partner to a limited partnership or is the managing member to a limited liability company with which the RIA has an advisory contract).

⁹ For purposes of the custody rule, the term "client" refers to the underlying investors in a pooled investment vehicle advised by the RIA.

¹⁰ This surprise audit is conducted by the RIA's own independent public accountant on an annual basis at a different time each year and with no notice to the RIA. The accountant who conducts the surprise audit must report findings to the SEC within 30 days of completion of the audit by filing an ADV-E with the SEC.

¹¹ A "fund-of-funds" is defined to mean "a limited partnership (or limited liability company, or another type of pooled investment vehicle) that invests 10 percent or more of its total assets in other pooled investment vehicles that are not, and are not advised by, a related person (as defined in Form ADV (17 CFR 279.1)) of the limited partnership, its general partner, or its adviser." See Rule 206(4)-2(c)(4) under the Advisers Act.

accordance with GAAP within 180 days of the fund-of-funds' fiscal year-end.

5. Written Compliance Policies and Procedures

Pursuant to Rule 206(4)-7 under the Advisers Act, effective as of October 5, 2004, all RIAs are required to adopt and to implement written policies and procedures designed to prevent the RIA and its personnel from violating the Advisers Act and its rules and regulations (“Written Compliance Policies and Procedures”).¹² The Written Compliance Policies and Procedures should address the following issues to the extent they are relevant to the RIA:

- Standards of conduct, including but not limited to, proprietary trading of the RIA, registration requirements of advisory personnel, proxy voting policies and procedures and personal trading activities of supervised persons (as defined below);
- Portfolio management processes, including allocation of investment opportunities among funds managed by an RIA, consistency of portfolios with clients' investment objectives, disclosures by the RIA and applicable regulatory restrictions;
- Trading practices, including procedures by which the RIA satisfies its best execution obligation, uses client brokerage to obtain research and other services (soft dollar arrangements) and allocates aggregated trades among clients;
- The accuracy of disclosures made to investors, clients and regulators, including, but not limited to, account statements, Form ADV amendments and advertisements;
- Safeguarding of client assets from conversion or inappropriate use by advisory personnel;
- The accurate creation of required records and their maintenance in a manner that secures them from unauthorized alteration or use and protects them from untimely destruction;
- Communications with clients and underlying investors, if any, of clients that are investment vehicles, including advisory contracts and fee and custody issues;
- Marketing advisory services, including the use of solicitors;
- Processes to value client holdings and assess fees based on those valuations;
- Safeguards for the privacy protection of client records and information, including records and information of underlying investors, if any, of a client that is itself an investment vehicle; and
- Business continuity plans.

¹² Effective as of February 5, 2004, all RIAs must comply with new Rule 206(4)-7 as of October 5, 2004.

Under Rule 206(4)-7 all RIAs:

- A. Must review at least annually the Written Compliance Policies and Procedures that have been adopted and implemented to ensure that such policies and procedures are adequate and effectively prevent violation; and
- B. Must designate a Chief Compliance Officer who shall be a partner, officer, director (or other person occupying a similar status or performing similar functions), or employee of the RIA, or other person who provides investment advice on behalf of the RIA and is subject to the supervision and control of the RIA and will be responsible for implementing and administering the Written Compliance Policies and Procedures.

6. Code of Ethics

Pursuant to Rule 204A-1 under the Advisers Act, effective as of January 7, 2005, all RIAs are required to adopt and to enforce a Code of Ethics applicable to its supervised persons.¹³ The Code of Ethics covers the following issues:

- A. Standards of business conduct that are expected of supervised persons and that reflect the RIA's fiduciary duties;
- B. An agreement to comply with all applicable securities laws;
- C. Written acknowledgement by all "supervised persons" that they acknowledge receipt of the written Code of Ethics;
- D. Provisions to prevent disclosure of material nonpublic information about securities recommendations, holdings and transactions;
- E. Provisions on personal securities reporting by "access persons"¹⁴; and
- F. Pre-clearance requirements for "access persons" of any personal investments in IPOs and private placements.

¹³ The term "supervised person" refers to the adviser's partners, officer, directors (or other person occupying a similar status or performing similar functions) and employees, as well as any other persons who provide advice on behalf of the adviser and are subject to the adviser's supervision and control. See Section 202(a)(25) of the Advisers Act.

¹⁴ The term "access person" is a functional definition that refers to any supervised person that performs the following functions:

- has access to nonpublic information regarding any clients' purchase or sale of securities, or nonpublic information regarding the portfolio holdings of any reportable fund; or
- is involved in making securities recommendations to clients, or has access to such recommendations that are nonpublic.

