

STATE OF CALIFORNIA
DEPARTMENT OF CORPORATIONS

TEXT OF PROPOSED CHANGES UNDER THE
CORPORATE SECURITIES LAW OF 1968
PURSUANT TO NOTICE
DATED: DECEMBER 15, 2011

1. Section 260.204.9 is amended to read:

§ 260.204.9. ~~Exemption for Certain Investment Advisers with Fewer than 15 Clients.~~Certificate Exemption for Investment Advisers to Private Funds.

(a) An exemption from the provisions of Section 25230 of the Code is hereby granted, as being necessary and appropriate in the public interest, to any person who (1) does not hold itself out generally to the public as an investment adviser, (2) during the course of the preceding twelve months has had fewer than 15 clients, (3) does not act as an investment adviser to any investment company registered under title I of the Investment Company Act of 1940, or a company that has elected to be a business development company pursuant to section 54 of title I of the Investment Company Act of 1940 and has not withdrawn its election, and (4) either (i) has assets under management, as defined in subsection (b)(2), of not less than \$25,000,000 or (ii) provides investment advice to only venture capital companies, as defined in subsection (b)(3).

(b) (a) Definitions. For purposes of this rule~~regulation~~, the following definitions shall apply:

(1) Client shall have the same meaning as defined by the Securities and Exchange Commission under the rule adopted pursuant to Section 222(d) of the federal Investment Advisers Act of 1940, as amended. "Private fund adviser" means an investment adviser who provides advice solely to one or more qualifying private fund(s).

(2) “Assets under management” means the securities with respect to which an investment adviser and its affiliated persons provide continuous and regular supervisory or management services; provided, that in the case of securities managed for an entity which is excluded from the definition of investment company by the exclusion provided in Section 3(c)(1) or Section 3(c)(7) of the federal Investment Company Act of 1940, as amended, assets under management shall also include any amount payable to such entity pursuant to a firm agreement or similar binding commitment pursuant to which a person has agreed to acquire an interest in, or make capital contributions to, the entity upon demand of such entity. “Qualifying private fund” means a private fund that meets the definition of a qualifying private fund in Rule 203(m)-1, adopted by the Securities and Exchange Commission under the Investment Advisers Act of 1940, as amended, (17 C.F.R. 275.203(m)-1).

(3) “3(c)(1) fund” means a qualifying private fund that qualifies for the exclusion from the definition of an investment company under section 3(c)(1) of the Investment Company Act of 1940, 15 U.S.C. 80a-3(c)(1).

(3)(4) An entity is a “venture capital company” if, on at least one occasion during the annual period commencing with the date of its initial capitalization, and on at least one occasion during each annual period thereafter, at least fifty percent (50%) of its assets (other than short-term investments pending long-term commitment of distribution to investors), valued at cost, are venture capital investments, defined in subsection (b)(4)(a)(5) or derivative investments described in subsection (b)(5)(a)(6).

(4)(5) A “venture capital investment” is an acquisition of securities in an operating company as to which the investment adviser, the entity advised by the investment adviser, or an affiliated person of either has or obtains management rights as defined in subsection (b)(6)(a)(7).

(5)(6) An acquisition of securities is a “derivative investment” if it is acquired by a venture capital company in the ordinary course of its business in exchange for an existing venture capital investment either (i) upon the exercise or conversion of the existing venture capital investment or (ii) in connection with a public offering of securities or the merger or reorganization of the operating company to which the existing venture capital investment relates.

(6)(7) “Management rights” means the right, obtained contractually or through ownership of securities, either through one person alone or in conjunction with one or more persons acting together or through an affiliated person, to substantially participate in, to substantially influence the conduct of, or to provide (or to offer to provide) significant guidance and counsel concerning, the management, operations or business objectives of the operating company in which the venture capital investment is made.

(7)(8) An “operating company” means an entity that is primarily engaged, directly or through a majority owned subsidiary or subsidiaries, in the production or sale (including any research or development) of a product or service other than the management or investment of capital, but shall not include an individual or sole proprietorship.

(8)(9) “Affiliated person” means a person that controls, is controlled by, or is under common control with the other specified persons. Control means possessing directly or indirectly, the power to direct or cause the direction of management and policies.

(10) “Advisory Affiliates” are (1) all of the investment adviser’s officers, partners, or directors (or any person performing similar functions); (2) all persons directly or indirectly controlling or controlled by the investment adviser; and (3) all of the investment adviser’s current employees (other than employees performing only clerical,

administrative, support or similar functions), or any other persons defined as “advisory affiliates” by the Securities and Exchange Commission.

