IA Registration 101:
A Primer on Investment Adviser Registration

Attorney Advertising

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IMPORTANT NOTICE: This presentation is intended to serve as a *primer* for prospective registrants.

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I. SEC REGISTRATION – THE ADVISERS ACT

Financial Reform and Registration of Investment Advisers

Pending financial reform legislation is expected to significantly expand the universe of investment advisers who will be required to register with and become subject to regulation by the SEC. The legislation is expected to eliminate the exemption found in Section 203(b)(3) of the Investment Advisers Act of 1940 (the "Advisers Act") exempting from registration investment advisers managing fewer than fifteen clients and not holding themselves out to the public as an investment adviser. It is expected that advisers with assets under management above a specified threshold (expected to be $150 million) will be required to register.

This presentation is intended to serve as a *primer* for prospective registrants. The following pages contain a brief discussion of the process by which an investment adviser registers with the SEC and some of the major operating requirements applicable to investment advisers under the Advisers Act.

The Investment Advisers Act of 1940

Advisers registered with the SEC must comply with all of the applicable provisions of the Advisers Act and the rules that have been promulgated thereunder (the "Rules").

To access the Advisers Act, the Rules and other related information, visit the SEC's website at www.sec.gov (the Advisers Act and rules are available at http://www.sec.gov/divisions/investment.shtml).

Definition of "Investment Adviser" Under the Advisers Act[1]

"Investment adviser" means any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities.

[1] Throughout this presentation, we refer to registered investment advisers as "advisers" or by the abbreviation "IAs."

I. SEC REGISTRATION – REGISTRATION PROCEDURES

Preparation and Filing of Form ADV, Part I[1]

- Application for registration as an adviser must be submitted to the SEC on Form ADV, which is comprised of Form ADV, Part 1 and Form ADV, Part II.

- Form ADV, Part I provides information about the adviser and its related persons, including:

  - identifying information: identity of person(s) who own/control the adviser
  - principal office and place of business, form of organization and jurisdiction
  - type(s) of advisory services and other business activities of the adviser
  - conflicts of interest such as:
    - financial industry affiliations
    - participation or interest in client transactions
    - brokerage activities
  - whether the adviser has custody of client assets
  - disciplinary history of the adviser and related persons
  - type and number of advisory clients

- Form ADV, Part I *must* be filed electronically with the SEC through the Investment Advisers Registration Depository (IARD).[2]

  - The SEC has forty-five (45) days from the filing of a completed Form ADV, Part I to approve the proposed registration. During this time, the SEC reviews the submission for completeness and any apparent discrepancies or problematic responses.[3]
  - IAs are required to file an annual update of Form ADV, Part 1A within ninety (90) days after the end of their fiscal year and must promptly file an amendment *whenever* certain information in the Form ADV becomes inaccurate.

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[1] See http://www.sec.gov/about/forms/formadv-part1a.pdf.

[2] To establish an account with the IARD, an applicant must complete certain "Entitlement Forms" and submit them to FINRA. Forms and information are available on the IARD website at http://www.iard.com.

[3] Historically, the SEC has taken 4-6 weeks to review and approve properly completed Form ADV, Part I submissions. Throughout 2010, it has been our experience that submissions are reviewed and approved within 3-4 weeks.

I. SEC REGISTRATION – REGISTRATION PROCEDURES

Preparation and Filing of Form ADV, Part II[1]

Form ADV, Part II (including Schedule F thereto) is a disclosure document that contains more detailed information and narrative about the adviser and its related persons, including:

- type(s) of advisory services provided by the adviser
- type(s) of fees charged by adviser
- types of investments made by adviser
- methods of securities analysis, sources of information and investment strategies and associated risks
- education and business credentials of principals of the adviser
- conflicts of interest such as:
  - financial industry affiliations
  - participation or interest in client transactions
  - brokerage activities
- description of code of ethics adopted by the adviser
- method of review of client accounts
- investment or brokerage discretion
- proxy voting policies of the adviser

The IA may, but is not required to (and typically does not) file Form ADV, Part II electronically through the IARD:

- Form ADV, Part II is "deemed" filed when it is complete and placed in the adviser's internal files.
- Whether or not an IA files Form ADV, Part II through IARD, IAs must continue to provide prospective clients[2] (*i.e.*, investors in pooled investment vehicles) with a copy of Form ADV Part II or a brochure containing at least the same required information.
- A copy of the Form ADV, Part II also must be kept in the adviser's office at all times for inspection by the SEC.

