COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, MAY 4, 2012

COMMONWEALTH OF VIRGINIA, *ex rel.*

STATE CORPORATION COMMISSION

CASE NO. SEC-2012-00009

Ex Parte: In the matter of
Adopting a Revision to the Rules
Governing the Virginia Securities Act

ORDER ADOPTING AMENDED RULES

By Order entered on February 14, 2012, all interested persons were ordered to take notice that the State Corporation Commission ("Commission") would consider the adoption of a revision to Chapter 80 of Title 21 of the Virginia Administrative Code ("Regulations") entitled "Rules and Forms Governing Virginia Securities Act" ("Order to Take Notice"). On February 16, 2012, the Division of Securities and Retail Franchising ("Division") mailed the Order to Take Notice of the proposed Regulations to all interested parties pursuant to the Virginia Securities Act, § 13.1-501 *et seq.* of the Code of Virginia. The Order to Take Notice described the proposed regulation and afforded interested parties an opportunity to file comments.

The proposed amendment to Commission Rule ("Rule") 21 VAC 5-80-215 replaces the temporary registration exemption for investment advisors created by the Commission in 2011. The temporary registration exemption was necessitated by the adoption of federal law known as the Dodd Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). When the bill became law, a portion of Dodd-Frank increased regulation over private fund advisors that were previously unregulated under state and federal law by eliminating the private advisor exemption under Section 203 (b) (3) of the Investment Advisors Act of 1940. Dodd-Frank

instructed the Securities and Exchange Commission ("SEC") to promulgate rules to implement the new legislation, and while the SEC was crafting a new exemption for federal covered advisors, it granted an extension to private fund advisors formerly exempt prior to the adoption of Dodd-Frank.

The adoption of the SEC extension necessitated that Virginia address that portion of its regulations. The Commission addressed the gap in 2011 by amending Rule 21 VAC 5-80-210 A 7, to remove the old exclusion for investment advisors that were exempt from registration under prior federal law and adopting an interim exemption, Rule 21 VAC 5-80-215, to comport with the interim SEC exemption. This interim exemption expired on March 30, 2012.

The North American Securities Administrators Association, Inc. ("NASAA"), the trade association for the state securities regulators, assisted the states with the drafting of a model uniform exemption for state covered advisors. The proposed exemption allows certain specifically defined private fund advisors to be exempt from registration if the advisors provide specific disclosures and financial information to their customers. The proposed exemption was substantially vetted nationwide before being adopted by state regulators as the model rule. The model rule is a uniform approach to the exemption of certain private fund advisors who meet the express criteria in the proposed amended Rule 21 VAC 5-80-215. Adoption of this exemption provides the investment advisory industry the ability to be uniformly regulated from state to state.

The Division received timely filed comments from three law firms and one investment advisory trade association. None of those commenting requested a hearing.

The California law firm of Gunderson Dettmer ("Gunderson") requested that: (1) the Commission clarify that the definition of "3 (c) (1) fund"[1] in Paragraph A. 4 of the proposed Rule does not include a § 3 (c) (7) fund; the Commission replace the definition of "qualified client" in Paragraph C. 1 of the proposed Rule with the definition of accredited investor found in 17 C.F.R. § 230.501 of the Securities Act of 1933 that is used for defining investors qualified for private offerings under the federal law; the Commission revise the proposed disclosure requirements of Paragraph C. 2 of the proposed Rule to only apply to non-accredited investors;[2] and the Commission should revise the proposed Rule, Paragraph H, a grandfathering provision to be effective on May 1, 2013.

The Virginia law firm of Hirschler Fleischer ("Hirschler") filed comments. Hirschler also requested that the "qualified client" definition be replaced with "accredited investor." The firm further requested that separate entities and accounts that follow a "private fund strategy" but do not qualify for the exemption be allowed to claim the exemption. In addition, Hirschler requested that "fund of funds" or feeder funds[3] not be required to provide audited financial statements unless the funds that the feeder fund invests in also produced audited financial statements.