See Rule 204A-1(e)(1)(i)(A) and (B) under the Advisers Act.

“Access persons” are required to submit the following to the Chief Compliance Officer:

A. Initial Holdings Reports

An “access person” must complete an initial report of his or her reportable securities holdings at the time the person becomes an “access person.” The initial report must be submitted to the Chief Compliance Officer no later than ten (10) days after the person becomes an “access person” of an RIA.

B. Annual Holdings Reports

On an annual basis, an RIA’s “access person” must complete a report of his or her reportable securities and submit it to the Chief Compliance Officer. The annual holdings report must be current as of a date no more than forty-five (45) days prior to the date the annual report was submitted

C. Quarterly Transaction Reports

“Access persons” must submit transaction reports of all personal securities transactions on a quarterly basis to the Chief Compliance Officer. Such quarterly transaction reports must be due no later than thirty (30) days after the close of the calendar quarter.

As an alternative to submitting quarterly transaction reports, RIAs may continue to require persons who are “access persons” to submit brokerage statements or trade confirmations as long as such documents contain the information required under Rule 204A-1(b)(2)(i)(A)-(E) under the Advisers Act. Moreover, such statements or confirmations must be received by the RIA no later than thirty (30) days after the close of the calendar quarter in which the transaction takes place.

7. Proxy Voting Policy

RIAs that exercise voting authority over their clients’¹⁵ proxies must adopt and implement written policies and procedures reasonably designed to ensure that the RIA votes proxies in the best interest of its client.¹⁶ A different policy and procedure may be applied to each particular fund managed by an RIA. An RIA’s proxy voting policies and procedures must be designed to enable the RIA to resolve material conflicts of interest with its clients before voting their proxies.

¹⁵ For purposes of the proxy voting rules, the term “client” refers to any underlying investor in a pooled investment vehicle advised by the RIA.

¹⁶ An RIA whose clients expressly retain voting authority is not required to adopt proxy voting procedures or policies, or make any disclosure to clients.

RIAs must give their clients notice of the proxy voting policy. This obligation can be satisfied by providing a summary of the RIA's proxy voting policy in Part II of the RIA's Form ADV or other written document that is used to satisfy the written disclosure statement delivery requirement.

An RIA that does not vote proxies or does not wish to retain the power to vote proxies must explicitly state that it does not exercise voting authority over their clients' proxies. This can be accomplished by explicitly stating in Part II of the Form ADV that such RIA does not vote proxies.

8. Restrictions on Charging Performance or Incentive-Based Fees

An RIA is prohibited from taking performance or incentive-based fees from clients, unless *inter alia* such clients qualify as "Qualified Clients." A Qualified Client must (i) have a net worth of more than \$1,500,000, (ii) have at least \$750,000 under management with the RIA, (iii) be a qualified purchaser as defined in Section 2(a)(51)(A) of the Company Act, (iv) be an executive officer, director, trustee, general partner, or person serving in a similar capacity of the RIA, or (v) be an employee of the RIA, who participates in the investment activities of such RIA for at least 12 months.

Furthermore, an RIA must look through an entity that is relying on the exemption from the definition of "investment company" pursuant to Section 3(c)(1) of the Company Act to determine whether each equity owner of the entity would be a Qualified Client in order for the RIA to charge such an entity a performance fee. Accordingly, each "tier" of the 3(c)(1) entity must be examined in this manner. This look through does not apply, however, if an entity is relying on the "qualified purchaser" exemption from registration under the Company Act (Section 3(c)(7)). A 3(c)(1) entity whose beneficial owners are all qualified purchasers automatically qualifies as a Qualified Client under the Advisers Act, and the RIA may charge a performance fee without further inquiry into the eligibility of such entity's beneficial owners.

Note that a hedge fund manager that has relied on the exemption from investment adviser registration pursuant to Section 203(b)(3) and Rule 203(b)(3)-1 under the Advisers Act but is now required to register may continue to charge a performance fee with respect to investors that are not Qualified Clients *provided* that such non-Qualified Client investors have been investors in the registered fund manager's fund prior to February 10, 2005.

Additionally, an RIA that advises non-U.S. persons need not ensure the above criteria is satisfied before taking a performance-based fee. As such, non-U.S. persons need not qualify as a Qualified Client.

