California Code of Regulations
Title 10. Investment
Chapter 3. Commissioner of Corporations
Subchapter 2. Corporate Securities
Article 8. Licensing of Broker-Dealers and Agents

§ 260.204.9. Certificate Exemption for Investment Advisers to Private Funds.

(a) Definitions. For purposes of this section 260.204.9 (this "rule"), the following definitions shall apply:

(1) "Private fund adviser" means an investment adviser who provides advice solely to one or more qualifying private fund(s).

(2) "Qualifying private fund" means an issuer that qualifies for the exclusion from the definition of an investment company under one or more of sections 3(c)(1), 3(c)(5), and 3(c)(7) of the Investment Company Act of 1940, as amended (15 U.S.C. 80a-3(c)(1), (5) and (7)).

(3) "Retail buyer fund" means a qualifying private fund that is not a venture capital company and that qualifies for the exclusion from the definition of an investment company under one or both of sections 3(c)(1) and 3(c)(5) of the Investment Company Act of 1940, as amended (15 U.S.C. 80a-3(c)(1) and (5)).

(4) "Venture capital company" means an entity that satisfies one or more of the conditions below:

(A) 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 or distribution to investors), valued at cost, are venture capital investments, as defined in subsection (a)(5) of this rule, or derivative investments, as defined in subsection (a)(6) of this rule; or

(B) the entity is a "venture capital fund" as defined in rule 203(l)-1 adopted by the Securities and Exchange Commission under the Investment Advisers Act of 1940, as amended (17 C.F.R. 275.203(l)-(1)); or

(C) the entity is a "venture capital operating company" as defined in rule 2510.3-101(d) adopted by the U.S. Department of Labor under the Employee Retirement Income Security Act of 1974 (29 C.F.R. § 2510.3-101(d)).

(5) "Venture capital investment" means 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 (a)(7) of this rule.

(6) "Derivative investment" means an acquisition of securities 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.

(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.

(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.

(9) "Affiliated person" means a person that controls, is controlled by, or is under common control with the other specified person(s).

(10) "Control" means possessing, directly or indirectly, the power to direct or cause the direction of management and policies.

(11) "Advisory affiliate" means an "advisory affiliate" as defined in the Glossary of Terms to Form ADV (Uniform Application for Investment Adviser Registration (17 C.F.R. § 279.1).

(12) "Fund of funds" means a qualifying private fund that invests a majority of its assets in one or more qualifying private funds.

(b) Exemption for private fund advisers. Subject to the additional requirements of subsection (c) of this rule below, a private fund adviser shall be exempt from the certificate requirement 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 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(a) through 25232(h) of the Code; and

(2) the private fund adviser files with the Commissioner:

(A) each report and amendment thereto that an investment adviser is required to file with the Securities and Exchange Commission pursuant to Rule 204-4 ("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); or

(B) if the private fund adviser is not required to submit such filings to the Securities and Exchange Commission, the private fund adviser prepares and files the reports and amendments referenced in paragraph (2)(A) immediately above (on or before the date(s) such reports would be required to be filed pursuant to Rule 204-4) directly with the Commissioner.

(3) The private fund adviser has paid the fee required by Section 25608(q) of the Code for each calendar year in which it relies upon the exemption established by this rule. If the private fund adviser has paid an initial fee pursuant to this rule and it intends to rely on the exemption in a succeeding calendar year, it must pay the renewal fee specified by Section 25608(q) before January 1 of the succeeding year.

(c) Additional requirements for private fund advisers to certain retail buyer funds. In order to qualify for the

exemption described in subsection (b) of this rule, a private fund adviser who advises at least one retail buyer fund shall, except as otherwise provided in subsection (h) of this rule, in addition to satisfying each of the conditions specified in subsections (b)(1) through (b)(3) of this rule, comply with each of the following requirements with respect to each retail buyer fund advised by the private fund adviser:

(1) The private fund adviser shall advise only retail buyer funds whose outstanding securities (other than short-term paper) are beneficially owned entirely by:

(A) persons who, at the time the securities were sold, either (i) met the definition of "accredited investor" 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)), or (ii) were managers, directors, officers, or employees of the private fund adviser; or

(B) any person that obtains the securities through a transfer not involving a sale of that security.

(2)

(A) At or before the time of purchase of any ownership interest in a retail buyer fund, the private fund adviser shall prominently and in plain English disclose (in a private placement memorandum or similar written document) to the purchaser of such ownership interest all material facts regarding the following:

(i) all services, if any, to be provided by the investment adviser to a beneficial owner of the fund, and to the fund itself; and

(ii) all duties, if any, the investment adviser owes to a beneficial owner of the fund, and to the fund itself.

(B) Compliance with subparagraph (2)(A) immediately above shall not relieve the private fund adviser of any disclosure obligation under any other state or federal law.

(3)

(A) The private fund adviser shall obtain, on an annual basis, financial statements of each retail buyer fund advised by the private fund adviser, audited by an independent certified public accountant (CPA) that is registered with, and subject to regular examination by, the Public Company Accounting Oversight Board (PCAOB), and shall deliver a copy of such audited financial statements to each beneficial owner of the retail buyer fund within 120 days after the end of each fiscal year (or within 180 days if the retail buyer fund is a fund of funds);

(B) if a retail buyer fund begins operations more than 180 days into a fiscal year, the investment adviser need not comply with suparagraph (3)(A) immediately above for that initial fiscal year, provided that the financial audit (conducted in accordance with the qualitative requirements set forth in subparagraph (3)(A) immediately above) for the fiscal year immediately succeeding this period is supplemented by, or includes, a financial audit of the initial fiscal year.

(4) A private fund adviser may not enter into, perform, renew or extend an investment advisory contract that provides for compensation to the investment adviser on the basis of a share of the capital gains upon, or the capital appreciation of, the funds, or any portion of the funds of an investor that is not a

"qualified client" as defined in Rule 205-3(d) (17 C.F.R. 275.205.-3(d)) adopted by the Securities and Exchange Commission under the Investment Advisers Act of 1940, as amended (15 USC 80b-1 et seq.).

(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 rule and does not otherwise act as an investment adviser representative.

(f) Electronic filing. The report described in subsection (b)(2) of this rule above shall be filed electronically through the IARD (Investment Advisor Registration Depository). 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 shall comply with all applicable laws and rules requiring registration or notice filing within ninety (90) days after the date the investment adviser's eligibility for this exemption ceases.

(h) Grandfathering for investment advisers to retail buyer funds. An investment adviser to a retail buyer fund that existed prior to the effective date of this rule and that does not satisfy the conditions set forth in subsection (c)(1) or (c)(4) of this rule, on the effective date, may nevertheless be eligible for the exemption contained in subsection (b) of this rule if the following conditions are satisfied:

(1) as of the effective date of this rule, the retail buyer fund ceases to sell interests to investors other than those described in subsection (c)(1)(A) of this rule.

(2) the investment adviser complies with subsection (c)(4) of this rule for every beneficial owner who purchases an ownership interest from the retail buyer fund on or after the effective date of this rule.

(3) the investment adviser discloses in writing the information described in subsection (c)(2) of this rule to every beneficial owner of the fund within 90 days after the effective date of this rule; and

(4) for every fiscal year ending after the effective date of this rule, the investment adviser delivers audited financial statements to each beneficial owner as required by subsection (c)(3) of this rule.

(i) Temporary Filing Extension. Any initial report required to be filed pursuant to subsection (b)(2) of this rule shall be filed no later than 60 days from the effective date of this rule.