Lowenstein Sandler

Client Alert

Investment Management

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Year-End Developments and Compliance Checklists

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Lowenstein Sandler's Investment Management Group is pleased to provide you with (i) a summary of recent legislative and regulatory developments that impact the investment management community and (ii) checklists of annual considerations for private investment funds, investment advisers, commodity trading advisors, and commodity pool operators. The checklists appear after the legislative and regulatory summary. For more information regarding any matter covered in this update, please contact one of the attorneys in our Investment Management Group.

SELECT LEGISLATIVE AND REGULATORY DEVELOPMENTS

Key Tax Reform Provisions Affecting Hedge Funds, Private Equity Funds, and Other Investment Vehicles

Synopsis: On December 20, 2017, Congress passed a statute originally named the Tax Cuts and Jobs Act (the "Act"), which enacted a broad range of tax changes. The President signed the Act on December 22. A number of provisions are of particular importance to the investment management industry.

Status: Among other changes, the Act: (i) imposes additional time-based restrictions on the recognition of long-term capital gain in respect of carried interest; (ii) subject to limitations, provides a new 20 percent deduction to individuals, trusts, and estates that receive income from certain S corporations, sole proprietorships, and partnerships (generally not available to investment funds or investment managers, but could be used by partners in a real estate investment fund); (iii) taxes corporate income at a flat 21 percent rate, resulting in less tax leakage in connection with an investment in a fund through a domestic blocker; (iv) restricts the deductibility of interest paid or accrued by certain investment funds that are engaged in a trade or business; (v) subjects to U.S. graduated income tax rates the gain on the sale of a partnership interest by a foreign person (including a foreign blocker), which may result in increased withholding responsibilities; and (vi) eliminates miscellaneous itemized deductions for expenses that were previously subject to the 2 percent floor.

The Lowenstein Sandler LLP Tax Group alert analyzing the Act's impact on hedge funds, private equity funds, and other investment vehicles is available here.

SEC Amends Form ADV and Recordkeeping Rules

Synopsis: Starting October 1, 2017, amendments to Form ADV implemented by the Securities and Exchange Commission (the "SEC") in a final rule adopted on August 25, 2016 have taken effect, providing for: (i) the disclosure of additional information regarding advisers, including information about their separately managed accounts,; (ii) a method for private fund adviser entities operating a single advisory business to register using a single Form ADV; and (iii) certain clarifying, technical, and other amendments to certain Form ADV items and instructions. The SEC also adopted amendments to the books and records rule under the Investment Advisers Act of 1940 (the "Advisers Act"). Advisers need to comply with the new disclosure requirements of Form ADV and new recordkeeping requirements.

Status: Amendments to Item 5 of Part 1A and Section 5 of Schedule D of Form ADV require advisers to report aggregate information about their separately managed accounts, which the SEC considers to include all advisory accounts other than those that are pooled investment vehicles (i.e., registered investment companies, business development companies, and pooled investment vehicles that are not registered).

Further amendments permit advisers to use umbrella registration subject to a number of conditions, which are consistent with the conditions required under previous guidance. To use umbrella registration, the adviser is required to file, and update as required, a single Form ADV (Parts 1 and 2) that relates to and includes all information concerning the adviser and each relying adviser, and must include this same information in any other reports or filings it must make under the Advisers Act. Each relying adviser must file a new Schedule R to Part 1A, providing identifying information, the basis for SEC registration, and ownership information about such relying adviser. A new question on Schedule D requires the identification of the filing adviser and relying advisers who manage or sponsor the funds reported on Form ADV.

Other amendments require several additional new disclosure items in Form ADV, including disclosure of: (i) all social media accounts and the address of each social media page (in addition to all websites); (ii) information concerning the total number of offices along with the 25 largest offices and information concerning their employees, businesses, and activities; (iii) information concerning any employment or compensation of the chief compliance officer by a party other than the adviser; (iv) identifying information regarding certain financial service providers; (v) information concerning the adviser's balance sheet assets; (vi) information concerning the number of clients across certain specified categories and the total regulatory assets under management by category; and (vii) information concerning whether sales of fund interests in funds formed under Section 3(c)(1) of the Investment Company Act of 1940 (the "Company Act") are limited to qualified clients.

Amendments to the recordkeeping rules under Rule 204-2(a) of the Advisers Act require that (i) records supporting performance claims in communications be maintained, even if distributed only to a single person, and (ii) advisers maintain originals of certain categories of written communications relating to the performance or rate of return of managed accounts or relating to securities recommendations.

Annual updating amendments to Form ADV (generally due by March 31, 2018) must be filed on the newly amended form. Investment advisers filing annual updating amendments should plan to budget additional time in gathering information toward and completing the newly amended form, especially investment advisers with relying advisers and managed accounts.

The Lowenstein Sandler LLP Investment Management Group alert analyzing the new disclosure requirements of Form ADV and new recordkeeping requirements is available here.

Department of Labor's Fiduciary Rule Becomes Effective, but Some Requirements Are Delayed Until July 1, 2019

Background: On April 6, 2016, the U.S. Department of Labor ("DOL") issued new regulations (collectively, the "Fiduciary Rule") expanding the circumstances under which a person who provides investment advice would be treated as a "fiduciary" under the Employee Retirement Income Security Act of 1974 ("ERISA"). Under the Fiduciary Rule, a person will be treated as an ERISA fiduciary if the person recommends investments or provides certain other investment advice for a fee (direct or indirect) to a plan, plan fiduciary, participant, beneficiary, or owner of an individual retirement account ("IRA"). Those treated as fiduciaries under the Fiduciary Rule are subject to heightened standards of conduct as well as restrictions under ERISA and the Internal Revenue Code that prohibit fiduciaries from receiving compensation that varies based on their investment advice.