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[1] See http://www.sec.gov/about/forms/formadv-part2.pdf.

[2] In the case of funds that are pooled investment vehicles, the Form ADV, Part II is delivered to individual investors in the fund.

II. SEC REGISTRATION – CERTAIN OPERATING REQUIREMENTS

IAs Are Fiduciaries (Section 206)

IAs owe their clients a "fiduciary" duty and must act in the best interests of their clients and provide investment advice in the clients' best interests. Further, IAs owe their clients a duty of undivided loyalty and utmost good faith, and should take steps reasonably necessary to fulfill these obligations. IAs must employ reasonable care to avoid misleading clients and provide full and fair disclosure of all material facts to clients and prospective clients. IAs must eliminate, or at least disclose, all conflicts of interest that might incline them to render advice that is not disinterested. If the adviser is unable to avoid a conflict of interest that could impact the impartiality of its investment advice, the adviser should make full and frank disclosure of the conflict. Departure from this fiduciary standard may constitute "fraud" upon the adviser's clients.

IAs Must Adopt Compliance Programs and Appoint a Chief Compliance Officer (Rule 206(4)-7)

IAs must adopt and implement written policies and procedures that are reasonably designed to prevent violations of the federal securities laws and designate a chief compliance officer ("CCO") who is *competent and knowledgeable* regarding the Advisers Act, and is responsible for administering and empowered to administer the compliance program. These policies and procedures must be reviewed at least annually (or within eighteen months after initial registration) for their adequacy and the effectiveness of their implementation. While there are a limited number of specific policies and procedures mandated by the Advisers Act, at a minimum and to the extent relevant, the IA should adopt policies and procedures governing the following business activities:[1]

- portfolio management procedures governing the investment process
- code of ethics/proprietary trading and personal securities trading
- regulatory disclosures
- custody/safeguarding of client assets
- maintenance of books and records
- advertising and marketing practices/communications with clients, investors and media
- valuation processes
- allocation of investment opportunities
- best execution/brokerage selection and trade errors
- investor and employee privacy
- disaster recovery
- insider trading safeguards
- anti-money laundering

[1]The policies and procedures to be adopted by an adviser vary based upon the type of clients, investment strategy, trading and operations of the adviser.

II. SEC REGISTRATION – CERTAIN OPERATING REQUIREMENTS

IAs Must Have a Code of Ethics and Enforce Certain Insider Trading Procedures (Rule 204A-1 of the Advisers Act)

IAs are required to adopt a code of ethics setting forth the standards of business conduct expected of their "supervised persons" or "access persons" (e.g., employees, officers, directors and others), and it must address personal securities trading by (at least) these persons. The Code must include, among other things: (i) standards of conduct expected of advisory personnel; (ii) a system of pre-clearance for personal investments in initial public offerings and private placements; (iii) a requirement that all violations of the Code be promptly reported to the CCO; and (iv) a requirement that "access persons" periodically report their personal securities transactions and holdings in securities. IAs typically adopt other policies and procedures in the Code of Ethics to address conflicts of interests relating to their particular operations/strategy and industry best practices.

IAs Must Provide Clients and Prospective Clients with a Written Disclosure Statement (Rule 204-3 of the Advisers Act, *aka* "The Brochure Rule")

IAs are required to provide their advisory clients and prospective clients with a written disclosure document[1]. IAs may comply with this requirement either by providing clients with the adviser's Form ADV, Part II or another document that contains, at a minimum, the information that is required to be disclosed in Form ADV, Part II. This written disclosure document must be delivered to prospective clients at least forty-eight (48) hours before entering into an advisory contract or, if it is delivered at the time the client enters into the contract, the client must be given five (5) business days after entering into the advisory contract to terminate the contract without penalty. Each year, IAs are required to deliver or offer to deliver (in writing) a disclosure document to each client, without charge, and to maintain a record (under Rule 204-2(a)(14)) reflecting the dates on which such disclosure was given or offered to be given to any client or prospective client who subsequently became a client.

