The Commonwealth of Massachusetts

William Francis Galvin, Secretary of the Commonwealth
Securities Division

REQUEST FOR COMMENT

DATE: November 2, 2011

RE: Changes to the Definition of Institutional Buyer – 950 CMR 12.205(1)(a)(6)
Exemption for Certain "Private Fund" Advisers – 950 CMR 12.205(2)
Investment Adviser Custody Requirements – 950 CMR 12.205(5)

Please Note: The hearing has been rescheduled from Tuesday, December 6, 2011, to Thursday, January 5, 2012 at 10:00 a.m. The comment submission deadline is Friday, January 6, 2011 at 5:00.

Introduction and Background

On April 20, 2011, the Massachusetts Securities Division (the "Division") requested comment on proposed changes to 950 CMR 12. 00 *et. seq.* (the "Regulations"). Among other things, the Division proposed changes to the definition of institutional buyer found at 950 CMR 12.205(1)(a)(6), proposed an exemption for certain "private fund" advisers (a "private fund exemption"), and proposed changes to the regulatory requirements for those investment advisers with discretion over, or custody of, client funds (collectively, the "original proposed rules" or "original proposal"). A public hearing on this matter was held on June 23, 2011. In light of the comments received on these matters and certain developments in the regulatory framework since the original proposal, the Division has amended these proposals (the "amended proposed rules" or "amended proposals") and is now seeking additional comment.

In April, the Division proposed a conditional registration exemption for certain types of private fund advisers (a "private fund exemption") in response to certain recent amendments to the Investment Advisers Act of 1940 (the "Advisers Act") as part of the Dodd-Frank Consumer Protection and Regulatory Reform Act of 2010. As originally proposed, the private fund exemption would have conditionally exempted from registration advisers solely to one or more venture capital funds as defined by Rule 203(l) under the Advisers Act (a "venture capital fund"), as well as advisers solely to one or more funds that are excluded from the definition of an investment company under section

3(c)(7) of the Investment Company Act of 1940 (a "3(c)(7) fund").[1] Such advisers would be "exempt reporting advisers" and be required, as a condition of the exemption, to make annual reports to the Division via Form ADV and pay a filing fee. The exemption would only be available where neither the adviser nor its affiliates were subject to a disqualification as described in Rule 262 of Regulation A.[2] Unlike the provisions of the Advisers Act and the rules thereunder, there was no provision in the original proposal to exempt advisers solely to a fund that is excluded from the definition of an investment company under section 3(c)(1) of the Investment Company Act of 1940 (a "3(c)(1) fund").[3]

Also in April, the Division proposed to phase out the use of certain aspects of the institutional buyer exclusion from the definition of investment adviser. Advisers to private funds have historically relied upon this definition of institutional buyer in lieu of registration. That proposal has been changed to allow for advisers to such funds to accept additional investments from existing beneficial owners, as detailed below.

The Division also proposed to modify the minimum financial requirements for advisers that have discretion over or custody of client funds. The original proposed rule would have increased the surety bond requirement for advisers with discretion from $10,000.00 to $50,000.00, and removed the option of maintaining a segregated account of $5,000.00. The proposal also would have removed the largely duplicative bonding requirements for custody and in its place would require advisers with custody to comply with the same rules and procedures that an adviser registered with Securities and Exchange Commission ("SEC") must follow under Advisers Act Rule 206(4)-2.

The amended proposal, after consideration of previously submitted public comments, makes substantive changes to the definition of institutional buyer, the proposed private fund exemption (including the introduction of a grandfathering provision), and requirements for advisers with discretion over, or custody of, client funds. This Request for Comment also proposes a technical change to 950 CMR 12.203(5)(a) to correct a typographical error. Namely, the provision changes the word "complete" to "incomplete," which, in context, is the only logical reading of the rule. The substantive changes, as well as areas in which the Division is requesting additional comment, are described in more detail below.