Status: The Fiduciary Rule, and an associated exemption from the prohibited transaction rules known as the "Best Interest Contract" (or BIC) exemption, became effective June 9, 2017. However, the effectiveness of key provisions of the BIC exemption has been delayed until July 1, 2019. In the interim, the DOL is reviewing the Fiduciary Rule for further changes and has established a temporary enforcement policy with respect to the Fiduciary Rule and the BIC exemption. Under the temporary enforcement policy, the DOL will not pursue claims against fiduciaries "who are working diligently and in good faith to comply with the fiduciary duty rule and exemptions, or treat those fiduciaries as being in violation of the fiduciary duty rule and exemptions." The Internal Revenue Service ("IRS") has announced that it will follow the temporary enforcement policy as well.

Impact: The effect of the Fiduciary Rule is to cause most advisors to employee benefit plans and IRAs to be treated as ERISA-covered fiduciaries. Among other things, the Fiduciary Rule generally requires that fiduciary advisors either be compensated based on fixed fees or meet the requirements of the BIC exemption. The BIC exemption requires fiduciaries to meet "impartial conduct standards" and comply with certain contractual obligations. However, the effectiveness of the contractual element of the BIC exemption has been delayed until July 1, 2019.

The impartial conduct standards require fiduciaries to (i) make recommendations that are in the customer's best interest; (ii) adhere to duties of prudence and loyalty; (iii) receive no more than reasonable compensation; and (iv) not make materially misleading statements. The written contractual obligations will require advisors, subject to any changes that the DOL may make prior to the July 1, 2019, delayed effective date, to include those standards in written agreements and afford benefit plan and IRA investors the right to enforce breaches of those contractual terms.

The Fiduciary Rule has caused consternation for private equity and hedge funds. Out of concern of being a "fiduciary," some funds have opted to preclude new IRA investors unless the investor can meet an exemption from the Fiduciary Rule. One such exemption applies to IRAs that are represented by a registered investment adviser. Fund operators should continue to monitor developments during 2018 that may result from the DOL's continued review of the Fiduciary Rule, and determine whether any changes to fund documents and procedures are needed in order to conform to the Fiduciary Rule.

The Lowenstein Sandler LLP Investment Management and Employee Benefits/Executive Compensation Groups' most recent alert about the Fiduciary Rule is available here.

Markets in Financial Instruments Directive II ("MiFID II")

Synopsis: MiFID II is a cornerstone financial services regulation for financial institutions providing services in the European Union ("EU") that generally became effective on January 3, 2018. MiFID II replaces MiFID I, which became effective in November 2007. MiFID II consists of the MiFID II Directive and the Markets in Financial Instruments and Amending Regulation.

Status: Among other requirements, MiFID II provides: (i) conduct of business and organizational requirements for investment firms; (ii) authorization requirements for regulated markets; (iii) regulatory reporting requirements to avoid market abuse; (iv) trade transparency obligations; and (iv) rules on the admission of financial instruments to trading.

MiFID II impacts a broad spectrum of areas, including providing specific rules and/or guidance with respect to: (i) investor protection; (ii) best execution; (iii) complex and noncomplex financial instruments for purposes of appropriateness requirements; (iv) the definition of advice; (v) the provision of speculative products to retail investors; (vi) intermediaries; (vii) transparency; (viii) commodity derivatives; (ix) data reporting; (x) market structures; (xi) secondary markets; (xii) cross selling; (xiii) complex debt instruments and structured deposits; (xiv) transaction reporting, order record keeping, and clock synchronization; (xv) trading halts; (xvi) market operators and data reporting service providers; (xvii) assessment of knowledge and competence; and (xviii) position limits.

MiFID II will impact all United States investment advisers to some extent, but particularly those having EU-based sub-advisers, brokers, or clients, or those trading in the EU.

General Data Protection Regulation ("GDPR")

Synopsis: On May 25, 2018, after four-plus years of negotiation and a two-year phase-in period, the GDPR will become effective and replace the current Privacy Directive (95/46/EC). The GDPR has jurisdiction over any entity that collects, receives, and/or processes the personal data of residents of the European Economic Area ("EEA"), without regard to the entity's location. Failure to comply with the GDPR may subject an entity to stiff penalties, including fines up to 2-4 percent of global annual turnover (revenue).

Status: The GDPR will impact a myriad of operational and strategic programs for U.S. entities that fall within its jurisdiction. In addition to its extraterritorial reach, the GDPR expands the concept of personal data to specifically include data that indirectly identifies a natural person (such as IP address), provides for "joint and several liability" for data misuse among controllers and processors, and requires appointment of a data protection officer by any organization that processes data as a "core activity" or that processes sensitive data on a "large scale." The GDPR cites consent, data transfer (including breach of standard contract clauses and binding corporate rules), data portability, and profiling violations as among those eligible for the maximum 4 percent penalty, with breach notification, data protection impact assessments, and failure to cooperate with data protection authorities identified as violations subject to a maximum fine of 2 percent.

Entities subject to the GDPR should already have in place an implementation plan that should include: (i) a mapping of data flows within or through the entity, including when, how, and where personal data is collected, processed, and stored, and documenting a legitimate basis for processing; (ii) identifying and documenting the nature and scope of notices to, and consents from, data subjects; (iii) evaluating the entity's data collection, usage, and disclosure practices, and ensuring they are aligned with the permitted purpose(s) consented to by the data subject; and (iv) assessment of any changes that may be required in connection with contracts and relationships with customers, service providers, controllers, processors, and subprocessors. Any entity that collects, receives, or processes the personal data of EEA residents (or is otherwise subject to GDPR) and is without an implementation plan should take prompt action prior to the March 25, 2018, deadline to ensure compliance.

Details regarding the GDPR can be found in the Lowenstein Sandler LLP Privacy and Information Security Group alert available here, or contact Mary J. Hildebrand, Chair, at mhildebrand@lowenstein.com with any questions.