IAs are Subject to Restrictions with Respect to Performance-Based Compensation (Section 205(a)(1) of the Advisers Act)

IAs are prohibited from receiving any type of advisory fee calculated as a percentage of capital gains or appreciation in the client account subject to certain exceptions as follows: (1) registered investment companies and clients having more than $1 million in managed assets, if specific conditions are met; (2) private investment companies excepted from the Investment Company Act ("ICA") under Section 3(c)(7); and (3) clients that are not U.S. residents. In addition Rule 205-3 permits investment advisers to charge performance fees to: (1) clients with at least $750,000 under management with the adviser or more than $1,500,000 of net worth; (2) clients who are "qualified purchasers" under section 2(a)(51)(A) of the ICA; and (3) certain knowledgeable employees of the investment adviser.

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[1] This rule applies to clients [i.e., funds] and not to individual investors in pooled investment vehicles, although it is considered best practice to enter into written agreements with solicitors and to provide disclosure to investors in pooled investment vehicles.

II. SEC REGISTRATION – CERTAIN OPERATING REQUIREMENTS

IAs Must Maintain Certain Books and Records (Rule 204-2 of the Advisers Act)

IAs must make and keep true, accurate and current certain books and records relating to their investment advisory business including, among others, the following:

- advisory business financial and accounting records, including cash receipts and disbursement journals; income and expense account ledgers; checkbooks; bank account statements; advisory business bills; and financial statements
- records that pertain to providing investment advice and transactions in client accounts with respect to such advice, including orders to trade in client accounts (referred to as "order memoranda"); trade confirmation statements received from broker-dealers; documentation of proxy vote decisions; written requests for withdrawals or documentation of deposits received from clients; and written correspondence the IA sent to or received from clients or potential clients discussing their recommendations or suggestions
- records that document the adviser's authority to conduct business in client accounts, including a list of accounts in which the adviser has discretionary authority; documentation granting discretionary authority; and written agreements with clients, such as advisory contracts
- advertising and performance records, including newsletters, articles and computational worksheets demonstrating performance returns
- records related to the Code of Ethics, including those addressing personal securities transaction reporting by access persons
- records regarding the maintenance and delivery of written disclosure documents and disclosure documents provided by solicitors who seek clients on behalf of the adviser
- compliance policies and procedures adopted and implemented by the adviser, including any documentation prepared in the course of the annual review

Advisers are generally required to maintain records in an "easily accessible place" for five (5) years, the first two (2) years on-site in the IA's office.

II. SEC REGISTRATION – CERTAIN OPERATING REQUIREMENTS

IAs Must Seek to Obtain the Best Price and Execution for Their Clients' Securities Transactions

As fiduciaries, IAs are required to act in the best interests of their advisory clients, and to seek to obtain the best price and execution for their securities transactions. The term "best execution" means seeking the best price for a security in the marketplace as well as ensuring that, in executing client transactions, clients do not incur unnecessary brokerage costs and charges. IAs are not obligated to get the lowest possible commission cost, but rather, should determine whether the transaction represents the best qualitative execution for their clients. The Commission has provided guidance on the requirement which generally provides that IAs must seek the most favorable terms under the circumstances.[1]

IAs Must Adopt Policies Regarding Voting of Proxies (Rule 206(4)-6 of the Advisers Act)

If an IA has voting authority over proxies for clients' securities, the IA must adopt policies and procedures reasonably designed to ensure that the IA votes proxies in the best interests of clients, discloses information to clients about those policies and procedures, and describes to clients how they may obtain information about how the IA has voted their proxies.

IAs Must Comply with Rules Regarding Agency Trades and Principal Transactions (Section 206-3 of the Advisers Act)

IAs may not, acting as principal for their own account(s), knowingly sell any security to, or purchase any security from, an advisory client without specifically disclosing to such client in writing, before the completion (i.e. settlement) of the transaction, the IA's role in the transaction and obtaining the client's consent. Further, IAs may not arrange transactions between different advisory clients on an agency basis unless the IA obtains advance written authorization from the clients to execute such transactions, and also provides the clients with specific written disclosures including detailed confirmations of the pertinent transactions.

[1]The authorization and disclosure requirements of Rule 206(3)-2 generally do not apply to agency cross trades where the IA receives no compensation (i.e., commissions or transaction-based compensation); however, full disclosure regarding this practice must be made to advisory clients in the IA's Form ADV, Part II and offering memoranda, as applicable.

