

FAST ACT CHANGES AFFECTING INVESTMENT ADVISERS TO SMALL BUSINESS INVESTMENT COMPANIES

On December 4, 2015, President Obama signed into law the Fixing America's Surface Transportation Act (the "FAST Act").¹ The Fast Act amended two provisions of the Investment Advisers Act of 1940 (the "Advisers Act") regarding the registration of investment advisers to small business investment companies ("SBICs").²

Prior to the enactment of the FAST Act, only advisers solely to one or more "venture capital funds," as defined in rule 203(l)-1,³ could rely on the exemption from investment adviser registration in Advisers Act section 203(l) (the "venture capital fund adviser exemption"). The FAST Act revised the venture capital fund adviser exemption by deeming SBICs to be venture capital funds for purposes of the exemption. Because an SBIC may not necessarily have the characteristics of a rule 203(l)-1 venture capital fund, an adviser that managed both rule 203(l)-1 venture capital funds and SBICs may not previously have qualified for the venture capital fund adviser exemption. As a result of the FAST Act amendments, an adviser whose only clients are rule 203(l)-1 venture capital funds and/or SBICs may rely on the venture capital fund adviser exemption.

Also prior to the enactment of the FAST Act, only advisers solely to private funds that had assets under management in the United States of less than \$150 million could rely on the exemption from investment adviser registration in Advisers Act section 203(m) (the "private fund adviser exemption"). The FAST Act revised the private fund adviser exemption by excluding SBIC assets from counting towards the \$150 million threshold. As a result, an adviser that has assets under management in the United States of less than \$150 million attributable to its non-SBIC private fund clients may rely on the private fund adviser exemption regardless of the assets under management in the United States attributable to its SBIC client(s).



Prior to the amendments described above, advisers solely to SBICs could rely on the exemption from investment adviser registration in Advisers Act section 203(b)(7)⁴ (the “SBIC adviser exemption”).⁵ With these amendments, it is the staff’s view that an adviser currently relying on the SBIC adviser exemption and advising only SBICs may choose to instead: (1) rely on the venture capital fund adviser exemption and advise both SBICs and rule 203(l)-1 venture capital funds; or (2) rely on the private fund adviser exemption and advise both SBICs and non-SBIC private funds, provided those non-SBIC private funds account for less than \$150 million in assets under management. However, unlike an adviser relying on the SBIC adviser exemption, the staff believes that an SBIC adviser that chooses to rely on either the venture capital fund adviser exemption or the private fund adviser exemption is required to submit reports to the Commission as an exempt reporting adviser.⁶

In addition, the staff believes that, as a result of the FAST Act amendments to the Advisers Act, an adviser currently relying on either the venture capital fund adviser exemption or the private fund adviser exemption to not register may now obtain SBIC clients consistent with the revised exemptions from registration. Finally, the staff notes that certain registered advisers that advise SBICs may be eligible to withdraw their registration and begin reporting to the Commission as exempt reporting advisers under either the venture capital fund adviser exemption or the private fund adviser exemption.⁷

Division staff is currently developing a recommendation for the Commission to consider that would amend Advisers Act rules 203(l)-1 and 203(m)-1 to reflect the FAST Act amendments to the Advisers Act. Until any final rule changes are considered and acted upon by the Commission, the staff would not object to an adviser relying on the FAST Act amendments to the venture capital fund adviser exemption or the private fund adviser exemption, provided that such an adviser files the reports required of an exempt reporting adviser on Form ADV.

Endnotes

- 1 Pub. L. No. 114-94, 129 Stat. 1312 (Dec. 4, 2015).
- 2 For purposes of the Advisers Act sections 203(l) and (m), an SBIC is (other than an entity that has elected to be regulated or is regulated as a business development company pursuant to section 54 of the Investment Company Act of 1940): (A) a small business investment company that is licensed under the Small Business Investment Act of 1958 (“SBIA”), (B) an entity that has received from the Small

Business Administration notice to proceed to qualify for a license as a small business investment company under the SBIA, which notice or license has not been revoked, or (C) an applicant that is affiliated with 1 or more licensed small business companies described in subparagraph (A) and that has applied for another license under the SBIA, which application remains pending. See Advisers Act section 203(b)(7).

- 3 Generally, the rule defines a venture capital fund as any private fund that: (i) holds no more than 20 percent of the fund's capital commitments in non-qualifying investments (other than short-term holdings); (ii) does not borrow or otherwise incur leverage in excess of 15 percent of the fund's capital commitments, other than limited short-term borrowing (excluding certain guarantees of qualifying portfolio company obligations by the fund); (iii) does not offer its investors redemption or other similar liquidity rights except in extraordinary circumstances; (iv) represents itself as pursuing a venture capital strategy to its investors and prospective investors; and (v) is not registered under the Investment Company Act and has not elected to be treated as a business development company. See rule 203(l)-1(a).
- 4 Advisers Act section 203(b)(7) provides an exemption from registration for any investment adviser, other than any entity that has elected to be regulated or is regulated as a business development company pursuant to section 54 of the Investment Company Act of 1940 (15 U.S.C. 80a-54), who solely advises (A) SBICs that are licensees under the Small Business Investment Act of 1958; (B) entities that have received from the Small Business Administration notice to proceed to qualify for a license as an SBIC under the Small Business Investment Act of 1958, which notice or license has not been revoked; or (C) applicants that are affiliated with 1 or more licensed SBICs described in subparagraph (A) and that have applied for another license under the Small Business Investment Act of 1958, which application remains pending.
- 5 Advisers relying on the exemptions from registration as investment advisers in either section 203(m) or 203(l) are deemed "exempt reporting advisers" because they are subject to annual reporting requirements under Commission rules. An adviser relying on the SBIC adviser exemption, on the other hand, is not subject to annual reporting requirements to the Commission.
- 6 An unregistered adviser becoming an exempt reporting adviser must submit its initial Form ADV filing within 60 days of relying on the exemption from registration under either Advisers Act section 203(l) or 203(m). See General Instruction 13 on

Form ADV. For instructions on how to establish an Investment Adviser Registration Depository (IARD) account to file electronic reports and related information for exempt reporting advisers, visit this page: <http://www.sec.gov/divisions/investment/iard.shtml>.

- 7 An adviser switching from being registered to being an exempt reporting adviser must file a Form ADV-W partial withdrawal prior to submitting its first report as an exempt reporting adviser. See General Instruction 13 to Form ADV. The adviser should check “No” for Item 2A in response to whether the adviser has ceased conducting advisory business and select “Switching to be an SEC ERA” for Item 2B as the reason for withdrawal. See also Form ADV FAQs, available at: <https://www.sec.gov/divisions/investment/iard/iardfaq.shtml#advw>.

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