Cybersecurity 2: Insights From OCIE's Recent Round of Cybersecurity Exams

Synopsis: On August 7, 2017, the SEC's Office of Compliance Inspections and Examinations ("OCIE") issued a risk alert providing a summary of observations from its recent exams conducted pursuant to the Cybersecurity Examination Initiative announced on September 15, 2015. The risk alert identified several areas of improvement, areas of consistent practices, and examples of improvements and robust controls at certain firms.

Status: The risk alert highlighted certain areas for improvement: (i) tailored policies and procedures reflecting the firm's specific attributes; (ii) strict adherence to the written cybersecurity policies and procedures; (iii) specific and clear procedures to safeguard information; (iv) clear and distinct policies that authorize remote customer access and investor fund transfers; (v) quick remediation of any high-risk areas identified in penetration testing; and (vi) incident response plans for data breach incidents.

The following elements are highlighted from the policies and procedures of firms found to have implemented "robust controls": (i) a comprehensive inventory of data, information, and vendors, and detailed risk classifications; (ii) specific, detailed penetration tests, security monitoring, and system auditing framework; (iii) detailed schedules and processes for testing data integrity and system vulnerability; (iv) beta testing of security patches with a small number of users and servers, and analysis of and solutions to any issues identified; (v) access controls requiring encryption and other restrictions on mobile access, third-party logs of server access, and prompt termination of access for departed personnel; (vi) mandatory and timely employee training; and (vii) senior management review and approval of policies and procedures.

It is likely that the practices of firms that were mentioned as having robust controls will become the expected standards for registrants. Firms should evaluate their cybersecurity policies and procedures in light of the key findings and implicit recommendations outlined in the risk alert. Most importantly, the risk alert reinforces the principles that advisers must continue to review their policies to ensure that they are appropriately tailored to their firms' unique attributes and that adherence to such written policies and procedures will continue to be an examination focus.

The Lowenstein Sandler LLP Investment Management Group alert analyzing the risk alert is available here.

Financial Industry Regulatory Authority ("FINRA") Examination Priorities for 2018

Synopsis: On January 8, 2018, FINRA announced its 2018 examination priorities. The examination priorities reflect several new areas of focus along with continued emphasis on certain previously identified areas.

Status: FINRA's 2018 examination priorities reflect guidance for FINRA-regulated members regarding areas that it will pay most attention to this year, falling under several broader categories: (i) fraud; (ii) high-risk firms and brokers; (iii) operational and financial risks; (iv) sales practice risks; and (v) market integrity.

Fraud. FINRA will continue to aggressively pursue investigations related to potential insider trading and other fraudulent activities. In addition, FINRA will focus on microcap fraud schemes, including schemes that target senior investors.

High-Risk Firms and Brokers. FINRA will continue to focus on identifying high-risk firms and individual brokers in order to mitigate the potential risks they pose. In addition, FINRA will continue to focus on registered representatives' activities away from their firms and to review firms' controls regarding such outside business activities.

Operational and Financial Risks. Areas of focus include: (i) business continuity planning; (ii) customer protection and verification of assets and liabilities; (iii) information technology management policies and procedures; (iv) cybersecurity; (v) anti-money laundering; (vi) liquidity risk; and (vii) short sales.

Sales Practice Risks. Areas of focus include: (i) suitability; (ii) initial coin offerings and cryptocurrencies; (iii) use of margin; and (iv) securities-backed lines of credit.

Market Integrity. Areas of focus include: (i) manipulation; (ii) best execution; (iii) Regulation SHO and short sales; (iv) fixed income data integrity; (v) market access; and (vi) alternative trading system surveillance.

FINRA also announced the launch of several new report cards in 2018 to assist firms with their compliance efforts: (i) The Auto Execution Manipulation Report Card relating to non-bona fide orders to move the final national best bid or offer ("NBBO"); (ii) The Alternative Trading System Cross Manipulation Report Card will identify instances of potential manipulation of the NBBO; and (iii) The Fixed Income Mark-up Report Card will provide information, including media and mean percentage markups for each firm based on certain criteria such as investment rating, product, and length of time to maturity.

SEC Staff Guidance Update on Robo-Advisers

Synopsis: On February 23, 2017, the SEC issued guidance with respect to various regulatory matters of particular importance to automated advisers, more commonly known as "robo-advisers." The guidance incorporates both SEC staff observations and input from various robo-advisers with respect to the current regulatory regime affecting these types of advisers, but does not include any new rules or changes to existing rules that would address robo-advisers' businesses.

Status: The guidance impacts robo-advisers in the following areas:

Substance and Presentation of Disclosures. The guidance suggests robo-advisers consider how they explain their business models and the scope of the investment advisory services they provide, as well as how material information is presented to clients. Robo-advisers are advised not to mislead clients as to the scope of advisory services to be provided and to carefully consider whether written disclosures provided are designed to be effective. Robo-advisers should consider whether their questionnaires are designed to elicit sufficient information to support their suitability obligations.

Effective Compliance Program. In addition to adopting and implementing written policies and procedures that address issues relevant to traditional investment advisers, robo-advisers should consider whether to adopt and implement written policies and procedures that address: (i) the development, testing, and back-testing of the algorithmic code and the post-implementation monitoring of its performance; (ii) the questionnaire eliciting sufficient information to allow the robo-adviser to conclude that its initial recommendations and ongoing investment advice are suitable and appropriate for that particular client; (iii) the disclosure of changes to the algorithmic code that may materially affect that client's portfolios; (iv) the appropriate oversight of any third party affiliated with the algorithmic code or software modules utilized by the robo-adviser; (v) the prevention and detection of, as well as response to, cybersecurity threats; (vi) the use of social and other forms of electronic media in connection with the marketing of advisory services; and (vii) the protection of client accounts and key advisory systems.

The Lowenstein Sandler LLP Investment Management Group alert analyzing the robo-adviser guidance is available here.

Advertising Rule Compliance Issues

Synopsis: On September 14, 2017, the OCIE issued a risk alert providing a list of compliance issues relating to Rule 206(4)-1 (the "Advertising Rule") under the Advisers Act.