Finally, an RIA, whether located within the U.S. or outside the U.S., that operates an offshore fund is not subject to the prohibition on performance fees. According to the

SEC staff, a registered investment adviser can charge performance fees to a non-U.S. domiciled fund *regardless* of whether such fund has U.S. investors

9. Advertisement Rules

An RIA is allowed to advertise (itself, not its private fund) whereas an unregistered advisor may not advertise at all.

However, the SEC feels that an RIA's fiduciary duties to its clients mandate that the standard of conduct of advertisements by an RIA should be stricter than that for other vendors of products. Advertisement is defined to include any written communication addressed to more than one person or any notice or announcement in any publication. There are extensive rules, no-action letters and interpretative releases regarding advertising and the dissemination of performance results by RIAs.¹⁷

10. Privacy Policy (Regulation S-P)

RIAs are required to distribute a notice of their privacy policy to each of its underlying investors in a fund that are *natural persons* at the time a person becomes an investor in the fund and on an annual basis (e.g. attaching the privacy notice with the annual statement sent to each investor). Both U.S. persons and non-U.S. persons are to receive the privacy notice.

If an RIA's privacy policy changes, before acting in accordance with such changed policy, the RIA must provide a new privacy policy to its investors. For example, an RIA is required to distribute a revised policy to its investors when: (i) the RIA discloses a new category of nonpublic personal information to any nonaffiliated third party (unless such third party is a service provider in the normal course of business); (ii) the RIA discloses nonpublic personal information to a new category of nonaffiliated third party (unless such third party is a service provider in the normal course of business); and (iii) the RIA discloses nonpublic personal information about a former investor to a nonaffiliated third party (unless such third party is a service provider in the normal course of business), if that former investor has not had the opportunity to exercise an opt-out right regarding that disclosure.

A change in an RIA's privacy policy may require that the RIA provide each natural person investor in the fund with an opportunity to opt out¹⁸. The RIA is required to wait a "reasonable period of time," generally, 30 days, in order to afford a Investor a

¹⁷ See e.g. Gallagher and Associates, Ltd. (July 10, 1995) (prohibition on testimonials); Clover Capital Management, Inc. (Oct. 28, 1986) (performance advertisement); Investment Company Institute (Aug. 24, 1987) (performance advertisement must be net of fees); JP Morgan Investment Management, Inc. (May 7, 1996) (model fees); Association for Inv. Management & Research (Dec. 18, 1996) (accounts to include in determining actual performance); Horizon Asset Mgmt, LLC (Sept. 13, 1996) (portability of past performance); and Great Lake Advisors, Inc. (Apr. 3, 1992) (portability of past performance).

¹⁸ An "opt out" means that an investor is provided with an opportunity to exercise, within a reasonable period of time, his or her statutory right to restrict an RIA from disclosing his or her nonpublic personal information to nonaffiliated third parties.

reasonable opportunity to opt out before disclosing nonpublic personal information according to the terms of the privacy notice. Until the RIA receives an opt out response or a “reasonable period of time” expires, the RIA cannot disclose the investor’s nonpublic personal information to the nonaffiliated third party.

11. Inspections/Books and Records

The SEC has authority to examine the books and records of RIAs (and the RIA may not challenge the requested production of documents and/or information on the grounds of self-incrimination). These inspections are called “regular inspections,” which constitute the SEC’s extensive and regular on-site inspection program. A regular inspection involves review of the books and records, review of sales and offering materials, review of advertising practices and possibly an interview of the RIA’s employees. These regular inspections are usually done on a surprise basis to ensure that the books and records are constantly maintained.¹⁹ The frequency of these inspections depends on the quality of compliance of an RIA. For instance, an RIA found to have weak controls will likely be inspected at least once every two years. RIAs that are found to have strong controls will likely be inspected every three to four years. Further, it is important to note that the Office of Compliance, Inspections and Examinations of the SEC may share its findings with other departments within the SEC as well as other federal and state regulators and/or self-regulatory organizations (“SROs”).

RIAs that operate “private funds” should note that the books and records of any “private fund” are considered to be the books and records of the RIA.

12. E-Mail Retention

An RIA is now expected to retain its e-mail as part of its general books and records obligations. Since November 2003, SEC examiners have requested RIAs to produce the past e-mail of senior members of such RIAs during a random fiscal quarter.

In terms of how long to retain archived e-mails, until the SEC issues further guidance, an RIA should retain e-mails in accordance with the current requirements under the Advisers Act. As such, archived e-mail should be retained for a period of five years, the first two years on-site at the adviser’s office.

