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SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 275

Release No. IA-4697; File No. S7-05-17

RIN 3235-AM02

AMENDMENTS TO INVESTMENT ADVISERS ACT RULES TO REFLECT CHANGES MADE BY THE FAST ACT

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: We are proposing to amend the definition of a venture capital fund (rule 203(*l*)-1) and the private fund adviser exemption (rule 203(m)-1) under the Investment Advisers Act of 1940 (the "Advisers Act") in order to reflect changes made by title LXXIV, sections 74001 and 74002 of the Fixing America's Surface Transportation Act of 2015 (the "FAST Act"), which amended sections 203(*l*) and 203(m) of the Advisers Act. Title LXXIV, section 74001 of the FAST Act amended the exemption from investment adviser registration for any adviser solely to one or more "venture capital funds" in Advisers Act section 203(*l*) by deeming "small business investment companies" to be "venture capital funds" for purposes of the exemption. Accordingly, we are proposing to amend the definition of a venture capital fund to include "small business investment companies." Title LXXIV, section 74002 of the FAST Act amended the exemption from investment adviser registration for any adviser solely to "private funds" with less than $150 million in assets under management in Advisers Act section 203(m) by excluding the assets of "small business investment companies" when calculating "private fund assets" towards the registration threshold of $150 million. Accordingly, we are proposing to amend the

definition of "assets under management" in the private fund adviser exemption to exclude the assets of "small business investment companies."

DATES: Comments on the proposed rule amendments should be received on or before June 8, 2017.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml); or

  Send an e-mail to rule-comments@sec.gov. Please include File No. S7-05-17 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper comments:

- Send paper comments to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-05-17. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's website (http://www.sec.gov/rules/proposed.shtml). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; the Commission does not edit personal

identifying information from submissions. You should submit only information that you wish to make available publicly.

Studies, memoranda or other substantive items may be added by the Commission or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on the Commission's website. To ensure direct electronic receipt of such notifications, sign up through the "Stay Connected" option at www.sec.gov to receive notifications by e-mail.

FOR FURTHER INFORMATION CONTACT: Jennifer Songer, Senior Counsel or Alpa Patel, Branch Chief at (202) 551-6787 or IArules@sec.gov, Investment Adviser Regulation Office, Division of Investment Management, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-8549.

SUPPLEMENTARY INFORMATION: The Commission is proposing amendments to rules 203(*l*)-1 [17 CFR 275.203(*l*)-1] and 203(m)-1 [17 CFR 275.203(m)-1] under the Investment Advisers Act of 1940 [15 U.S.C. 80b].[1]

[1] Unless otherwise noted, when we refer to the Advisers Act, or any paragraph of the Advisers Act, we are referring to 15 U.S.C. 80b of the United States Code [15 U.S.C. 80b], at which the Advisers Act is codified, and when we refer to Advisers Act rules, or any paragraph of these rules, we are referring to Title 17, Part 275 of the Code of Federal Regulations [17 CFR 275], in which these rules are published.

Table of Contents

I. BACKGROUND

The Fixing America's Surface Transportation Act of 2015 (the "FAST Act")[2] amended sections 203(*l*) and 203(m) of the Investment Advisers Act of 1940 (the "Advisers Act")[3] regarding the registration of investment advisers to small business investment companies ("SBICs").[4] Title LXXIV, section 74001 of the FAST Act amended the exemption from

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2 Pub. L. No. 114-94, 129 Stat. 1312 (Dec. 4, 2015).

3 15 U.S.C. 80b.

4 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 investment companies described in subparagraph (A) and that has applied for another license under the SBIA, which application remains pending. Advisers Act section 203(b)(7).

investment adviser registration for any adviser solely to one or more "venture capital funds" in Advisers Act section 203(*l*) ("venture capital fund adviser exemption") by deeming SBICs to be "venture capital funds" for purposes of the exemption. Accordingly, we are proposing to amend the definition of "venture capital funds" in Advisers Act rule 203(*l*)-1 to include SBICs. Title LXXIV, section 74002 of the FAST Act amended the exemption from investment adviser registration for any adviser solely to "private funds" with less than $150 million in assets under management in Advisers Act section 203(m) ("private fund adviser exemption") by excluding the assets of SBICs for purposes of calculating private fund assets towards the registration threshold of $150 million.[5] Accordingly, we are also proposing to amend the definition of "assets under management" in Advisers Act rule 203(m)-1 to exclude the assets of SBICs.

Advisers Act section 203(b)(7) provides an exemption from investment adviser registration for advisers solely to SBICs (the "SBIC adviser exemption"). We believe that, prior to the enactment of the FAST Act, the SBIC adviser exemption was the primary exemption from investment adviser registration available to advisers to SBICs.[6] The FAST Act expanded the applicability of the venture capital fund adviser exemption and the private fund adviser exemption to specifically include advisers to SBICs. Advisers relying on the SBIC adviser exemption are not subject to reporting or recordkeeping provisions under the Advisers Act or

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[5] The term "private fund" means an issuer that would be an investment company, as defined in section 3 of the Investment Company Act of 1940, but for section 3(c)(1) or 3(c)(7) of that Act. Advisers Act section 202(a)(29). While we believe most SBICs are private funds, it is possible for an SBIC to be an investment company registered with the Commission. *See* 13 CFR 107.115 (stating that a registered investment company is eligible to apply for an SBIC license).