Status: The OCIE identified the following as recurring compliance issues: (i) misleading performance results, including in respect of failures to deduct advisory fees and inadequate disclosures concerning benchmark comparisons and hypothetical or back-tested results; (ii) misleading one-on-one presentations, including failures to include relevant disclosures and deduct advisory fees; (iii) misleading claims of compliance with voluntary performance standards, such as the Global Investment Performance Standards; (iv) cherry-picked profitable stock selections; (v) misleading selection of recommendations; and (vi) inadequate compliance policies and procedures with respect to advertising.

The OCIE further observed the following with regard to touting of awards, rankings, professional designations, and other accolades: (i) misleading use of third-party rankings or awards; (ii) misleading use of professional designations; and (iii) use of prohibited testimonials.

The OCIE's risk alert with respect to advertising compliance issues can be found here.

Commodity Futures Trading Commission Amends Recordkeeping Requirements

Synopsis: On May 23, 2017, the Commodity Futures Trading Commission ("CFTC") approved a final rule amending its recordkeeping rules.

Status: The amended recordkeeping rules modernize and make technology-neutral the form and manner in which regulatory records may be kept. Further, the final rule removes several obligations regarding the form and manner in which regulatory records must be kept that should lessen the costs of compliance with the record-keeping rules.

SEC Chairman Testimony on Examination Frequency and Priorities

Synopsis: On September 26, 2017, in testimony before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, SEC Chairman Jay Clayton discussed trends and plans with respect to examinations of investment advisers. He noted that in 2016, the SEC had reassigned approximately 100 staff members to the investment adviser examination unit, resulting in an expected 30 percent increase in examinations during 2017 (i.e., annual examinations of approximately 15 percent of all investment advisers). He explained that the SEC is continuing to leverage data analytics to identify potentially problematic activities and problematic firms for examination. In addition, he noted that the OCIE expects to increase its cybersecurity-related inspections in 2018.

The full text of the SEC Chairman's testimony can be found here.

Electronic Messaging Sweep

Synopsis: Reports emerged in mid-2017 of the SEC conducting an examination sweep relating to the use of electronic messaging. Investment advisers should review the adequacy of their policies and procedures surrounding the use of, and recordkeeping with respect to, all forms of electronic communication, including traditional categories such as instant messaging, text/SMS messaging, and emails sent and received, as well as communications conducted through newer forms such as social media and apps on mobile devices.

Inadvertent Custody of Client Funds or Securities

Synopsis: In February 2017, the SEC's Division of Investment Management issued guidance for investment advisers who may inadvertently have custody of client funds or securities because of provisions in a separate custodial agreement entered into between its advisory client and a qualified custodian.

Status: The terms of an agreement between a client and a qualified custodian might permit the investment adviser to instruct the custodian to disburse, or transfer, funds or securities (which terms may conflict with the terms of the advisory agreement between the client and investment adviser). The guidance highlights that an investment adviser could in such situations have custody that it did not intend to have, and that investment advisers should ensure they comply with the custody rule in such situations. The guidance offers as a suggestion to avoid inadvertent custody a letter from the investment adviser, countersigned by the custodian, that limits the investment adviser's authority to "delivery versus payment," notwithstanding the wording of the custodial agreement.

The SEC's guidance with respect to inadvertent custody can be found here.

New Partnership Audit Rules

Synopsis: For tax years beginning after 2017, significantly revised rules applicable to federal income tax audits of all entities treated as partnerships will be in effect.

Status: The new regime replaces the current "TEFRA audit" system with a new system that, absent an election, imposes partnership-level liability with respect to audit adjustments. Any audit adjustments are now reflected on the return for the tax year the adjustment is finalized, not the tax year under review. The new rules include opt-out election provisions for certain partnerships with 100 or fewer qualifying partners.

Enforcement Action Regarding Expense Allocation Policies and Procedures

Synopsis: A recent SEC enforcement action, In the Matter of Capital Dynamics, Inc., highlights the risks of vague or contradictory expense allocation language in offering documents and the need for comprehensive expense allocation policies. The relevant offering documents provided, on the one hand, that the investment manager and affiliates would be responsible for "normal operating expenses" and, on the other hand, that the relevant fund would be responsible for expenses "incurred in relation to the administration and operations" of the fund. The SEC recognized the firm's efforts to remedy prior allocation errors by adopting comprehensive expense allocation policies and procedures that, among other things, established (i) multiple levels of review for expense allocations; (ii) escalation procedures to the compliance department if differences arose regarding the allocation of expenses; and (iii) increased oversight of expenses charged by investment personnel.

We note that the SEC continues to actively review and question expense allocation disclosures, policies, and procedures in its examinations of investment advisers.

The SEC's order in connection with this enforcement action can be found here.

BE-12 Benchmark Survey on Foreign Direct Investment in the United States

Synopsis: The Bureau of Economic Analysis's ("BEA") Form BE-12 must generally be filed by May 31, 2018, by all domestic entities directly owned by foreign persons or entities, subject to certain thresholds. Form BE-12 is due whether or not the entity subject to the reporting requirements has been contacted by the BEA.

Form BE-12 and related instructions have not yet been released, but should be available here in early 2018.

SEC Chairman Remarks on Initial Coin Offerings and Distributed Ledger and Blockchain Technologies

Synopsis: On January 22, 2018, in his opening remarks at the Securities Regulation Institute, SEC Chairman Jay Clayton highlighted several issues in relation to initial coin offering and distributed ledger or blockchain-related legal issues. Chairman Clayton reminded securities lawyers and other market professionals of the need to act responsibly and hold themselves to high standards with regard to initial coin offerings. He noted the tendency of lawyers to be involved in structuring offerings of products that have many of the key features of a securities offering where those lawyers claim the products are not securities. The SEC staff has been instructed to be on high alert in connection with initial coin offerings that may be contrary to the spirit of the securities laws and professional obligations. Chairman Clayton further noted that the SEC is looking closely at companies that may begin to dabble in distributed ledger or blockchain-related activities and/or change their names in reference to these new technologies, noting the need for adequate disclosures in the event of such changes.