13. USA Patriot Act (Proposed)

The SEC has proposed that Section 352 of the USA PATRIOT Act apply to RIAs.²⁰ If the proposal is adopted, RIAs would most likely be required to:

¹⁹ The SEC does not give advance notice of these regular inspections.

²⁰ Financial Crimes Enforcement Network; Anti-Money Laundering Programs for Investment Advisers; proposed rules; 68 Fed. Reg. 23646-23653 (May 5, 2003).

- A. Establish and implement policies, procedures and internal controls reasonably designed to detect and prevent money laundering and terrorist financing;
- B. Provide for independent testing for compliance with the USA PATRIOT Act;
- C. Designate a person or persons responsible for implementing and monitoring the anti-money laundering program; and
- D. Provide for ongoing employee training on anti-money laundering issues.

II. Other Requirements Applicable to RIAs

1. Form 13F filings:

An RIA that has \$100 million of 13F reportable securities²¹ under management (short positions are not included in this calculation) at any month end must file a Form 13F with the SEC within 45 days of the end of the calendar year in which the RIA goes over the threshold.²² Thereafter, the RIA must also file 13F reports within 45 days of the end of each of the following three quarters.²³ All 13F reports are filed through the SEC's Electronic Data Gathering, Analysis, and Retrieval system ("EDGAR") unless confidential treatment is to be requested. If confidential treatment is being requested, a 13F report must be prepared as discussed above and must be sent directly to the SEC to be received by the SEC no later than the dates indicated above.²⁴ Along with the request for confidential treatment, the RIA must list all of the securities for which confidential treatment is being requested along with the time for which the RIA is requesting confidential treatment (no more than 12 months) as well as a description of the strategy being followed and how each particular holding plays into that strategy and why confidentiality is being sought. The RIA must also demonstrate the substantial harm that would come about by public disclosure.

In the event an RIA realizes that information previously disclosed is erroneous, an amended Form 13F is required promptly. An amended 13F is also required within 6 business days of the expiration or denial of a confidential treatment request.

2. Schedule 13D filings:

A General Statement of Acquisition of Beneficial Ownership, ("Schedule 13D") is a report that is filed through EDGAR on behalf of any person who acquires, directly or indirectly, the beneficial ownership of any equity security of a class which is registered pursuant to Section 12 of the Securities Exchange Act of 1934, as amended (the

²¹ The SEC puts out an official list of all 13F securities. Generally, these are exchange-traded securities including common stock and options.

²² For example, if an RIA has \$100 million of 13F securities on March 31, 2003, the first 13F filing is required by February 14th, 2004 which is 45 days after the end of 2003.

²³ For an RIA with a 12/31 fiscal year, 13F reports will be due to the SEC by May 15th for 1st quarter, August 14th for 2nd quarter, November 14th for 3rd quarter, and February 14th of the next year for the 4th quarter.

²⁴ This means confidential treatment filings must be filed with the SEC no later than May 15th for 1st quarter, August 14th for 2nd quarter, November 14th for 3rd quarter, and February 14th of the next year for the 4th quarter.

“Exchange Act”). As such, an RIA must file a Schedule 13D²⁵, unless the RIA qualifies for the short form Statement of Acquisition of Beneficial Ownership (“Schedule 13G”), as discussed below, within 10 days of such acquisition. Amendments to a Schedule 13D must be filed promptly²⁶ if there has been any material change²⁷ in the information previously provided.

3. Schedule 13G filings:

In lieu of filing a Schedule 13D, certain classes of persons may file a Schedule 13G. In particular, those persons that have acquired the securities in the ordinary course of business and not with the purpose nor with the effect of changing or influencing the control of the issuer, nor in connection with or as a participant in any transaction having such purpose or effect and satisfy any one of A-J below may file a Schedule 13G. Schedule 13G is available for any of the following filers:

- A. A broker-dealer registered under Section 15 of the Securities Exchange Act (“Exchange Act”);
- B. A bank as defined in Section 3(a)(6) of the Exchange Act;
- C. An insurance company as defined in Section 3(a)(19) of the Exchange Act;
- D. An investment company registered under Section 8 of the Company Act;
- E. *Any person registered as an investment adviser under Section 203 of the Advisers Act or under the laws of any state;*
- F. An employee benefit plan as defined in Section 3(3) of the Employee Retirement Income Security Act (“ERISA”) that is subject to the provisions of ERISA, or any such plan that is not subject to ERISA that is maintained primarily for the benefit of the employees of a state or local government or instrumentality, or an endowment fund;
- G. A parent holding company or control person, provided the aggregate amount held directly by the parent or control person, and directly and indirectly by their subsidiaries or affiliates that are not persons specified in Rule 13d-1(b)(1)(ii)(A) through (I), does not exceed one percent of the securities of the subject class;
- H. A savings association as defined in Section 3(b) of the Federal Deposit Insurance Act;
- I. A church plan that is excluded from the definition of an investment company under Section 3(c)(14) Company Act; and
- J. Any group of people in items A-I above.

