

Custody Requirements Under Dodd-Frank



On July 21, 2011* the Dodd Frank Wall Street Reform and Consumer Protection Act will require certain private equity fund managers to become registered investment advisors and comply with the SEC's "custody rules." The rules are designed to ensure the safe keeping of client assets and also provide an independent review to deter fraud.

An SEC registered advisor is required to maintain all funds and securities over which it has "custody" with a "qualified custodian." An advisor has custody if it holds the assets directly or has authority to obtain possession of them. Typically, a private equity fund's general partner and/or management company has such custody and will need to keep its funds' cash and securities with a qualified custodian and not in the management company's office.

A "qualified custodian" generally means a bank or a registered broker-dealer. Capital contributions, other cash that belongs to the fund and all securities purchased by the fund should be sent directly from the investor or issuer to the custodian.

To provide a level of independent review, the custody rules require registered advisors to be subject to an annual surprise examination by an independent public accountant to verify their funds' assets. *However*, if a fund distributes audited financial statements prepared in accordance with U.S. GAAP to its investors within 120 days of the end of

each fiscal year (180 days for a fund of funds), the advisor will not have to submit to a surprise examination. Most registered advisors to private equity funds rely on this audit exception to the surprise examination requirement.

Additionally, registered advisors that do not meet the audit exemption must have their qualified custodian send an account statement at least quarterly to each investor in the fund. The account statement is required to include the amount of funds and of each security held in each fund's account and all transactions during the fiscal quarter. Advisors may also send a separate account statement to their fund investors. If they do, it must include a legend urging the recipient to compare the separate statement with the statement received from the custodian.

A special rule applies for uncertificated securities, including a fund's limited partner interests, if they are recorded only on the books of the issuer (or its transfer agent) and are transferable only with the consent of the issuer or its security holders. These interests do not need to be held with a custodian if the partnership sends audited financial statements to the investors within the time frames described above.

If you have any questions regarding the above information or general cash custody requirements, SVB is happy to help. Please feel free to contact your SVB representative.

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* As currently enacted, the Dodd Frank Wall Street Reform and Consumer Protection Act will require certain private equity fund managers to register by July 21, 2011. However, the SEC may decide to extend the registration deadline in the coming months.

This has been prepared for informational purposes only and does not constitute legal advice. Readers should not act upon this information without seeking guidance from their attorneys or other professional advisers.

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