

Dodd-Frank: Effect On Investment and Hedge Fund Advisers

By James E. Moniz



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With President Obama's recent signing of the Dodd-Frank Wall Street Reform and Consumer Protection Act into law, financial services firms, advisors and investment and hedge fund advisers should be prepared for numerous sweeping changes, including a new entity with which they will be registered, the acceptance of new fiduciary standards and an impending and significant rise in the threshold for state investment adviser registration and scrutiny.

The Dodd-Frank Act will restructure this country's financial system through the widespread regulation of financial institutions, consumer financial products/services, broker-dealers, over-the-counter derivatives, investment advisers, credit rating agencies and mortgage lending. The Act's broad scope has some pundits maintaining that its enactment will open the flood gates to a new regulatory era that has the potential to affect all elements of financial services.

While the core provisions focus on areas within the financial services industry, the law's ramifications will be felt by investment companies and private investment advisers in direct and indirect ways.

But for now the focus is on anticipated changes, most of which will become effective as of July 21, 2011. The exception is an immediate revision of the definition of "accredited investor." Parenthetically, the Act alters the definition to exclude the value of a person's primary

residence from the \$1 million net worth calculation; moreover, after four years and at least once every four years thereafter, the SEC must review the definition of "accredited investor" and establish whether further adjustments in definition should be made.

A number of substantial regulatory changes are included within Dodd-Frank under Title 4, sometimes cited as the Private Investment Advisers Registration Act of 2010. Key among those changes is a new framework that will effectively require many investment advisers and hedge fund managers to register as investment advisers with the SEC; it will also require some who are presently registered with the SEC to register with a state, instead.

Also, a new threshold for the amount of assets under management has been created; the Act includes a provision that disallows an investment adviser from registering federally as an investment adviser if the adviser is required to register in the state where its principal office is located and if it has less than \$100 million of assets under management.

Prior to the Act, investment advisers could register with the SEC if they had more than \$25 million of client assets under management; by eliminating the private investment adviser exemption and significantly increasing the assets under management threshold, there could be a large impact on larger investment advisers who advise/manage private investment funds with more than \$100 million of assets. These advisers could become subject to investment adviser registration, while smaller advisers managing between \$25 million and \$100 million of client assets will be subject to registration by individual states. This aspect of the Act could pose an issue for some, as most states employ rules and regulations that differ from those of the SEC. As such, written policies and procedures will have to be revised.

Hedge funds managers of separate accounts with assets under management of between \$25 million and \$100 million must register with their home state unless

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exempt under state law; in that case, registration with the SEC is mandatory.

The new law deletes the “private investment adviser exemption” from registration for investment professionals with less than 15 clients during the preceding 12 months and who do not identify themselves to the public as investment advisers. Previously, the private investment adviser exemption allowed those who did not advertise their services the freedom to maintain a small number of clients without registering with the SEC. Under Dodd-Frank, an adviser with just a single private fund or client or who has more than \$150 million of assets under management must register with the SEC.

Considered a “win” for family offices, the Act exempts single-family offices from the definition of investment adviser; therefore family offices are not mandated to register with the SEC, eliminating the expense and regulatory boundaries that come with federal registration.


What remains unclear, however, is the exact definition of “family office” under Dodd-Frank. The reform act leaves the definition to future SEC ruling, but does direct

the SEC to adopt a definition consistent with previous exemptive policy regarding family offices.

Venture capital funds advisers and small business investment companies will also be exempted from the registration requirements. Moreover, advisers to private equity funds will be subject to the same registration provisions as private fund managers.

It’s important to note that under Dodd-Frank, the SEC is allowed significant power for future expansion of its own authority.

Essentially the Dodd-Frank Act requires all hedge advisers with assets under management of more than \$150 million to register with the SEC, maintain comprehensive records about their practice, supply this information to the SEC, have a compliance program in place and be subject to periodic review by the SEC.

As such, new private fund adviser registration requirements are almost certain to result in new competitive trends. Since private fund advisers will be subject to increased recordkeeping, reporting and examination requirements, the gap that previously existed between the business and regulatory environments in which non-registered advisers to private funds and registered advisers to mutual funds have operated will become narrowed. 



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