Dodd-Frank Act Changes Affecting Private Fund Managers and Other Investment Advisers

By Adam Gale and Garrett Lynam

I. Introduction

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"),[1] which was signed into law on July 21, 2010, fundamentally changes a number of areas affecting private funds, including the regulation of swaps, a new restriction on the ability of banking entities to sponsor or invest in private funds (the "Volcker Rule"), and new reporting requirements for fund managers. This article discusses those changes, as well as more minor changes affecting the accredited investor definition, the qualified client definition and Rule 506 disqualifications.

One of the most fundamental Dodd-Frank changes affecting private funds is the elimination of the "private advisers" exemption from registration with the SEC as an investment adviser (also known as the "15-client" exemption). In its place, Dodd-Frank created several new, but less comprehensive, exemptions, with the result that most U.S. fund managers with $150 million or more in assets under management will need to register with the SEC, and most fund managers that also have non-fund clients (such as separately managed accounts) will need to register with the SEC or a state. Those changes are discussed in a separate article in this issue of *Inside*, and accordingly are not addressed here.[2]

II. Regulation of Swaps

Dodd-Frank provides for the comprehensive regulation of swaps and requires "swap dealers" and "major swap participants" to register with regulators.[3] As many private funds engage in various types of swaps and derivatives transactions, private fund managers will need to determine if their funds are captured by these new categories, which would then require registration and compliance with numerous new compliance requirements. Since many of the rules and definitions have only been proposed and not finalized, however, it is not possible to make any final determinations at this time.

Additionally, Dodd-Frank imposes mandatory clearing and trade execution requirements on most standardized swaps.[4] Prior to the implementation of Dodd-Frank, over-the-counter swaps were largely unregulated. The terms of many swaps were negotiated between eligible contract participants and not materially impacted by Commodity Futures Trading Commission ("CFTC") or SEC regulations. However, Dodd-Frank brings all swaps under CFTC or SEC regulation.[5] This article provides a brief overview of the new regulations.

A. Effective Dates

Originally, several provisions under Dodd-Frank concerning swaps would have taken effect on July 16, 2011, but since such provisions required the SEC and CFTC to implement final rules, that date was not achievable.[6] The effective date of most provisions was consequently delayed until December 31, 2011 or until new rules become effective, if earlier.[7] Importantly, any provision that references "swap," "security-based swap," "swap dealer," and "major swap participant" is delayed because these definitions have not yet been finalized.[8] Once finalized, these provisions will set forth most of Dodd-Frank's most stringent operating requirements.

B. Definitions of Key Terms

i. Definitions of "Swap" and "Security-Based Swaps"

Dodd-Frank required the SEC and the CFTC to issue a joint rule clarifying the definition of the term "swap" and "security-based swap."[9] Although not yet finalized, the definitions of "swap" and "security-based swap" under Dodd-Frank[10] are very broad and include commodity swaps, interest rate swaps, and the derivatives set forth in the definition of "security-based swap" in the Securities Exchange Act of 1934 (the "Exchange Act").[11]

ii. Definition of "Swap Dealer"

Dodd-Frank defines a "swap dealer" to include one who "regularly enters into swaps with counterparties as an ordinary course of business for its own account," among others.[12] Under a recently proposed rule,[13] a "swap dealer" is any entity that engages in at least one of the following activities:

1. Holds itself out as a dealer in swaps;
2. Makes a market in swaps;
3. Regularly enters into swaps with counterparties in the ordinary course of business for its own account; or
4. Engages in any activity that causes it to be commonly known as a dealer or market maker in swaps.