[6] Although we believe that most, if not all, SBICs are private funds, we believe that very few advisers to SBICs have private fund assets under management in the United States of less than $150 million. Therefore, very few advisers to SBICs are likely to qualify for the private fund adviser exemption. *See SBIC Program Overview*, Small Business Administration, Office of Investment and Innovation, Data Management Branch, September 30, 2016, available at: https://www.sba.gov/sbic/general-information/program-overview ("*SBIC Program Overview*").

examination by our staff.[7] Advisers who rely on the venture capital fund adviser exemption and the private fund adviser exemption are exempt from registration under the Advisers Act; however, they are considered "exempt reporting advisers" and must maintain such records and submit such reports as the Commission determines necessary or appropriate in the public interest or for the protection of investors.[8] Exempt reporting advisers are required to file a subset of the information requested by Form ADV with the Commission but are not subject to many of the other substantive requirements to which registered investment advisers are subject.

Advisers to SBICs can now rely on the following exemptions from investment adviser registration with the Commission: (1) the SBIC adviser exemption and advise only SBICs; (2) the venture capital fund adviser exemption and advise both SBICs and venture capital funds (as defined in rule 203(*l*)-1); or (3) the private fund adviser exemption and advise both SBICs and

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[7] Under section 204(a) of the Advisers Act, the Commission has the authority to require an investment adviser to maintain records and provide reports, as well as the authority to examine such adviser's records, unless the adviser is specifically exempted from the requirement to register pursuant to Advisers Act section 203(b). Advisers Act section 203(b)(7) provides an exemption from registration for advisers solely to SBICs. Advisers Act sections 204(a) and 203(b)(7); *Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers*, Investment Advisers Act Release No. 3222 (June 22, 2011) [76 FR 39646 (July 6, 2011)] ("*Exemptions Release"*) at footnote 5 and accompanying text.

[8] Under Advisers Act section 204(a), the Commission has the authority to require an investment adviser to maintain records and provide reports, as well as the authority to examine such adviser's records, unless the adviser is specifically exempted from the requirement to register pursuant to Advisers Act section 203(b). Investment advisers that are exempt from registration in reliance on other sections of the Advisers Act, such as sections 203(*l*) or 203(m), are not specifically exempted from the requirement to register pursuant to section 203(b), and thus the Commission has authority under Advisers Act section 204(a) to require those advisers to maintain records and provide reports and has authority to examine such advisers' records. Advisers Act sections 203(*l*)(1) and 203(m)(2). *See also Exemptions Release supra* footnote 7 at footnote 5 and accompanying text. Advisers Act rule 204-4 requires an exempt reporting adviser to complete and file reports on Form ADV by following the instructions in the Form, which specify the information that an exempt reporting adviser must provide. *See "Frequently Asked Questions on Form ADV and IARD"* available at: *https://www.sec.gov/divisions/investment/iard/iardfaq.shtml ("Form ADV FAQs")* at section entitled: "*Reporting to the SEC as an Exempt Reporting Adviser*"; *Form ADV: General Instructions* available at: https://www.sec.gov/about/forms/formadv-instructions.pdf ("*General Instructions to Form ADV*") at Instruction 3. Further, an adviser electing to be an exempt reporting adviser with the Commission must separately evaluate the need to register in any state in which it operates. *General Instructions to Form ADV* at Instruction 14.

non-SBIC private funds, provided those non-SBIC private funds account for less than $150 million in assets under management in the United States.[9]

As discussed above, we are proposing to amend our rules regarding the definition of "venture capital fund" in Advisers Act rule 203(*l*)-1 and the definition of "assets under management" in Advisers Act rule 203(m)-1 for private funds to reflect in our rules the changes made by the FAST Act's amendments to the Advisers Act.

II. DISCUSSION

A. Proposed Amendments to Rule 203(*l*)-1

The venture capital fund adviser exemption in section 203(*l*) of the Advisers Act provides that an investment adviser that *solely* advises venture capital funds is exempt from registration under the Advisers Act.[10] Advisers who qualify for the venture capital fund adviser exemption are exempt from registration under the Advisers Act; however, they are considered "exempt reporting advisers" and must maintain such records and submit such reports as the Commission

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[9] *See FAST Act supra* footnote 2. *See generally, FAST Act Changes Affecting Investment Advisers to Small Business Investment Companies* (March 2016), available at: https://www.sec.gov/investment/im-guidance-2016-03.pdf ("*Staff Guidance*").

[10] We note, however, that depending on the facts and circumstances, we may view two or more separately formed advisory entities, each of which purports to rely on a separate exemption from registration, as a single adviser for purposes of assessing the availability of exemptions from registration. For example, an adviser may not advise venture capital funds with more than $150 million in assets under management in reliance on the venture capital fund adviser exemption and also advise other types of private funds with less than $150 million in assets under management in reliance on the private fund adviser exemption. *See Exemptions Release supra* footnote 7 at footnote 314, footnote 506 and accompanying text. *See also In the Matter of TL Ventures Inc.,* Investment Advisers Act Release No. 3859 (June 20, 2014) (settled action); Advisers Act section 208(d), which prohibits a person from doing indirectly or through or by another person, any act or thing which it would be unlawful for such person to do directly.

determines necessary or appropriate in the public interest or for the protection of investors.[11] The FAST Act amended the venture capital fund adviser exemption by deeming SBICs to be venture capital funds for purposes of the exemption.[12]