The third comment was from the Virginia law firm of Hunton and Williams ("Hunton"). The firm's comments also included a request that the "qualified client" definition be replaced with the "accredited investor" definition. In addition, Hunton commented that the proposed exemption was different from that proposed by the SEC and that venture capital funds appear to

[1] A 3 (c) (1) fund is a fund that is eligible for the exclusion from the definition of an investment company under § 3 (c) (a) of the Investment Company Act of 1940.

[2] This request assumes that the Commission would replace the definition of "qualified client" with "accredited investor."

[3] Fund of funds or feeder funds are companies that invest in other fund companies and make no direct investments.

have distinguishing treatment. Further, Hunton stated that the mandated disclosures in Paragraph C. 2 are vague. Finally, Hunton requested that the grandfathering provision in Paragraph H. 4 be extended.

On April 26, 2012, the Division filed a response to the comments filed with the Commission in which it addressed each of the commenter's suggested revisions. The Division recommended that the Commission adopt the Rule as proposed, primarily because the changes requested would be detrimental to private fund advisors claiming the exemptions. The Division states that non-uniformity among states could cause confusion and difficulty with compliance for private fund advisors.

NOW THE COMMISSION, upon consideration of the proposed amendment to the Rule, the filed comments, the Division's response, and the record in this case, is of the opinion and finds that the proposed amendment to the Rule should be adopted.

Accordingly, IT IS ORDERED THAT:

(1) The proposed Rule is attached hereto, made a part hereof, and is hereby ADOPTED effective May 7, 2012.

(2) This matter is dismissed from the Commission's docket, and the papers herein shall be placed in the file for ended causes.

AN ATTESTED COPY of this Order shall be sent to each of the following by regular mail by the Division to: S. Brian Farmer, Esquire, Hirschler Fleischer, P.O. Box 500, Richmond, Virginia 23218-0500; David T. Bellaire, General Counsel, Financial Services Institute, 607 14th Street, N.W., Washington, D.C. 20005; Cyane B. Crump, Esquire, Hunton & Williams, LLP, Riverfront Plaza, East Tower, 951 East Byrd Street, Richmond, Virginia 23219; and Sean Caplice, Esquire, Gunderson Dettmer, 1200 Seaport Boulevard, Redwood City, California

94063; the North American Securities Administrators Association, Inc., 750 First Street, N.E., Suite 1140, Washington, D.C. 20002; the Commission's Division of Information Resources; the Commission's Office of General Counsel; and such other persons as the Division deems appropriate.

A True Copy
Teste:

Clerk of the
State Corporation Commission

STATE CORPORATION COMMISSION, DIVISION OF SECURITIES AND RETAIL FRANCHISING

Private advisor exemption

21VAC5-80-215. Exemption for certain private advisors.

~~Registration under the Act shall not be required of any investment advisor or its investment advisor representative whose only client is or clients are a corporation, general partnership, limited partnership, limited liability company, trust, or other legal organization that:~~

~~1. Has assets of not less than $5,000,000 and~~

~~2. Receives investment advice based on its investment objectives rather than the individual investment objectives of its shareholders, partners, limited partners, members, or beneficiaries, provided the investment advisor was exempt from registration pursuant to § 203(b)(3) of the Investment Advisors Act of 1940 immediately prior to July 21, 2011, and the investment advisor is subject to SEC Rule 203-1(e) granting an extension to investment advisors formerly exempt from registration under § 203(b)(3) of the Investment Advisers Act of 1940 until March 30, 2012, who would otherwise have been required to register with the SEC by July 21, 2011.~~

A. For purposes of this section, the following definitions shall apply:

1. "Value of primary residence" means the fair market value of a person's primary residence, subtracted by the amount of debt secured by the property up to its fair market value.