These definitions are designed to encompass certain large swap providers, including most major financial institutions. The SEC and the CFTC expect market participants to make their own determinations as to whether their activities make them "swap dealers."[14] Factors

indicating that an entity holds itself out as a swap dealer include (i) contacting potential counterparties to solicit interests in transactions; (ii) membership in a swap association in a category reserved for dealers; (iii) providing marketing materials that solicit interest in swap transactions; or (iv) generally expressing a willingness to provide a range of financial products that includes swaps.[15]

Excluded from the definition of "swap dealer" are entities entering into swaps for their own account and "not as part of a regular business."[16] Accordingly, it is likely that many private funds would be excluded from the definition, in the same way that private funds are generally considered to be "traders" and not "dealers" under Section 3(a)(5) of the Exchange Act because they buy and sell securities for their own account and not as part of a regular business. Additionally, a person or entity that engages in a *de minimis* quantity of swap dealing is not a swap dealer, but the definition of what constitutes a *de minimis* quantity has not yet been finalized.[17]

iii. Definition of "Major Swap Participant"

Dodd-Frank defines a "major swap participant" as a person or entity that:[18]

1. Maintains a substantial position in swaps (except positions held for hedging or mitigating commercial risk or positions hedging employee benefit risk);
2. Has outstanding swaps that create substantial counterparty exposure that could have serious adverse effects on the U.S. banking system; or
3. Is a highly leveraged financial entity not subject to federal banking agency requirements.[19]

Even if an entity otherwise holds a "substantial position" in swaps, it would not qualify as a major swap participant if those positions are held for "hedging or mitigating commercial risk," among other exceptions.[20] However, the proposed definition of "hedging or mitigating commercial risk" would exclude swap positions held for speculative purposes.[21] As most private funds would presumably be deemed to be holding their swap positions for speculative purposes, that exclusion is unlikely to apply to them. However, depending on the final definitions of "substantial position" and "substantial counterparty exposure," it is likely that only very large funds would end up meeting the definition of a major swap participant.

C. What Does It Mean to Be a Swap Dealer or a Major Swap Participant?

Swap dealers and major swap participants (collectively, "Regulated Swap Entities") will face the following operating requirements, most of which have been elaborated upon by proposed rules of the SEC and the CFTC:[22]

1. Registration with the CFTC and/or the SEC;
2. Swap position monitoring;
3. Compliance reporting;
4. Implementation of risk management procedures;
5. Appointment of a chief compliance officer;
6. Comprehensive recordkeeping of swap transaction data;
7. Capital reserve requirements;
8. Margin-collateral collection obligations;
9. Business conduct and governance standards;
10. Counterparty eligibility requirements; and
11. Segregation of uncleared funds.

D. Mandatory Clearing and Exchange Trading

Dodd-Frank requires that most swaps be cleared through a regulated clearinghouse if the clearinghouse accepts the swap for clearing. Under the proposed rules, all non-exempt swaps (i.e., swaps that are not subject to the "End User" exception discussed below) are generally expected to be subject to clearing and exchange trading requirements.[23] Additionally, swaps approved for clearing must be traded on a registered exchange approved by the applicable regulator (i.e., the CFTC or the SEC, depending on the type of swap), unless no registered exchange accepts the swap for trading.[24]

Dodd-Frank creates an exception from mandatory clearing and exchange trading for "End-Users."[25] An "End-User" may not be a "financial entity," which is broadly defined to include Regulated Swap Entities and certain other entities engaged in financial activities.[26] The proposed rules include certain exemptions for swaps entered into by End-Users for the purpose of hedging commercial risk, but not for those entered into as speculative investments or for any other purpose.[27]

Dodd-Frank subjects uncleared swaps to a number of operational requirements. For example, data on uncleared swaps must generally be reported to a registered swap data repository ("SDR") regardless of whether the parties are Regulated Swap Entities or qualify as "End-Users."[28] If a swap is neither cleared nor accepted by a SDR, both parties to the swap must maintain detailed records of the swap data.[29] Additionally, certain transaction data for all swaps (regardless of their execution method and whether they are cleared) must be made publicly available "as soon as technologically practicable" after execution (i.e., through "real time" reporting).[30] Regulated Swap Entities must abide by margin requirements and provide counter-

parties to uncleared swaps with the right to segregate any initial margin that was posted in respect of the swap.[31] Finally, certain entities engaged in swap trading will need to abide by capital reserve requirements and position limits.[32] The overall effect of these rules is that even private funds that are not Regulated Swap Entities may need to keep new records and face new costs and burdens in order to trade swaps.