The full text of the SEC Chairman's remarks can be found here.

Report of Investigation Relating to Virtual Currencies

Synopsis: On July 25, 2017, the SEC's Division of Enforcement published a report of investigation with respect to the sale of tokens for The DAO, which is described as a type of virtual organization embodied in computer code and executed on a distributed ledger or blockchain. The report reiterates several fundamental principles of U.S. federal securities laws and describes their applicability to virtual organizations or capital-raising entities that use distributed ledger or blockchain technology to facilitate capital raising and/or investment and the related offer and sale of securities.

The full text of the SEC's report of investigation can be found here.

COMPLIANCE CHECKLISTS

Private Investment Funds and Their Advisers

- ☐ **Conduct periodic review of compliance policies.**
- ☐ **Provide/collect new issues certifications regarding whether funds/investors are "restricted persons."**
- ☐ **Conduct periodic review and update of offering documents.**
- ☐ **Consult counsel regarding annual Form D amendments and blue-sky and local securities matters in connection with offers or sales.**
- ☐ **File Schedule 13G year-end amendments by February 14, 2018.**
- ☐ **File Schedule 13H year-end amendments by February 14, 2018.**
- ☐ **File Form 13F for fourth quarter of 2017 by February 14, 2018.**
- ☐ **File Form PF quarterly updates and annual updates.**
- ☐ **Conduct periodic review of Section 13 and Section 16 filings.**
- ☐ **Conduct periodic review of BEA and TIC forms.**
- ☐ **Monitor compliance with 25 percent ERISA limitation with respect to benefit plan investors.**
- ☐ **Prepare annual VCOC Certification (if required) for benefit plan investors.**
- ☐ **Prepare Form 5500 Schedule C fee disclosures for ERISA plan investors.**
- ☐ **Prepare year-end audits and distribute financial statements as appropriate.**
- ☐ **Collect annual holdings reports and annual certifications from access persons and other personnel.**
- ☐ **Renew "bad actor" questionnaires and conduct placement agent verifications.**
- ☐ **Conduct annual training of personnel.**
- ☐ **Update risk assessment.**
- ☐ **Conduct periodic anti-money laundering verifications (e.g., OFAC verifications).**
- ☐ **Distribute privacy notices, if required.**

Discussion:

Compliance Policies. The compliance and operating requirements pertaining to registered investment advisers and unregistered advisers (including exempt reporting advisers) have continued to merge, and more and more unregistered managers are adopting best practices and upgrading their compliance policies to meet the demands of regulators and/or investors. Whether your firm is currently federally registered or will be required to register in the future, you should review your compliance policies periodically to verify that they are adequate and appropriately tailored to your business risks, and verify that your firm is adhering to them.

New Issues Certifications. If you purchase "new issues" (i.e., equity securities issued in an initial public offering), your broker (or, if you are a fund-of-funds that invests indirectly in new issues, the underlying funds) will require that you certify each year as to whether the fund is a "restricted person" within the meaning of FINRA Rules 5130 and 5131. To make the certification, you must determine the status of investors in your fund as either restricted persons or unrestricted persons.

Offering Documents. Offering documents should be reviewed from time to time to verify that they (i) contain a current, complete, and accurate description of the fund's strategy, management, and soft-dollar and brokerage practices; (ii) comply with current laws and regulations; and (iii) reflect current disclosure best practices.

Form D Amendments and Blue-Sky and Local Securities Matters. You should continue to inform counsel of all offers or sales of fund interests. Ongoing offerings may necessitate an amendment to a private fund's Form D (typically required on an annual basis on or before the first anniversary of the most recent notice previously filed). Additionally, offers to U.S. persons may trigger filing obligations in a given investor's state of residence, while offers to foreign persons may require filings in the country of an investor's residence.

Beneficial Ownership Reporting Requirements. If you have filed Schedule 13G and the information reflected in the schedule is different as of December 31, 2017, from that previously reported, you are generally required to amend the schedule by February 14, 2018. Form 5 must be filed within 45 days of the end of the issuer's fiscal year (February 14, 2018, for issuers with a December 31, 2017, fiscal year-end). Year-end serves as a convenient time to confirm that all relevant Section 13 and Section 16 filings are current and complete.

BEA and TIC Forms. The beginning of the calendar year is a good time to conduct a review of the applicable BEA and TIC forms and filing requirements applicable to your firm. TIC forms may be due on a monthly, quarterly, or annual basis and are subject to frequent updates. BEA forms may be due, as applicable, within 45 days of a relevant transaction, or quarterly, annually, or every five years. As discussed above, Form BE-12 must generally be filed by May 31, 2018, by all domestic entities directly owned by foreign persons or entities, subject to certain thresholds

Form 13H. Section 13(h) of the Exchange Act established a reporting system and filing requirements for "large traders" (i.e., persons effecting transactions in certain securities in amounts equal to 2 million shares or $20 million (determined by fair market value of the shares) in one calendar day or 20 million shares or $200 million in one calendar month). Persons meeting these thresholds must file Form 13H no later than 10 days after the identifying activity level is reached. Amended filings must be effected promptly after the end of a calendar quarter during which any of the information contained in Form 13H becomes outdated or inaccurate. Large traders may file amended filings more often than quarterly but are not required to do so. Annual amendments (regardless of the number of amended filings previously effected) are due within 45 days of the end of each calendar year. Persons may now satisfy both the amended fourth-quarter filing as well as the annual update to Form 13H, as long as such filing is made within the period permitted for the fourth-quarter amendment (i.e., promptly after the fourth quarter's end).