Advisers Act rule 203(*l*)-1 defines a "venture capital fund" for purposes of the venture capital fund adviser exemption.[13] While most, if not all, SBICs meet the definition of a "private fund" under the Advisers Act,[14] they may not meet the rule 203(*l*)-1 definition of a "venture capital fund." We are proposing to amend Advisers Act rule 203(*l*)-1 to include SBICs in the definition of venture capital funds for purposes of the venture capital fund adviser exemption.[15] Amending the definition of venture capital fund in Advisers Act rule 203(*l*)-1 will make it consistent with Advisers Act section 203(*l*)(2), thereby reflecting in the rule the application of the venture capital fund adviser exemption to advisers to SBICs. Under this proposal, an adviser to SBICs who relies on the venture capital fund adviser exemption would be required to submit

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11 Advisers Act section 203(*l*)(1). *See Rules Implementing Amendments to the Investment Advisers Act of 1940*, Investment Advisers Act Release No. 3221 (June 22, 2011) [76 FR 42950 (July 11, 2011)] ("*Implementing Release*") at section II.B. Advisers Act rule 204-4 requires an exempt reporting adviser to complete and file reports on Form ADV by following the instructions in the Form, which specify the information that an exempt reporting adviser must provide. *See Form ADV FAQs supra* footnote 8 at section entitled: "*Reporting to the SEC as an Exempt Reporting Adviser*"; *General Instructions to Form ADV supra* footnote 8 at Instruction 4.

12 Advisers Act section 203(*l*)(2).

13 Advisers Act rule 203(*l*)-1(a) generally defines a "venture capital fund" as a private fund that: (i) represents to investors and potential investors that it pursues a venture capital strategy; (ii) holds no more than 20 percent of the fund's capital commitments in assets that are not qualifying investments (other than short-term holdings); (iii) does not borrow or otherwise incur leverage in excess of 15 percent of the fund's capital commitments, and such borrowing is for a non-renewable term of no longer than 120 days (excluding certain guarantees of qualifying portfolio company obligations by the fund from the 120 day limit); (iv) does not offer its investors redemption or certain other liquidity rights except in extraordinary circumstances; and (v) is not registered under the Investment Company Act and has not elected to be treated as a business development company. *See also* Advisers Act rule 203(*l*)-1(b) and (c).

14 Advisers Act section 202(a)(29).

15 Proposed Advisers Act rule 203(*l*)-1(a).

Form ADV reports to the Commission as an exempt reporting adviser, consistent with the current requirement for advisers relying on the venture capital fund adviser exemption.[16]

We are requesting comment on the proposed amendment to rule 203(*l*)-1.

- Prior to the enactment of the FAST Act, was the SBIC adviser exemption the primary exemption from investment adviser registration available to advisers to SBICs or did advisers to SBIC rely on other exemptions from registration? If so, which ones?
- Should we make any changes to the proposed amendment in order to better reflect the FAST Act's amendment to section 203(*l*) of the Advisers Act?
- Are there alternative methods for reflecting the FAST Act's amendment to section 203(*l*) of the Advisers Act that would be clearer?
- Like all exempt reporting advisers, advisers to SBICs relying on the proposed amendments would be required to report on Form ADV certain information about the private funds that they advise, including any SBIC that they advise that is a private fund.
    - Should we revise Form ADV to require advisers to SBICs to report more information for SBICs than is currently required to be reported for private funds? For example, should we require advisers to provide an identifier, such as the U.S. Small Business Administration ("SBA") license number for their SBICs? Would investors or other users benefit from such information? Why or why not?
    - Should we revise Form ADV to require advisers to SBICs to report less information for SBICs than is currently required to be reported for private funds? Why or why not?

[16] Advisers Act section 203(*l*)(1). *See Implementing Release supra* footnote 11 at section II.B.

B. Proposed Amendments to Rule 203(m)-1

The private fund adviser exemption in Advisers Act section 203(m) directs the Commission to provide an exemption from registration to any investment adviser that *solely* advises private funds if the adviser has assets under management in the United States of less than $150 million.[17] Advisers Act rule 203(m)-1 implements the private fund adviser exemption. Advisers who qualify for the private fund adviser exemption are exempt from registration under the Advisers Act; however, they are considered "exempt reporting advisers" and must maintain such records and submit such reports as the Commission determines necessary or appropriate in the public interest or for the protection of investors.[18] The FAST Act amended the private fund adviser exemption to require that private fund advisers exclude the assets of their SBICs for purposes of calculating private fund assets towards the registration threshold of $150 million.

Advisers Act rule 203(m)-1(d)(1) defines "assets under management" for purposes of the private fund adviser exemption.[19] We are proposing to amend Advisers Act rule 203(m)-1(d)(1) to exclude an adviser's regulatory assets under management attributable to SBICs from the

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17 *Supra* footnote 10.

18 Advisers Act section 203(m)(2). *See Implementing Release supra* footnote 11 at section II.B. Advisers Act rule 204-4 requires an exempt reporting adviser to complete and file reports on Form ADV by following the instructions in the Form, which specify the information that an exempt reporting adviser must provide. *See Form ADV FAQs supra* footnote 8 at section entitled: "*Reporting to the SEC as an Exempt Reporting Adviser*"; *General Instructions to Form ADV supra* footnote 8 at Instruction 3.