The Proposed Changes to the Definition of Institutional Buyer

Advisers to solely "institutional buyers" are excluded from the definition of "investment adviser" and therefore are not required to register as investment advisers in Massachusetts. The original proposal to amend 950 CMR 12.205(1)(a)(6) proposed to modify existing subsection (b), which defined institutional buyer as including "an investing entity whose only investors are accredited investors as defined in Rule 501(a) under the Securities Act of 1933 (17 CFR 230.501(a)) each of whom has invested a

[1] 15 U.S.C. 80a-3(c)(7).
[2] 17 C.F.R. § 230.262.
[3] 15 U.S.C. 80a-3(c)(1).

minimum of $50,000" (the "6(b) exclusion"). The original proposal proposed to not allow investment advisers claiming the 6(b) exclusion from accepting, as of the effective date, new beneficial owners or additional funds from existing owners. However, the original proposal did allow advisers relying upon the 6(b) exclusion to continue to manage existing funds received from beneficial owners.

One comment expressed the view that the phase out of the 6(b) exclusion and implementation of the proposed private fund exemption would force some advisers claiming the 6(b) exclusion to register because the private fund they advised was neither a venture capital nor 3(c)(7) fund.[4] In addition, the commenter claimed that the compliance costs associated with registration would add a large burden upon small private fund advisers currently functioning under the 6(b) exclusion.

The Division recognizes that there may be costs of registration for those advisers who have, to this point, availed themselves of the 6(b) exclusion and have therefore not been required to register. The Division also believes however that investment adviser registration furthers the goal of bringing transparency and oversight to the operation of private fund advisers, and that such a requirement will promote consistency between the various states' regulations and federal regulations.

The amended proposal will not allow advisers solely to funds that are institutional buyers (claiming the 6(b) exclusion) to obtain new beneficial owners. However, the amended proposal would allow such funds too accept additional investments from beneficial owners that existed as of the effective date of the regulation. The (6)(b) exclusion will be unavailable to advisers to private funds that come into existence after the effective date. The Division seeks comment on the amended proposed 6(b) exclusion.[5]

Specifically, the Division seeks comment on the following:

1. *Are there any other alternative definitions of institutional buyer that the Division should consider?*
2. *With regard to the proposed changes to the institutional buyer exclusion, what are the anticipated benefits, quantifiable costs and/or other impacts on advisers (and other affected parties)?*

The Proposed Private Fund Exemption

Definition of "Private Fund"

Under the original proposal, a "Private Fund" was defined as an issuer that would be an investment company as defined in section 3 of the Investment Company Act of 1940 (the

[4] It is also possible that even with the inclusion of certain 3(c)(1) funds as the Division now proposes, these institutional buyers will contain beneficial owners who are not qualified clients as defined in the amended proposal, or that the fund is excluded from the definition of investment company under a different provision of the Investment Company Act.

[5] An adviser to one or more institutional buyers that are private funds could alternatively choose to utilize the proposed private fund exemption outlined below.

"IC Act"), but for sections 3(c)(1) or 3(c)(7). This definition was taken from the model rule proposed by the North American Securities Administrators Association ("NASAA") and the definition found in section 202(a)(29) of the Advisers Act.[6] Some commenters have raised concern whether the "but for" language in the definition would make the exemption unavailable to advisers to funds that qualify for a 3(c)(1) or 3(c)(7) exclusion, but may also qualify for an exclusion under a different section of the Investment Company Act of 1940.

The amended proposal modifies the definition of private fund by defining such a fund as an issuer that would be an investment company under the IC Act, but qualifies for an exclusion from the definition of an investment company pursuant to section 3(c)(1) or 3(c)(7) of that Act.

It has also been suggested that advisers to entities that have historically been defined as institutional buyers may be unable to claim the proposed private fund exemption because they are not advisers to 3(c)(1) or 3(c)(7) funds. For example, an adviser to a fund excluded from the definition of investment company exclusively under section 3(c)(5) of the Investment Company Act (a "3(c)(5) fund") would not be able to claim the private fund exemption because the fund does not meet the definition of "private fund." The Division seeks comment on the amended proposed definition of private fund.