Form 13F. Section 13(f) of the Exchange Act requires "institutional investment managers" with investment discretion over $100 million or more of certain equity securities to file quarterly reports on Form 13F. Form 13F must be filed within 45 days of the end of each calendar quarter. An initial Form 13F must be filed at the end of the first year in which an institutional investment manager exceeds the $100 million threshold. To the extent that you have a Form 13F filing obligation, you must file your Form 13F for the fourth quarter of 2017 by February 14, 2018.

Form PF. Many smaller private advisers and large private equity advisers will be required to file an annual update to Form PF by April 30, 2018 (120 days after the end of their fiscal year). Quarterly updates to Form PF are required of large hedge fund advisers (by March 1, 2018 or 60 days after the end of their fiscal quarter) and large liquidity fund advisers (by January 16, 2018, or 15 days after the end of their fiscal quarter).

Monitor Compliance With 25 Percent ERISA Limitation on Benefit Plan Investors. If the aggregate amount invested in a fund by "benefit plan investors" (e.g., employee benefit plans, individual retirement accounts, Keogh plans and entities–the underlying assets of which include "plan assets" but excluding governmental plans, foreign plans, and certain church plans) equals 25 percent or more of the total value of any class of equity interests in the fund (excluding investments by the fund's managers that are not benefit plan investors), the fund will generally be deemed to hold plan assets subject to various ERISA requirements and prohibitions, unless the venture capital operating company ("VCOC") exception (described below) or another regulatory exception applies. Accordingly, many funds (particularly those that do not qualify as VCOCs, such as hedge funds) limit equity participation by benefit plan investors to less than 25 percent. If you sponsor such a fund, you should continuously monitor (i.e., upon subscriptions, capital calls, redemptions, transfers) the level of investments by benefit plan investors to ensure the 25 percent threshold is not exceeded.

Annual VCOC Certification. Prior to investing in a venture fund or a private equity fund, ERISA plan investors often require the fund to provide an annual VCOC certification stating that the fund qualifies as a VCOC. A venture fund or a private equity fund that qualifies as a VCOC will not be deemed to hold plan assets subject to ERISA, even if equity participation by benefit plan investors exceeds the 25 percent threshold (described above). In general, a fund will qualify as a VCOC if (i) at any time during the fund's annual valuation period, at least 50 percent of the fund's assets (other than short-term investments pending long-term commitment or distribution to investors), valued at cost, are invested in venture capital investments in operating companies for which the fund has management rights; and (ii) the fund, in the ordinary course of its business, actually exercises substantial management rights with respect to one or more of the operating companies in which it invests on an annual basis.

FORM 5500 Schedule C Fee Disclosures. Funds that have ERISA plan investors (including funds that do not allow equity participation by benefit plan investors to exceed the 25 percent threshold (described above) and, thus, are not subject to ERISA), excluding VCOCs and other entities treated as operating companies, are required to provide plan administrators of their ERISA plan investors with certain fee-related information that is necessary for the completion of Schedule C to the plan's annual report on Form 5500 in advance of the filing deadline for the annual report. The Lowenstein Sandler LLP alert analyzing the Form 5500 Schedule C rules is available here.

Year-End Audit. Now is the time to begin all necessary year-end audits so that funds can distribute financials to investors on a timely basis as required by relevant governing documents and, in certain instances, to comply with the custody rule under the registered or required to be registered under the Advisers Act and/or CFTC requirements.

Annual Holdings Reports and Annual Certifications. The beginning of the calendar year is a good time for investment advisers to have all "access persons" provide their annual holdings reports regarding securities ownership required pursuant to Rule 204A-1 of the Advisers Act. It is also a good time to have all personnel provide their annual certifications of compliance with firm policies and conflict-of-interest questionnaires.

"Bad Actor" Questionnaires and Placement Agent Verifications. The beginning of the calendar year is a good time to have certain personnel and service providers (e.g., directors of offshore private funds) recertify their status with respect to the SEC's "bad actor" rules in order to rely on the private placement exemption under Rule 506. This bad actor certification is often combined with the annual certification of compliance with firm policies discussed above. It is also a good time to have placement agents recertify their status with respect to such rules and certain other disciplinary matters.

Conduct Annual Training of Personnel. As a best practice under the Advisers Act, investment advisers should hold annual training sessions with existing employees to remind them of their obligations under the firm's compliance manual and code of ethics.

Update Risk Assessment. As a best practice under the Advisers Act, investment advisers should annually re-evaluate their "risk assessment" (i.e., evaluation of how the firm's activities, arrangements, affiliations, client base, service providers, conflicts of interest, and other business factors may cause violations of the Advisers Act or the appearance of impropriety) to determine that new, evolving, or resurgent risks are adequately addressed.

Periodic Anti-Money Laundering Verifications. Private investment funds and their advisers have ongoing anti-money laundering compliance obligations that necessitate periodic verifications, the frequency of which depends upon such funds' and advisers' operations. The beginning of the calendar year is a good time to assess such obligations and conduct renewed verifications such as comparing investor bases with the U.S. Treasury Department's Office of Foreign Assets Control lists.

Privacy Notices. In accordance with applicable federal law, investment advisers and investment funds must have a privacy policy in place. In addition to being provided at the time of initial subscription, privacy notices must generally be distributed at least annually and more frequently if there are any changes to the policy/notice. An exception provides that annual notice is not required where an adviser or fund (i) only shares nonpublic personal information (NPPI) with nonaffiliated third parties in a manner that does not require an opt-out right be provided, and (ii) has not changed its policies and practices with regard to disclosing NPPI since its most recent distribution of its privacy notice. Now is an opportune time for advisers and funds to determine whether they can rely on this exception. We believe that the best time for the annual distribution of the notice, if required, is with a fund's annual financial statements and/or tax reports. Additionally, some states have privacy regulations in place that may subject investment advisers and investment funds to additional or, in some cases, more stringent privacy requirements.