19 For purpose of Advisers Act section 203(m), assets under management means the regulatory assets under management as determined under Item 5.F of Form ADV. Advisers Act rule 203(m)-1(d)(1). Instruction 5.b. to Part 1A of Form ADV explains how to calculate regulatory assets under management for purposes of Item 5.F of Part 1A of Form ADV. In general, it states that an adviser should include the securities portfolios for which it provides continuous and regular supervisory or management services. In the case of private funds, advisers are instructed to determine the current market value (or fair value) of the private fund's assets and the contractual amount of any uncalled commitment pursuant to which a person is obligated to acquire an interest in, or make a capital contribution to, the private fund. *See Form ADV: Instructions for Part 1A* available at https://www.sec.gov/about/forms/formadv-instructions.pdf at Instruction 5.b.4.

definition of assets under management for purposes of the private fund adviser exemption.[20] We believe that amending the definition of assets under management in Advisers Act rule 203(m)-1 to make it consistent with Advisers Act section 203(m)(3) would reflect that advisers to both private funds and SBICs can rely on the private fund adviser exemption without regard to the SBIC assets that they advise. Under this proposal, an adviser to SBICs who relies on the private fund adviser exemption would still be required to submit reports to the Commission as an exempt reporting adviser and to include the SBICs that it advises on its Form ADV, consistent with the current requirement for advisers relying on the private fund adviser exemption.[21]

We are requesting comment on the proposed amendment to rule 203(m)-1.

- Should we make any changes to the proposed amendment in order to better reflect the FAST Act's amendment to section 203(m) of the Advisers Act?
- Are there alternative methods for reflecting the FAST Act's amendment to section 203(m) of the Advisers Act that would be clearer?

III. ECONOMIC ANALYSIS

A. Introduction and Economic Justification

The Commission is sensitive to the potential economic effects of the proposed amendments to Advisers Act rules 203(*l*)-1 and 203(m)-1. These effects include the benefits and costs to investment advisers, their funds, and the investors in their funds as well as the proposed

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[20] Proposed Advisers Act rule 203(m)-1(d)(1).

[21] Advisers Act section 203(m)(2). *See Implementing Release supra* footnote 11 at section II.B.

amendments' implications for efficiency, competition, and capital formation. The economic effects of the proposed amendments are discussed below.

The proposed amendments to Advisers Act rules 203(*l*)-1 and 203(m)-1 would reflect changes made by title LXXIV, sections 74001 and 74002 of the FAST Act to the Advisers Act. While the FAST Act does not expressly require the Commission to amend the Advisers Act rules, the proposed amendments eliminate any confusion that might otherwise exist if Advisers Act rules 203(*l*)-1 and 203(m)-1 were not amended. Proposed Advisers Act rule 203(*l*)-1 would reflect that advisers to venture capital funds and SBICs qualify for the venture capital fund adviser exemption from registration. Proposed Advisers Act rule 203(m)-1 would reflect that advisers to SBIC and non-SBIC private funds with less than $150 million in non-SBIC private fund assets under management in the United States qualify for the private fund adviser exemption from registration.

Economic Baseline

To establish a baseline useful for evaluating the economic effects of the proposed amendments, we briefly describe the nature of SBICs and then define the different classes of advisers that could be affected by the proposal.

According to the SBA, SBICs are investment funds that make equity and debt investments in qualifying small businesses and are licensed and regulated by the SBA.[22] SBICs have access to low-cost capital because of a guarantee by the SBA. According to the SBA, this funding subsidy is intended to promote the SBIC program's purpose of bridging the gap between

[22] *SBIC Program Overview supra* footnote 6.

the small business community's need for capital and traditional sources of financing that might otherwise be more expensive.[23]

Advisers to SBICs may also advise non-SBIC private funds, including venture capital funds. Depending on the amount and type of assets they advise, SBIC advisers belong to one of three categories: (1) registered investment advisers; (2) exempt reporting advisers; or (3) advisers exempt from registration and reporting requirements. Registered investment advisers are required to file Form ADV and are also subject to other substantive requirements including the establishment of a compliance program and a Code of Ethics.[24] Exempt reporting advisers are required to file a subset of the information requested by Form ADV with the Commission but are not subject to many of the other substantive requirements that registered investment advisers are subject to. Finally, any adviser that solely advises SBICs is exempt from registering with the Commission under section 203(b)(7) of the Advisers Act and does not have an obligation to report information to the Commission.[25]

Prior to the enactment of the FAST Act, an adviser to both SBICs and other non-SBIC private funds qualified for the private fund adviser exemption under Advisers Act rule 203(m)-1 if the adviser had assets under management in the United States, including assets of the SBICs it advised, of less than $150 million. Advisers to SBICs and other non-SBIC private funds that did not qualify for the private fund adviser exemption were required to register with the

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23 *Id.*

24 In addition to reporting requirements, registered investment advisers are required to comply with Advisers Act rules 204-2, 204-3, 204(b)-1, 204A-1, 206(4)-1, 206(4)-2, 206(4)-3, 206(4)-6 and 206(4)-7.

25 *See supra* footnote 7.

Commission. In addition, advisers to both venture capital funds and SBICs were required to register with the Commission unless they qualified for the private fund adviser exemption.

In establishing a baseline for the proposed amendments, two additional classes of investment advisers that did not advise SBICs prior to the FAST Act are relevant: (1) advisers solely to venture capital funds that qualify for the venture capital fund adviser exemption from registration and are considered exempt reporting advisers; and (2) advisers solely to private funds with less than $150 million in assets under management in the United States that qualify for the private fund adviser exemption from registration and are considered exempt reporting advisers. Prior to the FAST Act, advisers relying on the venture capital fund adviser exemption were required to register with the Commission if they added SBIC clients unless their total assets under management remained under $150 million, in which case they could instead rely on the private fund adviser exemption. In addition, prior to the FAST Act, advisers relying on the private fund adviser exemption were required to register with the Commission if they added SBIC clients that caused their total assets under management in the United States to equal or exceed $150 million.