III. The Volcker Rule

Section 619 of Dodd-Frank (the "Volcker Rule") generally prohibits any banking entity, including affiliates of banks, from the following (all of which are subject to a number of exceptions): (i) engaging in, sponsoring or investing in a "covered fund" (e.g., a hedge fund, private equity fund, and numerous other private funds and pooled investment vehicles), and (ii) having certain relationships with a covered fund.[33] Additionally, the Volcker Rule places further restrictions on banking entities and their affiliates from serving as an investment adviser to a private fund.[34] The Volcker Rule also prohibits banking entities from engaging in "proprietary trading,"[35] but that portion of the Rule does not affect private funds, so is not discussed here. Banking regulators and the SEC recently released proposed regulations pursuant to Dodd-Frank, though most of the proposed regulations relate to the proprietary trading restrictions, rather than the private fund restrictions.[36]

A. Effective Dates

The Volcker Rule prohibitions come into effect on July 21, 2012, regardless of whether the regulations are finalized by that point.[37] Banking entities have a further period of two years from the effective date to comply with the Volcker Rule.[38] Additionally, regulators may, upon application by any banking entity, extend the transition period for the requesting banking entity (i) for up to five years (which is in addition to the two year transition period),[39] and (ii) to the "extent necessary to fulfill a contractual obligation that was in effect on May 1, 2010" to take or retain any ownership interest in, or otherwise provide additional capital to, an "illiquid fund."[40] Accordingly, it is likely that banking entities that were invested in private equity funds (as well as in venture capital and other types of illiquid funds) prior to May 2010 will be able to obtain an extension and therefore will not need to transfer their interests or breach capital commitments.

B. Affected Banking Institutions

Both of the Volcker Rule prohibitions affect a "banking entity," which is generally defined as:[41]

- any insured depository institution (as defined in Section 3 of the Federal Deposit Insurance Act);
- any company that controls an insured depository institution;
- any company that is treated as a bank holding company for purposes of Section 8 of the International Banking Act of 1978;
- any affiliate of the above; and
- any subsidiary of the above.

Affiliates or subsidiaries of banks that are asset managers or other investment advisers are included in the definition of "banking entity."

C. Prohibition on Sponsoring and Investing in Covered Funds

The Volker Rule generally prohibits a banking entity from acquiring or retaining any ownership interest in,[42] or "sponsoring," a "covered fund,"[43] which includes hedge funds and private equity funds,[44] subject to the exceptions for "permitted activities" described below.[45] "Sponsoring" is defined as (i) serving as a general partner, managing member, or trustee of a covered fund; (ii) selecting or controlling (or having agents who constitute) a majority of the directors, trustees or management of a covered fund; or (iii) sharing the covered fund's name or a variant thereof.

i. Impact on Advisers to Covered Funds

The Volcker Rule permits advisers to advise covered funds if the adviser and the covered fund do not share the same name or a variant thereof. Merely advising a covered fund, however, subjects the adviser (if it is a "banking entity") and its affiliates to the restrictions set forth in Sections 23A and 23B of the Federal Reserve Act.

ii. The 3% and One-Year Seed Financing Permitted Activity

A banking entity may generally organize or offer a covered fund if, among other things, it (i) owns not more than 3% of the total ownership interests in any single fund within one year after establishment;[46] and (ii) invests an aggregate amount not exceeding 3% of the banking entity's Tier 1 capital (i.e., the bank's regulatory capital) in covered funds as a whole.[47] There is an exception to the 3% rule to allow the banking entity to make a seed investment in a fund (in which case it can own 100% of the fund),[48] provided that within one year of the covered fund's establishment, the banking entity must reduce its ownership to no more than 3% of the total ownership interests in the covered fund.[49]