II. SEC REGISTRATION – CERTAIN OPERATING REQUIREMENTS

IAs Must Comply with Requirements Relating to the Engagement of Solicitors (Rule 206(4)-3 of the Advisers Act, *aka* "The Cash Solicitation Rule")

IAs may pay cash compensation to "solicitors" or "finders" to seek out new clients on their behalf subject to the following conditions:

- The solicitor is not subject to certain disciplinary actions.
- The fee is paid pursuant to a written agreement that:
    - describes the solicitor's activities and compensation arrangement;
    - requires that the solicitor perform the duties the IA assigns and in compliance with the Advisers Act;
    - requires the solicitor to provide clients with a current copy of the adviser's disclosure document; and,
    - if seeking clients for personalized advisory services, requires the solicitor to provide clients with a separate written disclosure document containing specific information.
- The IA receives a signed and dated notice confirming that the client was provided with the disclosure document.

This rule applies to clients (*i.e.*, funds) and not to individual investors in pooled investment vehicles, although it is considered best practice to enter into written agreements with solicitors and to provide disclosure to investors in pooled investment vehicles.

IAs Must Take Measures to Safeguard Clients' Funds or Securities (Rule 206(4)-2(c)(1) under the Advisers Act)

IAs that have "custody" or "possession" of client assets must take specific measures to protect client assets from loss or theft. IAs with custody of client funds and securities must maintain them with "qualified custodians." The qualified custodian must hold the funds or securities in an account either under the client's name or under the adviser's name as agent or trustee for its clients. 2010 Amendments to this rule require, with certain exceptions, IAs with custody of client assets to have an independent accountant conduct an annual surprise examination.

IAs Must Disclose Certain Financial and Disciplinary Information (Rule 206(4)-4 under the Advisers Act)

IAs that have custody or discretionary authority over client funds or securities, or that require prepayment six months or more in advance of more than $500 in advisory fees, must promptly disclose to clients any financial conditions that are reasonably likely to impair their ability to meet their contractual commitments to their clients. All registered IAs must also promptly disclose any legal or disciplinary events that would be material to a client's or a prospective client's evaluation of the adviser's integrity or its ability to meet its commitments to clients (regardless of whether the IA has custody or requires prepayment of fees).

II. SEC REGISTRATION – CERTAIN OPERATING REQUIREMENTS

IAs Must Comply with Rules Relating to Advertisements (Rule 206(4)-1 of the Advisers Act and Section 206 of the Advisers Act)

To protect investors, the SEC prohibits certain types of advertising practices by IAs. An "advertisement" includes any communication addressed to more than one person that offers any investment advisory service with regard to securities. An advertisement could include both a written publication (such as a web site, newsletter or marketing brochure) as well as oral communications (such as an announcement made on radio or television). Advertising must not be false or misleading and must not contain any untrue statement of a material fact, and is subject to the general prohibition on fraud. Specifically prohibited are:

- testimonials;
- the use of past specific recommendations that were profitable, unless the adviser includes a list of all recommendations made during the past year;[1]
- a representation that any graph, chart, or formula can in and of itself be used to determine which securities to buy or sell; and
- advertisements stating that any report, analysis, or service is free, unless it really is free.

IAs Are Subject to SEC Examination (Section 204 of the Advisers Act)

The books and records of IAs are subject to compliance examinations by the SEC staff, which examinations may be announced or unannounced. The purpose of SEC examinations is to protect investors by determining whether registered firms are complying with the law, adhering to the disclosures that they have provided to their clients, and maintaining and complying with compliance policies and procedures that were adopted to ensure compliance with applicable law. Additionally, the SEC staff will typically ask to review e-mail correspondence from a select number of employees in various roles during a specified time period in order to test compliance and gauge the culture of compliance. Examinations, which may be done with notice or on a surprise basis, are typically conducted for the following reasons: (1) routine examination or inspection, (2) because of an investor complaint, and (3) a sweep, or industry-wide, examination focusing on a particular issue of investment adviser compliance or risk area.

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[1] The SEC has provided certain no-action relief on several occasions that explicitly permits the use of past specific recommendations in certain instances subject to certain requirements and disclosures.

III. LOWENSTEIN SANDLER OVERVIEW

Lowenstein Sandler is a nationally recognized full-service law firm with approximately 250 attorneys and offices in New York, Palo Alto and Roseland. Our commitment to our clients is demonstrated through our client-centered, service-oriented culture. Our attorneys are regularly cited for excellence by clients and peers in national publications, including *Best Lawyers in America*, *Chambers USA: America's Leading Lawyers for Business* and *The Legal 500*.