The FAST Act provided the classes of advisers discussed above with several options. First, registered investment advisers to SBICs and non-SBIC private funds can withdraw from registration and report to the Commission as exempt reporting advisers if their non-SBIC private fund assets under management in the United States are less than $150 million. Second, registered investment advisers to SBICs and venture capital funds can withdraw from registration and report to the Commission as exempt reporting advisers. Finally, advisers that qualified for either the venture capital fund adviser or private fund adviser exemptions prior to the FAST Act

can begin advising SBICs without changing their registration status independent of the amount of assets attributable to SBICs.

For those advisers that benefit from any of the above options, it would have been in their best economic interest to exercise such options following the passage of the FAST Act, particularly after the Commission's Division of Investment Management issued a guidance update regarding the application of the FAST Act. [26] That guidance update indicated that the Commission's Division of Investment Management would not object to advisers who exclude the assets of the SBICs they advise when determining whether they qualify for the private fund adviser exemption or advisers who consider SBICs to be venture capital funds for the purposes of the venture capital fund adviser exemption.[27] We believe, therefore, that it is likely that advisers have already exercised these options if doing so was in their best interest. However, inconsistencies in the definitions of venture capital funds and assets under management that exist between the Advisers Act rules and the FAST Act may have discouraged some advisers from exercising these options. For example, these inconsistencies may result in assets under management being calculated differently by advisers for purposes of the private fund adviser exemption, which could lead to similar advisers determining their reporting statuses differently.

As of December 31, 2016, there were approximately 12,182 registered investment advisers reporting a total of approximately $66.8 trillion in regulatory assets under

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[26] *See Staff Guidance supra* footnote 9.

[27] *Id*.

management.[28] In addition, there were 3,238 exempt reporting advisers, of whom 588 relied on the venture capital fund adviser exemption,[29] 2,348 relied on the private fund adviser exemption,[30] and 302 qualified for both exemptions. For exempt reporting advisers that relied on the private fund adviser exemption, total private fund assets under management were approximately $124 billion.[31] Registered investment advisers advise approximately 33,175 private funds, while exempt reporting advisers advise approximately 11,722 private funds. As of the end of 2016, there were 313 SBICs licensed by the SBA managing approximately $28 billion in assets.[32] We are unable to identify which of those 313 SBICs are managed by advisers solely to SBICs compared to advisers that also advise other funds because section 203(b)(7) of the Advisers Act exempts advisers solely to SBICs from registration and reporting, and filers of Form ADV are not required to explicitly indicate whether they advise SBICs. Because filers of Form ADV are not required to explicitly indicate whether they advise SBICs, we are not able to estimate the number of advisers that have already taken advantage of the exemptions afforded to them by the FAST Act compared to the number of advisers who have not done so due to any inconsistencies between the Advisers Act rules and the FAST Act.

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28 We calculate these estimates using the last Form ADV filing for each adviser in the 15 months prior to January 1, 2016. This allows us to exclude advisers that are technically still registered with the Commission but have not filed a Form ADV for their most recent fiscal year. We use the same approach in calculating statistics for exempt reporting advisers. Our estimate of assets under management excludes filings that did not report this value so it should be considered a lower bound.

29 Form ADV, Part 1A, Item 2.B.(1).

30 Form ADV, Part 1A, Item 2.B.(2).

31 Form ADV, Schedule D, Section 2.B. We exclude filings that did not report this value from our calculation so it should be considered a lower bound. Advisers relying on the venture capital fund adviser exemption are not required to answer this question.

32 *See SBIC Program Overview supra* footnote 6.

The proposed amendments may affect the classes of investment advisers mentioned above, the funds they advise, and the investors in those funds. We discuss the potential economic effects of the proposed amendments on these parties in the next two sections.

B. Costs and Benefits

In this section, we discuss the costs and benefits that may result from the proposed amendments for each affected party. The economic effects discussed in this section only apply to the extent that advisers have not already exercised the exemption options provided to them under the baseline due to any inconsistencies between the FAST Act and the Advisers Act rules. As discussed above, we believe that it is likely that advisers have already exercised any exemption options provided to them by the FAST Act under the baseline if doing so was in their best interest, so we do not expect the magnitude of these effects to be significant. We discuss the amendments' likely impact on efficiency, competition, and capital formation in the next section.

As discussed in the Economic Baseline Section, advisers solely to SBICs are exempt from registering as investment advisers with the Commission. To the extent that any inconsistencies between the FAST Act and Advisers Act rules 203(*l*)-1 and 203(m)-1 have discouraged advisers solely to SBICs from taking advantage of the venture capital fund adviser or private fund adviser exemptions, the proposed amendments could lead these advisers to take on additional venture capital or private fund clients. Such advisers can weigh the additional fee revenue associated with advising non-SBIC private funds against the costs of reporting to the Commission as exempt reporting advisers when determining whether to rely on either of the exemptions. We estimate that the annual cost of filing Form ADV for an exempt reporting

adviser is $916.[33] In addition, advisers that switch from exempt to exempt reporting status may incur indirect costs if the information they disclose on Form ADV, such as any disciplinary history, reduces investor demand for their advisory services. We are unable to estimate how many advisers solely to SBICs would choose to take on non-SBIC private funds as a result of the proposal because we do not have information on the demand for their advisory services from non-SBIC private funds or whether any additional business generated would offset these reporting costs. Furthermore, we cannot estimate the extent to which advisers solely to SBICs have been deterred from exercising their option to rely on the venture capital fund adviser and private fund adviser exemptions due to any inconsistencies between the FAST Act and the Advisers Act rules under the baseline.