REGISTERED INVESTMENT ADVISERS AND EXEMPT REPORTING ADVISERS (WHERE INDICATED)

- ☐ **Prepare annual updating amendments to Form ADV (for registered investment advisers and certain "Exempt Reporting Advisers").**
- ☐ **Deliver Form ADV Part 2A (or portions thereof) to Clients and Fund Investors (for registered investment advisers).**
- ☐ **Comply with state annual filing requirements.**
- ☐ **Conduct periodic review of compliance policies and code of ethics.**
- ☐ **Comply with custody rule annual surprise examination.**
- ☐ **File Form 13F for fourth quarter of 2017 by February 14, 2018.**

- ☐ **Distribute privacy notices, if required.**
- ☐ **Prepare Form 5500 Schedule C fee disclosures for ERISA plan accounts.**
- ☐ **Comply with ERISA Section 408(b)(2) fee disclosure requirements for Covered Plans.**

Discussion:

Annual Updating Amendments to Form ADV. An investment adviser that (i) is registered with the SEC; or (ii) is considered an "Exempt Reporting Adviser" (i.e., an investment adviser relying on the private fund adviser exemption or the venture capital adviser exemption), in each case as of December 31, 2017 (and with a December 31, 2017 fiscal year-end), must file an annual updating amendment of items on the form by March 31, 2018. As discussed above, Form ADV has been amended as of October 1, 2017 and investment advisers will need to file their annual updating amendment on the new form and should budget additional time in this regard.

Deliver Form ADV Part 2. An investment adviser that is registered with the SEC and whose Form ADV Part 2A has materially changed since such adviser's last annual amendment must deliver either an amended Part 2A (which must include a summary of such material changes) or a summary of such material changes (which must include an offer to provide a copy of the amended Part 2A). Although such delivery requirements expressly apply only to "clients" (as defined in federal securities laws), we recommend that advisers to private funds deliver such items to their fund investors. For advisers with a December 31, 2017, fiscal year-end, such items must be delivered by April 30, 2018.

State Filing Requirements. Applicable state law may require a federally registered investment adviser to make notice filings and to pay fees in the state if he or she has clients or a place of business therein. Laws vary significantly from state to state. There also may be certain licensing or qualification requirements for representatives of investment advisers. Please contact counsel with any state-specific questions.

Compliance Policies and Code of Ethics. Federally registered investment advisers must adopt and maintain comprehensive compliance policies and a code of ethics and also appoint a chief compliance officer. If you have not already done so, please contact counsel immediately so that counsel may assist you in creating and/or documenting compliance procedures appropriately tailored to your business. In addition, compliance policies and procedures must be reviewed by the adviser at least annually. The compliance policies and procedures review should focus on an evaluation of the effectiveness of the policies and procedures in light of current risks and the need for revisions as a result of (i) any compliance issues that arose during the prior year; (ii) any changes in the business activities of the investment adviser; and/or (iii) any regulatory changes. We recommend that this review be conducted relatively early in the year or staggered throughout the year so that it does not interfere with other time-sensitive activities when quarter-end or year-end matters are pressing. Policies that are materially changed as a result of such review should be redistributed to all appropriate personnel. In addition, Item 11 of Form ADV Part 2A must contain a current description of the code of ethics and a statement that the investment adviser will provide the code of ethics to any current or prospective client upon request.

Custody Rule Annual Surprise Examination. With certain limited exceptions, where the adviser (or its related person) possesses or may possess client funds and securities, the adviser is required to undergo an annual surprise examination by an independent public accountant.

FORM 5500 Schedule C Fee Disclosures. Advisers managing ERISA plan accounts are required to disclose certain fee-related information necessary for plan administrators to complete Schedule C to the plan's annual report on Form 5500 in advance of the date such annual report is required to be filed. The Lowenstein Sandler LLP alert analyzing the Form 5500 Schedule C rules is available here.

Compliance With ERISA Section 408(b)(2) Fee Disclosure Requirements. Advisers providing services directly to an ERISA-covered defined contribution or defined benefit plan as either a fiduciary or a registered investment adviser (as well as fiduciary services to a first-tier ERISA "plan asset" fund in which a covered plan has a direct investment, brokerage, and record-keeping services to certain participant-directed plans to which investment alternatives are made available, and certain other services) are generally required to make detailed fee disclosures to a plan fiduciary in advance of the date the underlying contract or arrangement is entered into, extended, or renewed. Additionally, changes to such required fee disclosures must be disclosed as soon as practicable, but in no event more than 60 days from the date on which the adviser becomes informed of such change. Advisers providing such services should monitor ongoing compliance with the ERISA Section 408(b)(2) disclosure requirements. The Lowenstein Sandler LLP alert analyzing the Section 408(b)(2) Fee Disclosure Requirements is available here.

COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

- ☐ **Registered CPOs and CTAs must conduct annual regulatory compliance reviews and complete certain regulatory requirements, which include preparation of annual questionnaires and annual registration updates.**
- ☐ **Prepare and file certain portions of Form CPO-PQR by March 1, 2018 (CPOs with $1.5 billion or more AUM), or April 2, 2018 (other CPOs).**
- ☐ **Prepare and file certain portions of Form CTA-PR by February 14, 2018.**
- ☐ **Annual affirmation of CPO registration exemption under Sections 4.5, 4.13(a)(1)-(3) or 4.13(a)(5) or exemption from CTA registration under Section 4.14(a)(8) by March 1, 2018.**
- ☐ **Review CPO delegations in connection with annual pool financial statement filings.**

Discussion:

Annual Compliance Reviews/Regulatory Requirements. Registered CPOs and CTAs must conduct annual compliance reviews. These reviews and requirements include (i) the preparation and filing with the National Futures Association ("NFA") of Annual Questionnaires and Annual Registration Updates within 30 days of the anniversary date of their registration; (ii) completion of the NFA's Self-Examination Checklist (available here); (iii) sending Privacy Policies to every current customer, client, and pool participant; (iv) testing disaster recovery plans and making necessary updates; (v) providing ethics training to staff and inspecting the operations of branch offices; (vi) for registered CPOs, preparation of Pool Quarterly Reports within 45 days after the end of the year (and within 45 days after the end of each quarter); and (vii) for registered CTAs that are NFA members, the filing of Form CTA-PR, required within 45 days after the end of the year (and within 45 days after the end of each quarter). Finally, unless the applicable fund(s) qualify for an exemption, registered CPOs and CTAs must update their disclosure documents periodically, as they may not use any document dated more than 12 months prior to the date of its intended use. Disclosure documents that are materially inaccurate or incomplete must be promptly corrected, and the correction must be promptly distributed to pool participants. The NFA's Notice to Members regarding these regulatory compliance matters is available here.