Since an RIA is eligible to file Schedule 13G as a result of satisfying item E above, an RIA must file within 45 days after the end of the calendar year in which such

²⁵ 13D Forms can be accessed from the SEC’s website at <http://www.sec.gov/about/forms/sched13d.pdf>.

²⁶ Promptly depends on the facts and circumstances, but in no event shall the filing be more than 10 days after the event triggering the filing.

²⁷ Rule 13d-2 of the Exchange Act indicates that an acquisition or disposition of 1% is deemed material for this purpose.

an RIA became obligated to report the RIA's beneficial ownership as of the last day of the calendar year, *provided*, that it shall not be necessary to file a Schedule 13G unless the percentage of the class of equity security beneficially owned as of the end of the calendar year is more than 5%. By way of example, if on March 31, 2004 a person was deemed the beneficial owner of 5.2% of the outstanding shares, but on December 31, 2004 sold off shares and holds only 4% of the outstanding shares, the person will not be required to file Schedule 13G. However, if the person's direct or indirect beneficial ownership exceeds 10% of the class of equity securities prior to the end of the calendar year, the initial Schedule 13G is required to be filed within 10 days after the end of the first month in which the person's direct or indirect beneficial ownership exceeds 10% of the class of equity securities, computed as of the last day of the month.

Notwithstanding the forgoing, a Schedule 13G may also be filed by an RIA that has not acquired the securities with any purpose, or with the effect of, changing or influencing the control of the issuer, or in connection with or as a participant in any transaction having that purpose or effect, provided that such person is not directly or indirectly the beneficial owner of 20% or more of the class. **An RIA filing Schedule 13G pursuant to this provision, must file within 10 days of acquisition of 5% or more of a class of securities.**

If at any time an RIA becomes ineligible to file Form 13G, but still has 5% or more of the class of securities, such RIA must file Form 13D within 10 days of becoming ineligible.

Amendments to Form 13G must be filed:

1. Annually within 45 days after year end, if there have been any changes to the information previously reported; and
2. Promptly upon acquiring directly or indirectly, greater than 10% of a class and thereafter promptly upon increasing or decreasing beneficial ownership by 5% or more.

4. Forms 3, 4 and 5

Form 3 (the initial statement of beneficial ownership), Form 4 (the statement of changes in beneficial ownership) and Form 5 (the annual statement of beneficial ownership) are required to be filed by all beneficial owners of 10% or more of an equity class of an issuer's securities. As such, an RIA would complete and file Forms 3, 4, and 5 if the fund it operates acquires a 10% or more of the equity class of an issuer. These forms are required to be filed under Section 16 of the Exchange Act in order to comply with the short-swing profit rules and are filed through EDGAR.

- A. Form 3 must be filed within 10 days of the final acquisition which causes the owner to become a beneficial owner of 10% or more.

B. Form 4 must be filed before the end of the second business day following the day on which the subject transaction has been executed.

C. Form 5 must be filed within 45 days after the end of the year.

5. NASD New Issues Rule (NASD Conduct Rule 2790)

RIAs that purchase initial public offerings of equity securities (“new issues”) will be asked to provide a written representation to their broker from whom they purchase new issues, that the account is eligible to participate in new issues. Furthermore, if an RIA operates a fund-of-funds that invests in other funds (the “investee funds”) that purchase new issues, the RIA will be requested to make a representation to the investee fund that its fund is in compliance with the new issue rules and its fund is eligible to participate in new issues. In order to make this representation, the RIA must review employment information, business affiliations, and other securities relationships and/or receive a written representation from all underlying investors to make sure that those investors defined as restricted under NASD Conduct Rule 2790 are distinguished from those that are not restricted. Moreover, an RIA must ensure that restricted persons that are investors in its fund do not exceed in the aggregate 10% of the beneficial ownership of such fund as allowed by the *de minimis* exemption to the rule²⁸. Also, on an annual basis, an RIA will have to verify the validity of its investors’ representations. NASD Conduct Rule 2790 went into effect on March 23, 2004.