Specifically, the Division seeks comment on the following:

3. *Should the definition of private fund be changed so that the exemption is based on investor qualification alone?*
4. *Are there additional types of funds that should be included in the proposed definition of private fund?*
5. *Should the Division broaden the definition of private fund to cover all funds excluded from the definition of investment company under section 3(c) of the Investment Company Act?*
6. *Are there any modifications or alternatives to the amended proposed private fund definition that the Division should consider?*
7. *With regard to the proposed changes to the definition of private fund, what are the anticipated benefits, quantifiable costs and/or other impacts on advisers (and other affected parties)?*

Inclusion of Advisers to Certain 3(c)(1) Funds as Exempted Advisers

Similar to rules 203(m) and 203(l) under the Investment Advisers Act of 1940, the Division's original proposal would have conditionally exempted from registration

[6] The NASAA model rule has not yet been adopted by the membership. The proposed rule is available online at: http://www.nasaa.org/1787/proposed-model-rule-for-exempt-reporting-advisers/.

advisers to 3(c)(7) funds and venture capital funds. Unlike the federal rule, the original proposal did not provide for an exemption for 3(c)(1) funds.

Unlike 3(c)(7) funds, which generally require beneficial owners to be "qualified purchasers," a 3(c)(1) fund is not by its terms required to have beneficial owners with any particular level of financial assets or sophistication. The Division therefore does not believe that a full exemption from registration for all advisers of 3(c)(1) funds is necessarily consistent with investor protection interests. However, the Division does recognize that there may be appropriate reasons to exempt advisers to certain 3(c)(1) funds from registration, provided that investor protection concerns are addressed.

As a result, the Division's amended proposal would exempt advisers to certain 3(c)(1) funds where the beneficial owners demonstrate a certain certain level of net worth. Specifically, the exemption would be conditional upon all beneficial owners being "qualified clients", as defined by Advisers Act Rule 205-3(d)(1).[7] However, the amended proposal would require the value of the beneficial owner's primary residence to be excluded from the net worth calculation.

As an additional condition of the exemption from registration, advisers to 3(c)(1) funds must disclose in writing at the time of the beneficial owner's purchase: i) all services to be provided to individual beneficial owners; ii) all duties the investment adviser owes to the beneficial owners; and iii) any other material information affecting the rights or responsibilities of the beneficial owners. If no services or duties are to be provided or owed to the beneficial owners, that fact must also be disclosed. Additionally, the private fund adviser shall obtain annually audited financial statements for each 3(c)(1) fund that is not a venture capital fund, and must deliver a copy of those audited financial statements to the beneficial owners.

The Division believes the amended proposal allows additional private funds to claim the exemption, while promoting investor protection interests. The Division seeks comment on the amended proposed private fund exemption.

Specifically, the Division seeks comment on the following:

8. *Should the Division extend the exemption to cover advisers to 3(c)(1) funds as described in the proposal in light of investor protection concerns?*
9. *Should the Division extend the exemption to advisers to other types of funds and based the exemption on investor qualification alone?*
10. *Are there any other alternative methods of exempting advisers to 3(c)(1) funds that the Division should consider?*

[7] The Securities and Exchange Commission, by order, recently raised certain criteria for being considered a qualified client. Specifically, effective September 19, 2011, the criteria for being qualified by virtue of the client's assets under the management of the adviser was raised from $750,000.00 to $1,000,000.00, and the client net worth criteria was raised from $1,500,000.00 to $2,000,000.00. See "Order Approving Adjustment for Inflation of the Dollar Amount Tests in Rule 205-3 under the Investment Advisers Act of 1940," IA Release No. 3236 (July 12, 2011)[76 FR 41838 (July 15, 2011)].

11. *How might this proposed conditional exemption affect 3(c)(1) fund advisers that have historically not been required to register?*
12. *With regard to the proposed private fund exemption, what are the anticipated benefits, quantifiable costs and/or other impacts on advisers (and other affected parties)?*

Grandfathering Provisions

The Division has amended the proposed private fund exemption to allow certain private fund advisers currently in operation to claim the private fund exemption even when they advise a 3(c)(1) fund with non-qualified beneficial owners. In order to do so, the subject fund must have existed prior to the effective date of the proposed regulation, i) the subject fund must have ceased to accept beneficial owners who are not qualified clients as of the effective date; ii) the private fund adviser to the fund must be in compliance with investment adviser registration requirements of as of the effective date;[8] iii) the private fund adviser must disclose in writing the information described in paragraph (3)(b) of the amended proposal to beneficial owners; and iv) the private fund adviser must deliver audited financial statements as required by paragraph (3)(c). Existing non-qualified beneficial owners would be permitted to make additional investments into the fund under these circumstances.