The proposal provides registered advisers to SBICs and non-SBIC private funds that have not taken advantage of the venture capital fund adviser and private fund adviser exemptions due to inconsistencies between the FAST Act and the Advisers Act rules with clarification on the option to switch from registered investment adviser to exempt reporting adviser status. This option is difficult to value, but its value is broadly determined by the cost reductions associated with the change in registration status compared to the explicit and implicit costs of withdrawing from registration. Advisers that elect to change from registered to exempt reporting adviser status should expect to face reduced ongoing costs associated with filing Form ADV because, as exempt reporting advisers, they would only be required to complete certain portions of Form

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[33] "*Form ADV under the Investment Advisers Act of 1940*" (Office of Management and Budget "OMB" Control No. 3235-0049) Supporting Statement at footnotes 37-42 and accompanying text. The total aggregate annual monetized burden for exempt reporting advisers is estimated to be $2,976,632 assuming there are 3,248 such advisers, resulting in an estimated cost of approximately $916 per exempt reporting adviser. Similarly, the total aggregate annual monetized burden for registered investment advisers is estimated to be $89,427,727 assuming there are 12,024 such advisers, resulting in an estimated cost of approximately $7,437 per registered investment adviser.

ADV.[34] We estimate the annual cost savings associated with filing Form ADV as an exempt reporting adviser instead of as a registered investment adviser to be $6,521.[35] Furthermore, such advisers would no longer bear the costs associated with the substantive requirements of being an adviser registered with the Commission.[36] Such advisers would incur the one-time cost of filing a Form ADV-W withdrawal, which we estimate to be $119 per full withdrawal and $13 per partial withdrawal.[37] They may also incur one-time operational costs associated with switching from registered to exempt reporting status, such as those associated with adapting information technology systems to a new reporting regime. Finally, to the extent that advisers benefit from marketing themselves as registered investment advisers to client funds and investors, they will forgo this benefit by withdrawing from registration. Because advisers are not required to rely on either of the exemptions in Advisers Act rules 203(*l*) or 203(m) even though they may qualify for them, we expect only those registered investment advisers that would experience a net benefit by

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[34] Exempt reporting advisers that are not also registering with any state securities authority must complete only the following Items of Form ADV, Part 1A: 1, 2, 3, 6, 7, 10, and 11, as well as corresponding schedules. Exempt reporting advisers that are registering with any state securities authority must complete all of Form ADV. *See Form ADV FAQs supra* footnote 8 at section entitled: "*Reporting to the SEC as an Exempt Reporting Adviser*"; *General Instructions to Form ADV supra* footnote 8 at Instruction 3.

[35] *See supra* footnote 33. The estimated annual cost of filing Form ADV as a registered investment adviser is approximately $7,437 and the estimated cost for an exempt reporting adviser is approximately $916.

[36] *See supra* footnote 24 for a more detailed list of these requirements.

[37] "*Rule 203-2 and Form ADV-W under the Investment Advisers Act of 1940*" (OMB Control No. 3235-0313) Supporting Statement at footnotes 7 and 9 and accompanying text. An adviser would file full withdrawal if it was only registered with the Commission. An adviser would file a partial withdrawal if it was required to remain registered with one or more States. *See Form ADV FAQs supra* footnote 8 at section entitled: "*Form ADV-W*."

relying on these exemptions and have not already done so following the FAST Act and subsequent Staff Guidance to withdraw from registration.[38]

Investors in private funds, including venture capital funds and SBICs, may experience costs and benefits as a result of the proposed amendments. If investors face fixed costs in transacting with a given adviser, for example in performing any necessary due diligence, they may benefit if the proposed amendments encourage more advisers to advise both SBIC and non-SBIC private funds, allowing investors to consolidate different types of investments with a single adviser. We cannot quantify the extent to which investors prefer to use a single adviser or the number of advisers who will expand into either SBICs or non-SBIC private funds because we do not have the information needed to assess investors' latent demand for consolidated advice services or the number of advisers that have been deterred from expanding their client bases under the baseline. We therefore cannot estimate the magnitude of this potential cost reduction for investors.

In addition, to the extent that the proposed amendments result in advisers changing their status from registered to exempt reporting, it may impose costs on investors. If investors value the transparency provided by complete Form ADV reporting and the safeguards associated with the other substantive requirements of being a registered investment adviser, then the proposed amendments could impose costs on investors if they result in advisers changing their status from registered to exempt reporting. However, such investors have the option of moving their investments to advisers that are registered and, as noted above, we expect that advisers will

[38] An adviser that qualifies for one of these exemptions can still choose to register with the Commission if it has sufficient assets under management. *See Exemptions Release supra* footnote 7 at footnote 24 and accompanying text.

weigh the benefits and costs associated with remaining registered in connection with any change in reporting status. The proposal could also impose costs on investors if any reduction in transparency or the other substantive requirements associated with registration reduce the ability of the Commission to protect investors from potentially fraudulent investment advisory schemes.

C. Efficiency, Competition, and Capital Formation

As discussed above, because the proposed amendments potentially reduce the reporting requirements for advisers to both SBICs and non-SBIC private funds, they could result in an increased number of advisers in both markets. Advisers solely to SBICs may enter the market for venture capital or other private fund advisory services, and current advisers to non-SBIC private funds may enter the market for SBIC advisory services. In this section, we discuss the potential effects of these changes on efficiency, competition, and capital formation. As was the case above, the economic effects discussed in this section only apply to the extent that advisers have not already exercised the exemption options provided to them under the baseline due to any inconsistencies between the FAST Act and the Advisers Act rules, and we do not expect the magnitude of these effects to be significant.