6. Blue Sky Laws

Blue Sky is a term used to refer to the states’ securities laws. In addition to the federal securities regime, RIAs and the funds they operate must comply with the various states securities laws. Each state has its own law regulating advisers and the securities offered in their fund. While the level of regulation varies for each state, in general advisers will either have to register with states where they have clients or avail themselves of an exemption from registration. Furthermore, the securities offered by their funds will either have to be registered or qualify for an exemption from registration in states where investors are solicited. This section will cover the general requirements under Blue Sky Laws. We can assist you with respect to specific state requirements.

A. Investment Adviser Registration under Blue Sky Laws

RIAs will not be required to register with the state(s) where their clients²⁹ are located, but will typically have to make a notice filing with the state(s) before they can accept a certain number³⁰ of clients.³¹

²⁸ The *de minimis* rule can also be adhered to by carving out restricted persons so that no more than 10% of the profits or losses from the initial public offering are allocated to restricted persons in the fund.

²⁹ For purposes of investment adviser registration under Blue Sky Laws only, “client” does not include underlying investors, if any, of a client that is itself an investment vehicle (i.e. a fund), unless an adviser provides any such underlying investor investment management services through a managed account.

If an RIA is required to make a notice filing in any particular state, the state securities regulator³² may request a copy of the RIA's Form ADV Part II. Upon receipt of such a request, an RIA will have 30 days within which to respond.

Some states also require registration of supervised persons of RIAs. In order to determine if supervised persons are required to register, it is necessary to review the Blue Sky Laws of the state where the RIA intends to make a notice filing. If the state requires registration of supervised persons, such registration is accomplished by filing a Uniform Application for Securities Industry Registration or Transfer ("Form U-4") through the IARD. Supervised persons that are required to register will typically be required to successfully take the NASAA administered Series 65 exam.

B. Securities Registrations and Exemptions under Blue Sky Laws

Securities offered by privately placed pooled investment vehicles must either be registered or exempt from registration under the states' Blue Sky Laws. The interests in hedge funds are privately placed securities and generally rely on the exemption from SEC registration found in Regulation D Rule 506 under the Securities Act of 1933, as amended (the "Securities Act"). Every state has a corresponding exemption under their Blue Sky Laws, and, depending on the state, may require nothing or may require a notice of offer of sale in the state ("Notice Filing") along with a minimal filing fee. If a Notice Filing is required, it will typically be required within 15 days of the first sale in that state. New York is an exception to this provision and requires that a Notice Filing be made before any offer or sale is made in or from New York. In order to determine whether a Notice Filing is required, it is necessary to review the Blue Sky Laws of each state in which investors are solicited.

Conclusion

There are many regulatory, disclosure and filing requirements which RIAs must comply with under the Advisers Act and other various securities laws and regulations (both federal and state). Many of these laws and regulations have requirements applicable to all RIAs while others may or may not apply depending upon the activities of the RIA in question. These requirements cannot be taken lightly and it is very important that every RIA adopt policies and procedures that address the various

³⁰ Some states have a *de minimis* provision applicable to advisers which provide that an adviser can have up to 5 (or more in some states) clients without having to make the notice filing, but some states require that the advisers not be located in the state in order to avail themselves of the *de minimis* provision. Typically, an adviser will have to make a notice filing in the state where their principal offices are located, but to be certain, a review of the states' laws where clients are located is necessary.

³¹ Under this provision, client does not include the investors in the fund, unless the adviser also advises a managed account for the investor.

³² "State securities regulator" shall be the person responsible for administering the state's securities laws.

obligations and that all filings are made in a timely manner to prevent regulatory enforcement action against the RIA.

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If you have any questions or comments regarding compliance with the various federal and state regulations discussed in this memorandum or with drafting the policies and procedures required under the Advisers Act, please feel free to contact:

Michael G. Tannenbaum
(212) 508-6701
tannenbaum@tanhelp.com

Ricardo W. Davidovich
(212) 508-6710
davidovich@tanhelp.com

Wayne H. Davis
(212) 508-6705
davis@tanhelp.com

Shelley J. Chaben
(212) 508-6774
chaben@tanhelp.com

Ella D. Cohen
(212) 508-6775
cohen@tanhelp.com

Barry E. Breen
(212) 508-6725
breen@tanhelp.com

Pattie L. Hand
(212) 508-6771
hand@tanhelp.com

Roderick J. Cruz
(212) 702-3149
cruz@tanhelp.com

Tannenbaum Helpern Syracuse & Hirschtitt LLP
New York London
www.tanhelp.com