In addition to the requirements discussed above, the Volcker Rule sets forth other requirements for "permitted activities" involving the 3% limit and seed investments. For example, the banking entity must not (i) directly or indirectly guarantee, assume or otherwise insure the

obligations or performance of the covered fund, or of any fund in which such covered fund invests;[50] (ii) share the same name or a variant thereof with a covered fund and use the word "bank" in its name;[51] and (iii) violate Sections 23A and 23B of the Federal Reserve Act.[52]

iii. Permitted Activities for Foreign Activities by Foreign Banking Entities

A banking entity may invest in or sponsor a covered fund if (i) the banking entity is not directly or indirectly controlled by a U.S. banking entity;[53] (ii) the banking entity is a "foreign banking organization," or, if not a foreign banking organization, meets at least two of the following tests: (a) total non-U.S. assets exceed total U.S. assets;[54] (b) total non-U.S. revenues exceed total U.S. revenues;[55] and (c) total non-U.S. income exceeds total U.S. income; (iii) no ownership interests in the covered fund are offered or sold to a U.S. resident,[56] and (iv) the investment or sponsoring occurs solely outside the U.S.[57]

iv. Permitted Activities for Risk-Mitigating Hedging

A banking entity may acquire or retain an ownership interest in a covered fund for hedging purposes if the acquisition or retention of the ownership interest meets specified criteria. Among other things, the hedging activity must (i) be made in accordance with the banking entity's internal controls (which must comply with certain requirements);[58] (ii) be performed by persons whose compensation arrangements are not designed to reward proprietary risk-taking;[59] and (iii) be made in connection with liabilities of the banking entity that are (a) conducted on behalf of a non-banking entity customer to facilitate exposure by the customer to the covered fund; or (b) directly connected to a compensation arrangement for an employee who directly provides investment advisory services or other services to the covered fund.[60] Additionally, the banking entity must document all hedging activities in accordance with guidelines established by the regulators.[61]

v. Additional "Permitted Activities"

Under the proposed rules, additional "permitted activities" include (i) loan securitizations;[62] (ii) acquiring or obtaining an ownership interest in, or sponsoring, a covered fund that is (a) a small business investment company,[63] (b) an investment designed to promote "public welfare,"[64] or (c) an investment that is a "qualified rehabilitation expenditure;"[65] and (iii) investing in, or sponsoring, certain types of vehicles (e.g., joint ventures, wholly owned subsidiaries and acquisition vehicles).[66]

D. Additional Limitations in the Volcker Rule

In addition to the limitations set forth above, in order to invest in a covered fund or engage in any other "permitted activity" under the Volcker Rule, certain covered fund advisers and sponsors must comply with Sections 23A and 23B of the Federal Reserve.[67] Also, in order to invest in a covered fund or engage in any other "permitted activity" under the Volcker Rule, no transaction may, among other things (i) involve or result in a "material" conflict of interest between the banking entity and its clients, customers, or counterparties;[68] (ii) pose a threat to the safety and soundness of such banking entity;[69] or (iii) pose a threat to U.S. financial stability.[70]

IV. Other Changes Impacting Private Funds

A. Changes to the Definition of "Accredited Investor"

Effective July 21, 2010, the definition of "accredited investor," which defines eligible participants to certain private and limited offerings that are exempt from the registration requirements of the Securities Act of 1933, was amended to exclude the value of a person's primary residence for purposes of the net worth calculation.[71] This change impacts all private offerings under Regulation D. Accordingly, if they have not done so already, private fund managers should amend the investor representations and questionnaires in their fund subscription documents concerning accredited investor status.