The Division believes the amended proposal addresses many of the concerns raised with respect to existing private fund advisers' transition to the new regulatory framework while promoting the Division's goal of enhancing transparency and investor protection as it relates to private funds. The Division seeks comment on these grandfathering provisions.

Specifically, the Division seeks comment on the following:

13. *How will the proposed grandfathering provision affect private funds created after the effective date?*
14. *Are there any other alternative grandfathering provisions that the Division should consider?*
15. *With regard to the proposed grandfathering provisions, what are the anticipated benefits, quantifiable costs and/or other impacts on advisers (and other affected parties)?*

Effective Date

One commenter noted that under the original proposal certain advisers currently exempt from SEC registration could be forced to register at the state level or claim the proposed private fund exemption, only to transition to federal registration early next year. The Division's intention is to implement any changes affecting private fund advisers in a manner that complements the effective date of relevant SEC rules and in a manner that promotes a seamless transition to state registration.

[8] The Division intends that the grandfathering provision be available only to private fund advisers who were properly registered or not required to be registered prior to the effective date.

The Division plans to enforce the provisions of the private fund and institutional buyer proposals on March 30, 2012. This date coincides with relevant Advisers Act rule implementation dates set by the SEC. Compliance with certain requirements of the private fund exemption will not be possible until the Investment Adviser Registration Depository ("IARD") is updated later this year.

The Division is requesting comment as to the appropriateness of this proposed implementation date.

Specifically, the Division seeks comment on the following:

16. *Is the March 30, 2012 implementation date reasonable?*
17. *Are there issues affecting transition that would support either an earlier or later implementation date?*
18. *Should the proposed changes in the institutional buyer definition be enforced at the same time that the private fund exemption becomes available?*
19. *Are there any other alternative implementation dates that the Division should consider?*

Custody and Discretion Requirements (950 CMR 12.205(5))

Investment Discretion

The Regulations currently provide two options for compliance with the minimum financial requirements for advisers with discretionary authority over client funds. First, the adviser may maintain a surety bond in the amount of $10,000.00. Second, the adviser may maintain a segregated account of $5,000.00 and demonstrate that the adviser maintains a positive net worth via a balance sheet that is certified and prepared in accordance with generally accepted accounting principles applied on a consistent basis. [9]

The original proposal proposed to increase the surety bond level from $10,000.00 to $50,000.00. The Division received many comments in opposition to the proposed increase, citing various reasons why the increase in costs to advisers would outweigh any benefit to investors. Based upon these comments and the Division's research, we have eliminated this aspect of the proposal and propose to maintain the $10,000.00 surety bond.

The original proposal also proposed to eliminate the segregated account option. In our experience, there is a substantially greater degree of non-compliance with this alternative, and because the segregated account is not secured interest in any way, it does not provide the same level of investor protection as a surety bond. The Division received only one comment on this proposal. The commenter contended that to remove the segregated account option would remove any corporate shield protection an owner may have should

[9] See "Demonstration of Positive Net Worth for Certain Massachusetts-Based, State Registered Investment Advisers" available at http://www.sec.state.ma.us/sct/sctprs/prspnw/pnwidx.htm (available September 30, 2011). See also 950 CMR 12.205(5) and 950 CMR 14.412(C).

the adviser be found in violation of the securities laws, because the insurance companies issue the bond based on the creditworthiness and personal finances of the owner(s) of the advisory firm. The amended proposal would eliminate the segregated account option.

The Division seeks additional comments on this proposal.