Changes in the costs of advising both SBIC and non-SBIC private funds, as described above, could have several competitive effects. First, to the extent that non-SBIC private fund advisers find it profitable to enter the market for SBICs under the proposed amendments, the amendments might increase competition in that market, resulting in reduced profits for SBIC advisers and lower advisory fees for their SBICs and their investors. Similarly, to the extent that SBIC advisers find it profitable to enter the non-SBIC private fund advisory market, the proposed amendments might increase competition in that market, resulting in reduced profits for

non-SBIC private fund advisers and lower advisory fees for their non-SBIC private funds and their investors. Whether the proposed amendments result in such a reallocation of advisory services depends on whether advisers find it profitable to expand operations into new markets and whether they can do so without changing the quality or quantity of services in current markets. While we cannot precisely estimate the relative likelihood of the above competitive effects, the fact that the market for SBIC advisers is an order of magnitude smaller than the market for non-SBIC private fund advisers suggests that non-SBIC private fund advisers are more likely to have benefitted from expanding into the SBIC market following the FAST Act's enactment, thereby increasing the amount of competition in that market. As discussed above, it is likely that most advisers would have already exercised this option under the baseline if it was in their best interest to do so. Therefore, the competitive effects of the proposed amendments are not likely to be significant.

Any relative shift of advisory talent from one segment of the market to another could also have effects on efficiency and capital formation. To the extent that advisers who expand into new markets as a result of the proposal possess skill in identifying investment opportunities, an increase in the supply of advisers in the SBIC and/or non-SBIC private fund markets could result in more efficient investment decisions and market prices that more accurately reflect the fundamental value of assets where applicable (for example, SBICs invest in private businesses that do not trade on public exchanges, but some private funds invest in publicly-traded securities). Also, any increase in the number of advisers in the SBIC market could make more capital available to small businesses if the increased supply of SBIC advisers attracts more capital to that market. In addition, to the extent that there are economies of scale in the provision of advisory services, advisory services may be provided at lower aggregate cost if the proposed

amendments result in an expansion of advisers in either the SBIC or non-SBIC private fund market. To the extent that the proposed amendments result in reduced transparency into advisers because they opt to switch from registered to exempt reporting status, and to the extent that investors rely on that transparency when making investment decisions, the proposed amendments might cause a reduction in the efficiency of investor allocations to these advisers. Any reduction in transparency could also reduce the aggregate amount of capital managed by investment advisers if investors cannot find suitable registered investment advisers as replacements and these investors value transparency more than any benefits, such as potentially lower advisory fees, of the proposed amendments. Finally, if the proposed amendments increase the supply of investment advisers to SBICs and non-SBIC private funds, and these advisers attract assets that were not already invested in other markets, they may increase the aggregate amount of capital investment.

D. Request for Comment

We are requesting comment on our analysis of the potential economic effects of the proposed amendments to Advisers Act rules 203(*l*)-1 and 203(m)-1.

- Are there any other affected parties that we should consider in our analysis?
- Do commenters agree that our quantitative estimates of the costs and benefits are reasonable and accurate? If not, please provide estimates of these costs, and explain why those estimates are different.
- Are there any other costs to investment advisers, funds, or their investors that we should consider in this analysis? If so, please explain why those costs may be relevant to our analysis, and provide estimates for those costs.

- Are there other effects on efficiency, competition, and capital formation that we should consider in our analysis?
- We have not identified any reasonable alternatives to the proposed amendments. Are there alternative approaches to the proposed amendments that we should consider?

IV. PAPERWORK REDUCTION ACT ANALYSIS

We do not believe that the proposed amendments to reflect changes made by the FAST Act make any substantive modifications to any existing collection of information requirements or impose any new substantive recordkeeping or information collection requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[39]

The proposed amendments to reflect the changes made by the FAST Act as described in Section II above may shift the number of advisers between each class of advisers as well as include advisers solely to SBICs that take on additional non-SBIC venture capital fund or private fund clients and therefore would become exempt reporting advisers.

However, we do not have information at this time to estimate whether and to what extent these changes may occur and therefore believe that the current burden and cost estimates for the existing collection of information requirements remain appropriate.[40] Thus, we believe that the

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[39] 44 U.S.C. 3501 *et seq*.

[40] The most recent Paperwork Reduction Act analysis for Form ADV, which is pending approval by the Office of Management and Budget, is based upon the number of registered advisers and exempt reporting advisers as of May 1, 2016. Because approximately five months had passed between the signing of the FAST Act and May 1, 2016, we believe that most of the advisers who wanted to change their registration status as a result of the FAST Act, did so in that five month period and are therefore included in the most recent Paperwork Reduction Act analysis for Form ADV. "*Form ADV under the Investment Advisers Act of 1940*" (OMB Control No. 3235-0049).

proposed amendments should not impose substantive new burdens on the overall population of respondents or affect the current overall burden estimates for the affected forms.[41] Accordingly, we are not revising any burden and cost estimates in connection with these amendments. We request comment on whether our belief that the proposed amendments would not impose substantive new burdens on the overall population of respondents or affect the current overall burden estimates for the affected forms is correct.