(b) Exemption for private fund advisers. Subject to the additional requirements of paragraph (c) below, a private fund adviser shall be exempt from the certificate requirements of Section 25230(a) of the Code if the private fund adviser satisfies each of the following conditions:

(1) neither the private fund adviser nor any of its advisory affiliates, as that term is defined in the instructions to Form ADV (SEC 1707 (09-11)), are subject to a disqualification as described in Rule 262 of Regulation A adopted by the Securities and Exchange Commission under the Securities Act of 1933, as amended, (17 C.F.R. § 230.262); or have done any of the acts, satisfy any of the circumstances, or are subject to any order specified in Section 25232, subdivisions (a) through (h) of the Code; and

(2) the private fund adviser files with the Commissioner each report and amendment thereto that an exempt reporting adviser is required to file with the Securities and Exchange Commission pursuant to Rule 204-4 adopted by the Securities and Exchange Commission under the Investment Advisers Act of 1940, as amended (17 C.F.R. § 275.204); and

(3) The private fund adviser pays the fee required by Section 25608(q) of the Code, and payment of this amount shall keep the exemption, if otherwise satisfied, in effect during the calendar year during which it is filed. In order to keep the exemption in effect for an additional period, the private fund adviser shall pay a renewal fee set forth in Section 25608(q) on or before the 31st day of December.

(c) Additional requirements for private fund advisers to certain 3(c)(1) funds. In order to qualify for the exemption described in paragraph (b) of this regulation, a private fund adviser who advises at least one (3)(c)(1) fund that is not a

venture capital company shall, in addition to satisfying each of the conditions specified in paragraphs (b)(1) through (b)(3), comply with each of the following requirements:

(1) The private fund adviser shall advise only those 3(c)(1) funds (other than venture capital companies) whose outstanding securities (other than short-term paper) are beneficially owned entirely by persons who would each meet the definition of accredited investor as defined in Rule 501(a) of Regulation D adopted by the Securities and Exchange Commission under the Securities Act of 1933, as amended (17 C.F.R. § 230.501(a)), at the time the securities are purchased from the issuer;

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

(A) all services, if any, to be provided to an individual beneficial owner;
(B) all duties, if any, the investment adviser owes to the beneficial owner; and
(C) any other material information affecting the rights or responsibilities of the beneficial owner.

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

(4) The private fund adviser shall comply with Section 25234(a)(1) of the Code, and Section 260.234 of these rules (Cal. Code Regs., tit. 10, § 260.234).

(d) **Federal covered investment advisers.** If a private fund adviser is registered with the Securities and Exchange Commission, the adviser is not eligible for this exemption and shall comply with the state notice filing requirements applicable to federal covered investment advisers in Section 25230.1 of the Code.

(e) **Investment adviser representatives.** A person is exempt from the requirements of Section 25230(b) of the Code if he or she is employed by or associated

with an investment adviser that is exempt from registration in this state pursuant to this regulation and does not otherwise act as an investment adviser representative.

(f) Electronic filing. The report filings described in paragraph (b)(2) above shall be made electronically through the IARD. A report shall be deemed filed when the report and the fee required by Section 25608(q) of the Code are filed and accepted by the IARD on the state's behalf.

(g) Transition. An investment adviser who becomes ineligible for the exemption provided by this rule must comply with all applicable laws and rules requiring registration or notice filing within ninety (90) days from the date the investment adviser's eligibility for this exemption ceases.

(h) Grandfathering for investment advisers to 3(c)(1) funds with non-qualified clients. An investment adviser to a 3(c)(1) fund (other than a venture capital company) that has one or more beneficial owner who is not an accredited investor as described in subparagraph (c)(1) is eligible for the exemption contained in paragraph (b) of this regulation if the following conditions are satisfied:

- (1) the subject fund existed prior to the effective date of this regulation;
- (2) as of the effective date of this regulation, the subject fund ceases to accept beneficial owners who are not accredited investors, as described in subparagraph (c)(1) of this regulation;
- (3) the investment adviser discloses in writing the information described in paragraph (c)(2) to all beneficial owners of the fund; and
- (4) as of the effective date of this regulation, the investment adviser delivers audited financial statements as required by paragraph (c)(3).

(i) Temporary Exemption Extension for Private Advisers.

(1) An exemption from the provisions of Section 25230 of the Code is hereby granted, as being necessary and appropriate in the public interest, to any person who (i) does not hold itself out generally to the public as an investment adviser, (ii) during the course of the preceding twelve months has had fewer than 15 clients, (iii) does not act as an investment adviser to any investment company registered under title I of the Investment Company Act of 1940, or a company which has elected to be a business development company pursuant to section 54 of title I of the Investment Company Act of 1940 and has not withdrawn its election, and (iv) either (A) has assets under management, as defined in subsection (i)(2)(B), of not less than \$25,000,000 or (B) provides investment advice to only venture capital companies, as defined in subsection (a)(4).

(2) For purposes of this subsection (i), the following definitions shall apply:

(A) "Client" has the same meaning as defined in Rule 222-2 adopted by the Securities and Exchange Commission under the Investment Advisers Act of 1940, as amended (17 C.F.R. § 275.222-2).

(B) "Assets under management" means the securities with respect to which an investment adviser and its affiliated persons provide continuous and regular supervisory or management services; provided, that in the case of securities managed for an entity which is excluded from the definition of investment company by the exclusion provided in Section 3(c)(1) or Section 3(c)(7) of the federal Investment Company Act of 1940, as amended, assets under management shall also include any amount payable to such entity pursuant to a firm agreement or similar binding commitment pursuant to which a person has agreed to acquire an interest in, or make capital contributions to, the entity upon demand of such entity.

(3) Subsection (i) of this rule shall become inoperative effective June 28, 2012.

Note: Authority cited: Sections 25204 and 25610, Corporations Code. Reference: Section 25230, Corporations Code.