B. Changes to the Definition of "Qualified Client"

Subject to a number of exceptions, fund managers that are SEC-registered investment advisers may not charge any type of performance fee or carried interest to their fund investors.[72] Rule 205-3 of the Investment Advisers Act of 1940, as amended (the "Advisers Act"), allows registered fund managers to charge such fees to "qualified clients."[73] Rule 205-3 historically defined "qualified clients" as clients with at least $750,000 in assets under management or a net worth of at least $150 million. Pursuant to Dodd-Frank, the SEC has recently adjusted these thresholds to $1 million and $2 million, respectively.[74] Additionally, a client's primary residence is proposed to be excluded from calculating the client's net worth.[75] Accordingly, private fund managers that currently are registered as advisers, or who will become registered, should change their subscription documents to reflect these changes.

The SEC has proposed two grandfathering provisions to the performance fee restrictions and the qualified client definition. First, as to funds managed by a registered investment adviser, if an investor met the qualified client standard in effect at the time of its investment into the fund, then the investor can remain in the fund, even if the investor does not meet the new standard. Second, as to funds managed by an adviser exempt from registration pursuant to the private adviser exemption (and certain other exemptions), investors in the fund at that time may remain in the fund once the manager becomes registered,

regardless of whether the investors were qualified clients at any point. Although these rules are not yet final, it is very likely that the SEC will adopt them.

C. Disqualification of "Bad Actors" from Rule 506 Offerings

Rule 506 is a "safe harbor" for the private offering exemption of Section 4(2) of the Securities Act.[76] Pursuant to a specific Dodd-Frank mandate, the SEC has proposed a rule to disqualify issuers (which would include private funds) from using Rule 506 for any securities offerings involving "felons and other bad actors."[77] The "bad boy" disqualification would prohibit private funds from relying on Rule 506 if the fund, any general partner or managing member of the fund, the fund's placement agent, any 10% owner of the fund, or certain other parties, have engaged in any "bad acts," including having been convicted or sanctioned for violating specified laws, including securities fraud.[78] Once the rules are adopted and become effective, private fund managers will need to implement procedures to ensure that the fund is in compliance with the rule.

D. New Reporting Requirements for Private Fund Managers

Dodd-Frank includes a number of provisions requiring increased reporting by private fund managers. Pursuant to Dodd-Frank, the SEC, in its recent amendments to Form ADV, added a number of items concerning detailed disclosure of various information concerning private funds managed by the registered adviser. In addition, pursuant to a Dodd-Frank mandate that the SEC require private fund advisers to file reports for the assessment of systemic risk by the Financial Stability Oversight Council, the SEC has proposed, but not finalized, a new Form PF,[79] which will apply to most registered private fund advisers, with additional reporting required by certain fund managers with $1 billion in assets under management. Dodd-Frank also amends Section 13(f) of the Exchange Act to require the SEC to adopt rules providing for the public disclosure of certain information regarding short sales by institutional investment managers (i.e., persons who own or manage U.S. $100 million or more in publicly traded securities) who are currently required to file Form 13F beneficial ownership reports quarterly with the SEC.[80] The SEC has not yet proposed rules in this regard.