Specifically, the Division seeks comment on the following:

20. *Are there other alternatives other than a surety bond and a segregated account that the Division should consider as a requirement for advisers with discretion over client assets?*
21. *The Division encourages any comments as to the potential effects of removing the segregated account option.*
22. *With regard to the proposed changes to the minimum financial requirements for advisers with discretion, what are the anticipated benefits, quantifiable costs and/or other impacts?*

Custody

As with discretion, the Regulations currently provide two options for compliance with the minimum financial requirements for advisers with custody of client funds. First, the adviser may maintain a surety bond in the amount of $10,000.00. Second, the adviser may maintain a segregated account of $10,000.00 and maintain a balance sheet certified to be in accordance with generally accepted accounting principles. These requirements are often duplicative of the requirements to exercise discretion (particularly given the proposal to eliminate the segregated account option for advisers with discretion), as one surety bond is typically utilized to satisfy both requirements if the adviser has both discretion over, and custody of, client funds. Recognizing that the requirements are largely duplicative, and in light of recent scandals including the infamous case involving Bernard L. Madoff and the desire to further safeguard client funds, the Division proposed to explicitly adopt Rule 206(4)-2 under the Investment Advisers Act of 1940 (the "SEC custody rule").

Generally, Rule 206(4)-2 defines custody to mean holding, directly or indirectly, client funds or securities or having any authority to obtain possession of them. An adviser that has custody is generally required to, among other things, i) use a "qualified custodian"; ii) make certain disclosures to clients including the name of the custodian; iii) ensure statements are sent to the client by the qualified custodian; and iv) have an unannounced examination performed annually to verify client funds.[10] Certain alternative methods of compliance exist for advisers to private funds, and exceptions exist for certain advisers.[11]

[10] The auditing firm may under certain circumstances need to be a member of the Public Company Accounting Oversight Board ("PCAOB").

[11] For example, an adviser that has custody solely as a result of deduction of client fees may not be subject to the annual surprise audit requirement, provided they comply with the requirements of the exemption as outlined both in Rule 206(4)-2 and the additional requirements in proposed 950 CMR 12.205(5)(b)(ii).

One commenter recommended maintaining the bonding requirement for investment advisers with custody. Another commenter stated that the expense of an annual unannounced examination to verify assets would be overly burdensome for small private fund advisers.

The amended proposal to adopt the SEC custody rule has changed in one respect. Rule 206(4)-2 generally exempts advisers from the independent verification requirement if the adviser has custody of the funds and securities of clients solely as a consequence of its authority to make withdrawals from client accounts to pay its advisory fees. The Division believes that the interests of investor protection are served by maintaining the current Division policy that requires the adviser to invoice the client for advisory fees.[12] The Division therefore proposes that, in order to be exempt from the independent verification requirement (in the case that custody is solely a consequence of deduction of advisory fees), the adviser: i) has written authorization from the client to deduct advisory fees and ii) sends the qualified custodian and client an invoice or statement of the amount of the fee to be deducted from the client's account each time a fee is directly deducted. The Division seeks additional comments on this proposal.

Specifically, the Division seeks comment on the following:

23. *Should the Division require invoicing of clients as proposed at 950 CMR 12.205(5)(b)(ii)?*
24. *Should the Division require the use of PCAOB member firms in the same instances as rule 206(4)-2 does?*
25. *What are the relevant costs of hiring a PCAOB vs. non-PCAOB firm for an unannounced independent verification of assets?*
26. *Are there any modifications or alternatives to the amended proposed custody rule that the Division should consider?*
27. *With regard to the proposed custody requirements for advisers with custody of client funds, what are the anticipated benefits, quantifiable costs and/or other impacts?*

Comment Submission Process

Written comments on the amended proposed regulations should be received by the Division no later than **Friday, January 6, 2012 at 5:00 p.m.** All comment letters should reference the specific question or question(s) the comment addresses, if applicable.

All comments are subject to public posting on the Securities Division website. We do not edit personal indentifying information from submissions; submit only information that you wish to make available publicly.

[12] This requirement is not satisfied by disclosure of the advisory fee in the qualified custodian's periodic statements.