2. "Private fund advisor" means an investment advisor who provides advice solely to one or more qualifying private funds.

3. "Qualifying private fund" means a private fund that meets the definition of a qualifying private fund in SEC Rule 203(m)-1, 17 CFR 275.203(m)-1.

4. "3(c)(1) fund" means a qualifying private fund that is eligible for the exclusion from the definition of an investment company under § 3(c)(1) of the Investment Company Act of 1940, 15 USC § 80a-3(c)(1).

5. "Venture capital fund" means a private fund that meets the definition of a venture capital fund in SEC Rule 203(l)-1, 17 CFR 275.203(l)-1.

B. Subject to the additional requirements of subsection C of this section, a private fund advisor shall be exempt from the registration requirements of § 13.1-504 of the Act if the private fund advisor satisfies each of the following conditions:

1. Neither the private fund advisor nor any of its advisory affiliates are subject to a disqualification as described in Rule 262 of SEC Regulation A, 17 CFR 230.262;

2. The private fund advisor files with the commission each report and amendment thereto that an exempt reporting advisor is required to file with the Securities and Exchange Commission pursuant to SEC Rule 204-4, 17 CFR 275.204-4; and

3. The private fund advisor pays a notice fee in the amount of $250.

C. In order to qualify for the exemption described in subsection B of this section, a private fund advisor who advises at least one (3)(c)(1) fund that is not a venture capital fund shall, in addition to satisfying each of the conditions specified in subsection B of this section, comply with the following requirements:

1. The private fund advisor shall advise only those 3(c)(1) funds (other than venture capital funds) whose outstanding securities (other than short-term paper) are beneficially owned entirely by persons who, after deducting the value of the primary residence from

the person's net worth, would each meet the definition of a qualified client in SEC Rule 205-3, 17 CFR 275.205-3, at the time the securities are purchased from the issuer;

2. At the time of purchase, the private fund advisor shall disclose the following in writing to each beneficial owner of a 3(c)(1) fund that is not a venture capital fund:

a. All services, if any, to be provided to individual beneficial owners;

b. All duties, if any, the investment advisor owes to the beneficial owners; and

c. Any other material information affecting the rights or responsibilities of the beneficial owners; and

3. The private fund advisor shall obtain on an annual basis audited financial statements of each 3(c)(1) fund that is not a venture capital fund, and shall deliver a copy of such audited financial statements to each beneficial owner of the fund.

D. If a private fund advisor is registered with the Securities and Exchange Commission, the advisor shall not be eligible for this exemption and shall comply with the notice filing requirements applicable to federal covered investment advisors in § 13.1-504 of the Act.

E. A person is exempt from the registration requirements of § 13.1-504 of the Act if he is employed by or associated with an investment advisor that is exempt from registration in this Commonwealth pursuant to this section and does not otherwise act as an investment advisor representative.

F. The report filings described in subdivision B 2 of this section shall be made electronically through the IARD system. A report shall be deemed filed when the report and the notice fee required by subdivision B 3 of this section are filed and accepted by the IARD system on the commission's behalf.

G. An investment advisor who becomes ineligible for the exemption provided by this section must comply with all applicable laws and regulations requiring registration or notice filing within 90 days from the date the investment advisor's eligibility for this exemption ceases.

H. An investment advisor to a 3(c)(1) fund (other than a venture capital fund) that has one or more beneficial owners who are not qualified clients as described in subdivision C 1 of this section is eligible for the exemption contained in subsection B of this section if the following conditions are satisfied:

1. The subject fund existed prior to May [~~17~~], 2012;

2. As of May [~~17~~], 2012, the subject fund ceases to accept beneficial owners who are not qualified clients, as described in subdivision C 1 of this section;

3. The investment advisor discloses in writing the information described in subdivision C 2 of this section to all beneficial owners of the fund; and

4. As of May [~~17~~], 2012, the investment advisor delivers audited financial statements as required by subdivision C 3 of this section.