Endnotes

1. H.R. 4173, 111th Cong. (as passed by House of Representatives, Dec. 11, 2009) [hereinafter Dodd-Frank], *available at* http://financialservices.house.gov/Key_Issues/Financial_Regulatory_Reform/FinancialRegulatoryReform/111_hr_finsrv_4173_full.pdf.
2. In addition, due to space limitations, this article does not address every Dodd-Frank change affecting private funds.
3. *See* Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 75 Fed. Reg. 80,174 (Dec. 21, 2010) [hereinafter Proposed Rules on Definitions].
4. *See id.*
5. Proposed Rules on Definitions, *supra* note 3. In addition, "mixed swaps" are subject to joint jurisdiction by the CFTC and the SEC.
6. *See, e.g.*, Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, § 754.
7. *See, e.g.*, Temporary Exemptions and Other Temporary Relief, Together with Information on Compliance Dates for New Provisions of the Securities Exchange Act of 1934 Applicable to Security-Based Swaps, Exchange Act Release No. 34-64678, 17 C.F.R. § 240, *available at* http://sec.gov/rules/exorders/2011/34-64678.pdf.
8. *See, e.g., id.*
9. Wall Street Reform and Consumer Protection Act, *supra* note 6, § 712(d)(1).
10. *Id.* § 721.
11. *See* Section 3(a) of the Securities Exchange Act of 1934. For purposes of this article, "swap," "security-based swap" and "mixed swap" are collectively referred to as "swaps."
12. *Id.* § 721.
13. Proposed Rules on Definitions, *supra* note 3.
14. *Id.* at 80,175.
15. *Id.* at 80,178.
16. *Id.* at 80,175.
17. *Id.*
18. Wall Street Reform and Consumer Protection Act, *supra* note 6, § 721(a)(33).
19. The proposed rules provide definitions for "substantial position," "substantial counterparty exposure" and "financial entity." Proposed Rules on Definitions, *supra* note 3, at 80,190, 198. Note that an alternative test for "substantial position" also exists. *See id.*
20. *Id.* at 80,201.
21. *See, e.g., id.* at 80,187.
22. This is not an exhaustive list.
23. *See* Requirements for Processing, Clearing, and Transfer of Customer Positions, 76 Fed. Reg. 13,101 (Mar. 10, 2011).
24. *See id.* at 13,102.
25. Wall Street Reform and Consumer Protection Act, *supra* note 6, § 723; End-User Exception to Mandatory Clearing of Swaps, 75 Fed. Reg. 80,747 (Dec. 23, 2010).
26. End-User Exception to Mandatory Clearing of Swaps, *supra* note 25, at 80,748.
27. *Id.* at 80,752.
28. *See, e.g.*, Reporting, Recordkeeping, and Daily Trading Records Requirements for Swap Dealers and Major Swap Participants, 75 Fed. Reg. 76,666 (Dec. 9, 2010).
29. *See, e.g.*, Wall Street Reform and Consumer Protection Act, *supra* note 6, § 729.
30. *See* Real-Time Reporting of Swap Transaction Data, 75 Fed. Reg. 76,140 (Dec. 7, 2010).
31. *See* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 23,732 (Apr. 28, 2011).
32. *See* Capital Requirements of Swap Dealers and Major Swap Participants, 76 Fed. Reg. 27,802 (May 12, 2011).
33. PROHIBITIONS AND RESTRICTIONS ON PROPRIETARY TRADING AND CERTAIN INTERESTS IN, AND RELATIONSHIPS WITH, HEDGE FUNDS AND PRIVATE EQUI-

TY FUNDS (Oct. 6, 2011), at 112 [hereinafter PROPOSED RULE], *available at* http://fdic.gov/news/board/2011Octno6.pdf. Comments on the proposed regulations are due January 13, 2012. *Id.*