Submission Via Regular Mail

Please mail any comments on the proposed changes to:

Office of the Secretary of the Commonwealth
Attn: Proposed Regulations
Securities Division, Room 1701
One Ashburton Place
Boston, MA 02108

Submission Via Facsimile

Faxed comments may be sent to (617) 248-0177. Comments sent via facsimile should include a cover sheet to the attention of "Proposed Regulations."

Submission Via E-Mail

E-mail comments or submissions of scanned comment letters attached to an e-mail may be submitted to securitiesregs-comments@sec.state.ma.us.

Public Hearing

A public hearing on these proposed changes will be held at **10:00 a.m. on Thursday, January 5, 2011** at One Ashburton Place, 17th Floor, Boston, MA 02108.

Interested parties will be afforded an opportunity to orally present data, views and arguments relative to the proposed action. Written presentations may be made at the hearing or submitted at any time prior to the close of business Friday, January 6, 2012 to the Securities Division, One Ashburton Place, Room 1701, Boston, Massachusetts 02108. Copies of the proposed amendments are available on the Division's website at http://www.sec.state.ma.us/sct/ or by calling (617) 727-3548 or (800) 269-5428 (Massachusetts only).

Amended Regulation Proposal

PROPOSED PRIVATE FUND EXEMPTION

950 CMR 12.205(2): Change heading to read: "Registration and Notice Filing Requirements and Private Fund Exemption"

950 CMR 12.205(2)(a) through 950 CMR 12.205(2)(b): No Change.

950 CMR 12.205(2)(c): Registration Exemption for Certain Private Fund Advisers

1. **Definitions.** For purposes of this 950 CMR 12.205(2)(c), the following definitions shall apply:

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

b. "Private fund adviser" means an investment adviser who provides advice solely to one or more private funds.

c. "Private fund" means an issuer that qualifies for an exclusion from the definition of an investment company pursuant to section(s) 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940, 15 U.S.C. 80a.

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

e. "Venture capital fund" means a private fund that meets the definition of a venture capital fund in SEC Rule 203(l)-1, 17 C.F.R. § 275.203(l)-1.

2. **Exemption for private fund advisers.** Subject to the additional requirements of 950 CMR 12.205(2)(c)(3), a private fund adviser shall be exempt from the registration requirements of M.G.L c.110A, § 201 if the private fund adviser satisfies all of the following conditions:

a. neither the private fund adviser nor any of its advisory affiliates are subject to a disqualification as described in Rule 262 of SEC Regulation A, 17 C.F.R. § 230.262;

b. the private fund adviser files with the state each report and amendment thereto that an exempt reporting adviser is required to file with the Securities and Exchange Commission pursuant to SEC Rule 204-4, 17 C.F.R. § 275.204-4; and

c. the private fund adviser pays a $300 reporting fee;

3. **Additional requirements for private fund advisers to certain 3(c)(1) funds.** In order to qualify for the exemption described in 950 CMR 12.205(2)(c)(2), a private fund adviser 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 paragraphs (2)(a) through (2)(c), comply with the following requirements:

a. The private fund adviser shall advise only those 3(c)(1) funds (other than venture capital funds) whose outstanding securities (other than short-term paper) are beneficially owned solely 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 C.F.R. § 275.205-3, at the time the securities are purchased from the issuer;

b. 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 fund:

i. all services, if any, to be provided to individual beneficial owners. If no services are to be provided to individual beneficial owners, that fact must be disclosed;

ii. all duties, if any, the investment adviser owes to the beneficial owners. If no duties are owed to individual beneficial owners, that fact must be disclosed; and

iii. any other material information affecting the rights or responsibilities of the beneficial owners.

c. 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 fund, and shall deliver a copy of such audited financial statements to each beneficial owner of the fund.

4. **Federal covered investment advisers.** If a private fund adviser is registered with the Securities and Exchange Commission, the adviser shall not be eligible for the exemption outlined in 950 CMR 12.205(2)(c) and shall comply with the state notice filing requirements applicable to federal covered investment advisers in M.G.L. c.110A, §202(b).