Our lawyers possess the credentials, skills and experience rivaling the largest global firms, yet we continue to maintain a boutique, entrepreneurial approach to the practice of law and our relationships with clients. Regardless of the transaction or matter, understanding our clients' needs and helping them to achieve successful outcomes are at the core of what we do.

Our attorneys counsel clients on complex transactions and matters, in practice areas that include:

- Antitrust and Trade Regulation
- Appellate Litigation
- Bankruptcy, Financial Restructuring & Creditors' Rights
- Business Tax Counseling & Structuring
- Capital Markets Litigation
- Class Action & Derivative Litigation
- Commercial & Business Litigation
- Construction Law & Litigation
- Consumer Fraud Litigation
- Corporate Finance & Securities, Corporate Governance
- Derivatives
- Employee Benefits & Executive Compensation
- Environmental Law & Litigation
- Fiduciary Counseling & Litigation
- Immigration
- Insurance Coverage
- Intellectual Property Counseling & Litigation
- Investment Management
- Lending & Financial Services
- Mergers & Acquisitions
- Mortgage Banking & Finance
- PIPEs, SPACs & Registered Direct Offerings
- Private Equity & Mezzanine Financing
- Products & Specialty Torts
- Real Estate
- Securities Litigation
- Venture Capital and Angel Investing
- Tech Transfer
- Trusts & Estates
- White Collar Criminal Defense

"Clients are attracted by the combination of experience and tremendous client service."

IV. INVESTMENT MANAGEMENT GROUP PROFILE

Lowenstein Sandler is home to one of the nation's leading Investment Management practices. For more than 30 years, our firm has represented preeminent domestic and offshore hedge funds, private equity funds, venture capital funds and other pooled investment vehicles, as well as managed accounts. Our global clients comprise more than 200 domestic and international investment funds and their advisers, with assets under management ranging from $100 million to more than $25 billion. These fund clients span a broad and diverse range of organizational structures and investment strategies. In addition to fund managers and IAs, our clients include administrators, broker-dealers and institutional investors. We provide a full range of legal services, which are outlined on the following page, to our investment management clients. We also represent these clients on a wide array of commercial transactions, including large going-private transactions, midsize acquisitions, and pioneering PIPE and registered direct transactions. In addition, our litigators have achieved landmark results for fund clients in high-profile securities law matters.

Our investment management attorneys are recognized for their innovative solutions and dedication to client service; many have been featured in "best of" legal publications, including *Best Lawyers in America*, *Chambers USA: America's Leading Lawyers for Business* and *The Legal 500*. We take an interdisciplinary approach to advising our clients and collaborate with colleagues in the firm's M&A, corporate finance and securities, litigation, venture capital, bankruptcy, intellectual property, employee benefits, real estate, specialty finance and tax practices to ensure that our clients' varied legal and business needs are fully addressed.

Regulatory & Compliance

As a result of the increasing regulatory oversight and enforcement in the investment fund industry, our regulatory and compliance lawyers are called upon to provide critical advice and guidance to our clients on a wide variety of matters. By establishing strong relationships with clients, and gaining a thorough understanding of their business, investment strategies, and front and back office operations, we are able to develop comprehensive and robust compliance programs, and produce novel solutions to the complex regulatory and compliance issues that our clients increasingly confront. Our practice has also played a key role in shaping proposed legislation and regulation at the national and state levels.

We are intimately familiar with the investment industry and, for more than three decades, have worked with a broad constituency of market participants as well as various regulatory bodies. Our attorneys include experienced practitioners, and former in-house counsel and compliance personnel who provide practical advice and guidance on regulatory and compliance matters, from routine trading issues, regulatory examinations and due diligence inquiries, to enforcement proceedings and hotly contested litigation.

IV. INVESTMENT MANAGEMENT GROUP PROFILE

We counsel investment management clients on a wide variety of matters, including:

- Fund Formation and Advisory Services
- Fund Structuring
- Mergers and Acquisitions
- Financing Transactions
- Partnership and Limited Liability Company Law
- Comprehensive Regulatory and Administrative Compliance
- Investor Suitability Standards
- Marketing and Reporting Guidelines
- Conflicts of Interest
- Public and Private Equity and Debt Instruments
- *PIPE* and *RD* Transactions
- Commodity Trading
- Swaps and Derivatives Transactions
- Insider Trading Issues
- Activist Investing
- Taxation and ERISA
- Employee Benefits
- Intellectual Property Law

Lowenstein Sandler's Investment Management group once again ranks among the top practices in the country for investment fund formation & management.

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