34. *Id.* at 115.
35. *Id.* at 11.
36. *See id.*
37. *Id.* at 22.
38. *See* 12 U.S.C. § 1851(c)(2) (2006).
39. *Id.* § 1851(c)(3)(B).
40. *Id.* § 1851(c)(3)(A). A banking entity is eligible for the extended transition period to make investments in an illiquid fund if (i) the illiquid fund was a covered fund that as of May 1, 2010 principally invested in illiquid assets or was committed to invest in illiquid assets; and (ii) the illiquid fund's investment was necessary to fulfill an investment obligation of the banking entity that was in effect on May 1, 2010. *Id.* § 1851(h)(7)(A).
41. *Id.* § 1851(h)(1).
42. "Ownership interest" generally does not include carried interest, which can be held by a banking entity subject to certain conditions. (see proposed rule)
43. PROPOSED RULE, *supra* note 33, at 112.
44. *Id.* at 115. The proposed rules permit a banking entity to acquire and retain an ownership interest in a covered fund that is an issuer of mortgage-backed securities, so long as the assets consist entirely of (i) loans; (ii) "contractual rights or assets directly arising from those loans supporting the asset-backed securities;" and (iii) "interest rate or foreign exchange derivatives that (a) materially relate to the terms of such loans or contractual rights or assets, and (b) are used for hedging purposes with respect to the securitization structure." *Id.* at 147.
45. "Hedge fund" and "private equity fund" are both defined as an issuer that would be an investment company as defined in the Investment Company Act of 1940, as amended (the "Investment Company Act"), but for section 3(c)(1) or 3(c)(7) of the Investment Company Act, or "such similar funds" as the appropriate regulator may, by rule, determine. 12 U.S.C. § 1851(h)(2). Note that unlike the amendments concerning the registration of advisers to venture capital funds pursuant to the Advisers Act, there is no exemption in the Volcker Rule for venture capital funds.
46. *Id.* § 1851(d)(4)(B)(ii)(I).
47. *Id.* § 1851(d)(4)(B)(ii)(II).
48. *Id.* § 1851(d)(4)(A)(i).
49. *Id.* § 1851(d)(4)(B)(ii)(I). This one-year limit may be extended for two additional years. *Id.* § 1851(d)(4)(C).
50. *Id.* § 1851(d)(1)(G)(v).
51. PROPOSED RULE, *supra* note 33, at 121.
52. *Id.* at 124.
53. *Id.* at 144.
54. *Id.*
55. *Id.*
56. *Id.* at 145.
57. *Id.*
58. *Id.* at 141.
59. *Id.*
60. *Id.*
61. *Id.* at 142.
62. *Id.* at 147.
63. *Id.* at 138.
64. *Id.*
65. *Id.*
66. *Id.* at 150.
67. *Id.* at 124.
68. 12 U.S.C. § 1851(d)(2)(A)(i) (2006).
69. *Id.* at § 1851(d)(2)(A)(iii).
70. *Id.* at § 1851(d)(2)(A)(iv).
71. SEC Proposes Net Worth Standard for Accredited Investors Under Dodd-Frank Act (last visited Oct. 21, 2011), http://www.sec.gov/news/press/2011/2011-24.htm. The SEC will further adjust the definition of "accredited investor" periodically. *Id.*
72. Investment Advisers Act of 1940, § 205, *available at* http://www.sec.gov/about/laws/iaa40.pdf. The fee restrictions do not apply to a fund relying on Section 3(c)(7) of the Investment Company Act, or to the non-U.S. investors of a non-U.S. fund. *See id.*
73. RULE 205-3: EXEMPTION FROM THE COMPENSATION PROHIBITION SECTION OF 205(A)(1) FOR INVESTMENT ADVISERS, *available at* http://www.sec.gov/rules/extra/iarules.htm
74. *See* ORDER APPROVING ADJUSTMENT FOR INFLATION OF THE DOLLAR AMOUNT TESTS IN RULE 205-3 UNDER THE INVESTMENT ADVISERS ACT OF 1940 (July 12, 2011), *available at* http://www.sec.gov/rules/other/2011/ia-3236.pdf.
75. Investment Adviser Performance Compensation, Investment Advisers Act Release No. 3198, 76 Fed. Reg. 27,959 (May 13, 2011). Pursuant to Dodd-Frank, the SEC must further adjust the "qualified client" dollar thresholds for inflation at least once every five years. *Id.*
76. *See* Rule 506 of Regulation D (last visited Oct. 21, 2011), http://www.sec.gov/answers/rule506.htm.
77. Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings, SEC Release No. 33-9211, *available at* http://www.sec.gov/rules/proposed/2011/33-9211.pdf. The current version of Rule 506 does not disqualify "bad actors" from a Rule 506 offering. *See id.* at 5.
78. *Id.* at 5
79. *See* SEC Proposes Private Fund Systemic Risk Reporting Rule, http://www.sec.gov/news/press/2011/2011-23.htm (last visited Oct. 11, 2011).
80. *See* Dodd-Frank, *supra* note 1, § 951.

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