5. **Investment adviser representatives.** A person acting as an investment adviser representative is exempt from the registration requirements of M.G.L c.110A, §201 if he or she is employed by or associated with an investment adviser that is exempt from registration in the Commonwealth pursuant to 950 CMR 12.205(2) and does not otherwise act as an investment adviser representative.

6. **Electronic filing.** The report filings described in paragraph (2)(b) above shall be made electronically through the IARD. A report shall be deemed filed when the report and the fee are filed and accepted by the IARD on the behalf of the Securities Division.

7. **Grandfathering for private fund advisers with non-qualified clients.** A private fund adviser to one or more 3(c)(1) funds (other than a venture capital fund) that is beneficially owned by persons who are not qualified clients as described in subparagraph (3)(a) may nonetheless qualify for the exemption described in 950 CMR 12.205(2)(c) if:

(a) the subject fund(s) existed prior to March 30, 2012; and,
(b) as of March 30, 2012, the fund(s) cease(s) to accept beneficial owners who are not qualified clients, as described in 950 CMR 12.205(2)(c)(3)(a) of this regulation; and,
(c) the private fund adviser to the subject fund(s) was in compliance with the requirements of MGL c.110A §201(c) as of March 30, 2012; and,
(d) the private fund adviser discloses in writing the information described in paragraph 950 CMR 12.205(2)(c)(3)(b) to all beneficial owners of the fund(s); and
(e) the adviser delivers audited financial statements as required by paragraph (3)(c).

Renumber the current subsection (c) of 950 CMR 12.205(2) as subsection (d) Registration of Investment Adviser Representatives.

PROPOSED CHANGES TO INSTITUTIONAL BUYER DEFINITION

950 CMR 12.205(1)(a)(6)(b):

6. Institutional Buyer, for the purposes of MGL c. 110A § 401(m), shall include any of the following:

a. An organization described in Section 501(c)(3) of the Internal Revenue Code with a securities portfolio of more than $25 million.
b. An investing entity:
   i. whose only investors are accredited investors as defined in Rule 501(a) under the Securities Act of 1933 (17 CFR 230.501(a)) each of whom has invested a minimum of $50,000; and
   ii. the subject fund existed prior to March 30, 2012; and.
   iii. as of March 30, 2012, the subject fund ceased to accept new beneficial owners.
c. An investing entity whose only investors are financial institutions and institutional buyers as set forth in M.G.L. c. 110A, § 401(m) and 950 CMR 12.205(1)(a)6.a.

PROPOSED RULE TEXT ON DISCRETION AND CUSTODY REQUIREMENTS

950 CMR 12.205(5):

Discretion and Custody Requirements

a. An investment adviser registered or required to be registered under M.G.L. c. 110A who has discretionary authority over client funds or securities shall be bonded in an amount of not less than $10,000.00 by a bonding company qualified to do business in the Commonwealth.

b. An investment adviser registered or required to be registered under M.G.L. c. 110A who has custody of client funds or securities shall comply with the provisions of Rule 206(4)-2 under the Investment Advisers Act of 1940 (17 CFR 275.206(4)-2).

i. "Custody" shall have the meaning defined in Rule 206(4)-2(d)(2) under the Investment Advisers Act of 1940 (17 CFR 275.206(4)-(2)(d)(2)).

ii. An adviser is not exempt from the independent verification requirement pursuant to Rule 206(4)-2(b)(3) under the Investment Advisers Act of 1940 unless the adviser meets the following additional requirements:

A. The adviser has written authorization from the client to deduct advisory fees from the account held with the qualified custodian; and

B. The adviser sends the qualified custodian and client an invoice or statement of the amount of the fee to be deducted from the client's account each time a fee is directly deducted.

TECHNICAL CHANGE TO 950 CMR 12.203(5)(a):

(5) Duty to Amend Information Previously Filed

(a) If the information contained in any application or amended application for registration as a broker-dealer, agent, or issuer-agent changes in a material way, or is or becomes inaccurate or incomplete in any material respect, an amendment shall be filed at the time of knowledge of such change. Such amendments shall be filed with the CRD or directly with the Division. Events considered material include, but are not necessarily limited to, the following:

[1-13: no change]