V. REGULATORY FLEXIBILITY ACT CERTIFICATION

Pursuant to section 605(b) of the Regulatory Flexibility Act,[42] the Commission hereby certifies that the proposed amendments to Advisers Act rules 203(*l*)-1 and 203(m)-1 would not, if adopted, have a significant economic impact on a substantial number of small entities. Under Commission rules, for the purposes of the Advisers Act and the Regulatory Flexibility Act, an investment adviser generally is a small entity if it: (i) has assets under management having a total value of less than $25 million; (ii) did not have total assets of $5 million or more on the last day of its most recent fiscal year; and (iii) does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of $25 million or more, or any person (other than a natural person) that had $5 million or more on the last day of its most recent fiscal year ("small adviser").[43]

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41 *See* Section III above.

42 5 U.S.C. 605(b).

43 Rule 0-7(a) (17 CFR 275.0-7(a)).

Small advisers to SBICs and venture capital funds and small advisers to SBICs and private funds would be generally prohibited from registering with the Commission under section 203A of the Advisers Act because of their assets under management.[44] However, there may be some small advisers to SBICs and venture capital funds and some small advisers to SIBCs and private funds that are not prohibited from registering with the Commission.[45] We believe that small advisers to SBICs and venture capital funds that are not prohibited from registering with the Commission are able to rely on the venture capital fund adviser exemption under section 203(*l*) of the Advisers Act as implemented by Advisers Act rule 203(*l*)-1. We also believe that small advisers to SBICs and private funds that are not prohibited from registering with the Commission are able to rely on the private fund adviser exemption under section 203(m) of the Advisers Act as implemented by Advisers Act rule 203(m)-1. As discussed in Section III above, we do not believe that our proposed amendments, if adopted, would result in a significant economic impact. Also, we do not know the exact number of advisers to SBICs. However, as of the end of 2016, there were 313 SBICs licensed by the SBA.[46] Even if we assume that there is a separate adviser for each SBIC, the maximum number of advisers to SBICs would be only 313. We believe that only a small subset of these 313 advisers would meet the definition of small adviser described above. For these reasons, the Commission preliminarily believes that the

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44 Section 203A(a)(1)(A) of the Advisers Act generally prohibits an investment adviser regulated as an investment adviser by the State in which it maintains its principal office and place of business from registering with the Commission unless the adviser has at least $25 million of assets under management. Section 203(A)(a)(2) further prohibits certain advisers from registering with the Commission unless they have at least $100 million of assets under management.

45 For example, the prohibition of Advisers Act section 203A(a) does not apply to advisers that are required by the laws of 15 or more States to register as an investment adviser with the state securities authority in the respective States. Advisers Act rule 203A-2(d) (17 CFR 275. 203A-2(d)).

46 *See SBIC Program Overview supra* footnote 6.

proposed amendments to Advisers Act rules 203(*l*)-1 and 203(m)-1 would not, if adopted, have a significant economic impact on a substantial number of small entities.

The Commission requests written comments regarding this certification. The Commission requests that commenters describe the nature of any impact on small businesses and provide empirical data to support the extent of the impact.

VI. CONSIDERATION OF THE IMPACT ON THE ECONOMY

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA,"[47] we must advise the Office of Management and Budget whether a proposed regulation constitutes a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results in or is likely to result in (1) an annual effect on the economy of $100 million or more; (2) a major increase in costs or prices for consumers or individual industries; or (3) significant adverse effects on competition, investment or innovation.

We request comment on the potential impact of the proposed amendments on the economy on an annual basis. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

VII. STATUTORY AUTHORITY

The Commission is proposing to amend rule 203(*l*)-1 under the authority set forth in sections 211(a) and 203(*l*) of the Advisers Act, (15 U.S.C. 80b-11(a) and 80b-3(*l*), respectively).

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[47] Public Law 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

The Commission is proposing to amend rule 203(m)-1 under the authority set forth in sections 211(a) and 203(m) of the Advisers Act (15 U.S.C. 80b-11(a) and 80b-3(m), respectively).

List of Subjects in 17 CFR Part 275

Reporting and recordkeeping requirements; Securities.

VIII. TEXT OF PROPOSED RULE AMENDMENTS

For the reasons set forth in the preamble, the Commission proposes to amend Title 17, Chapter II of the Code of Federal Regulations as follows.

PART 275 – RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940

1. The authority citation for Part 275 continues to read, in part, as follows:

Authority: 15 U.S.C. 80b-2(a)(11)(G), 80b-2(a)(11)(H), 80b-2(a)(17), 80b-3, 80b-4, 80b-4a, 80b-6(4), 80b-6a, and 80b-11, unless otherwise noted.

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2. Amend section 275.203(*l*)-1 by revising the introductory text to paragraph (a) to read as follows:

§275.203(*l*)-1 Venture capital fund defined.

(a) *Venture capital fund defined*.– For purposes of section 203(*l*) of the Act (15. U.S.C. 80b-3(l)), a venture capital fund is any entity described in subparagraph (A), (B), or (C) of section 203(b)(7) of the Act (15 U.S.C. 80b-3(b)(7)) (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 (15 U.S.C. 80a-53)) or any private fund that:

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3. Amend section 275.203(m)-1 by revising paragraph (d)(1) to read as follows:

§275.203(m)-1 Private fund adviser exemption.

* * * * *

(d) * * *

(1) Assets under management means the regulatory assets under management as determined under Item 5.F of Form ADV (§ 279.1 of this chapter) except that the regulatory assets under management attributable to a private fund that is an entity described in subparagraph (A), (B), or (C) of section 203(b)(7) of the Act (15 U.S.C. 80b-3(b)(7)) (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 (15 U.S.C. 80a-53)) shall be excluded from the definition of assets under management for purposes of this section.

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By the Commission.

May 3, 2017

Brent J. Fields

Secretary