Prepare and File Portions of Form CPO-PQR. CPOs with AUM exceeding $1.5 billion must file Schedules A, B, and C by March 1, 2018, and other CPOs must file Schedule A (and Schedule B if AUM exceed $150 million) by April 2, 2018.

Prepare and File Portions of Form CTA-PR. CTAs are required to complete Form CTA-PR by February 14, 2018 (45 days after the end of the calendar quarter for CTAs who are NFA members, and 45 days after the end of the calendar year for other CTAs).

Annual Affirmation of CPO or CTA Exemption. Each person who has filed a notice of exemption from CPO registration under Sections 4.5, 4.13(a)(1)-(3), or 4.13(a)(5), or exemption from CTA registration under 4.14(a)(8), must affirm such notice of exemption by March 1, 2018, through the NFA's exemption system.

Review of CPO Delegations. All CPO delegation agreements entered into by registered CPOs must comply with specific criteria set forth by the CFTC and must be retained as part of the relevant CPO's records. As part of their annual pool financial statement filings through the NFA website, CPOs should ensure that all necessary CPO delegations are in place and appropriately documented.

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RECENT PUBLICATIONS AND COMMENTARY:

Below are links to recent articles and publications featuring or authored by members of the Investment Management Group.

CLIENT ALERTS AND NEWSLETTERS

- Key Tax Provisions Affecting Hedge Funds, Private Equity Funds And Other Investment Vehicles
  Tax Client Alert
  Brian A. Silikovitz, Kenneth J. Slutsky, John L. Berger, Michael N. Gooen, Michael Walutes, Lesley P. Adamo, Sophia Mokotoff, Kristin V. Taylor, Min Xue
  December 26, 2017

- The New Tax Law: Employee Benefits And Executive Compensation Provisions
  Employee Benefits & Executive Compensation Client Alert
  Andrew E. Graw, Christine Osvald-Mruz, James E. Gregory, Darren Goodman, Megan Monson
  December 26, 2017

- Department of Labor Grants 18-Month Delay of Significant Features of the Fiduciary Rule
  Investment Management and Employee Benefits & Executive Compensation Client Alert
  Andrew E. Graw, Scott H. Moss, Megan Monson
  December 1, 2017

- Common Pitfalls in Investment Adviser Advertising: Balancing Marketing Goals with Compliance Obligations
  Investment Management Client Alert
  Scott H. Moss, David Lifshitz, Ted O. McBride
  September 27, 2017

- Digital Tokens: Should SEC Registered Investment Advisers Update Their Code of Ethics?
  Investment Management Client Alert
  Scott H. Moss, Benjamin Kozinn
  September 6, 2017

- Cybersecurity 2: Insights from OCIE's Recent Round of Cybersecurity Exams
  Investment Management Client Alert
  Benjamin Kozinn, Scott H. Moss, Preeti Krishnan
  August 15, 2017

- Department of Labor Proposes Delay of Significant Features of the Fiduciary Rule to July 1, 2019
  Investment Management and Employee Benefits/Executive Compensation Client Alert
  Andrew E. Graw, Scott H. Moss, Megan Monson
  August 11, 2017

- New Guidance Establishes June 9 Effective Date for Fiduciary Rule, but also Raises Uncertainty as the DOL Continues to Review the Rule
  Investment Management and Employee Benefits/Executive Compensation Client Alert
  Andrew E. Graw, Scott H. Moss, Megan Monson
  May 9, 2017

- FINRA's Foray into Insider Trading
  Investment Management Client Alert
  Benjamin Kozinn, Ethan L. Silver, Ted O. McBride
  April 5, 2017
- Fiduciary Rule Update: Department of Labor Issues Temporary Enforcement Relief
  Investment Management and Employee Benefits/Executive Compensation Client Alert
  Andrew E. Graw, Scott H. Moss, Megan Monson
  March 16, 2017
- SEC Staff Issues Guidance Update On Robo-Advisers
  Investment Management Client Alert
  Ethan L. Silver, Scott H. Moss
  March 1, 2017
- President Trump Directs Department of Labor to Reexamine Fiduciary Rule
  Investment Management and Employee Benefits/Executive Compensation Client Alert
  Andrew E. Graw, Scott H. Moss, Megan Monson
  February 7, 2017
- REMINDER - Form SHC: Report of U.S. Ownership of Foreign Securities Due March 3, 2017
  Investment Management Client Alert
  Scott H. Moss, Robert Bee
  February 3, 2017

UPCOMING EVENTS

Below is information regarding upcoming events sponsored by or featuring members of the Investment Management Group. For more information regarding any of these events, please contact events@lowenstein.com.

Opal Family Office Winter Forum 2018
March 1, 2018
New York Marriott Marquis, NY

Marie T. DeFalco, panelist:
Investing in Private Equity/Venture Capital

Elaine M. Hughes, panelist:
Opportunities in the Private Credit Markets

MFA Legal & Compliance 2018
March 8, 2018
The Plaza, New York, NY

Peter D. Greene, panelist:
Alternative Data and Web Scraping

GAIM Ops Cayman 2018
April 23, 2018
Ritz Carlton, Grand Cayman

Benjamin Kozinn, speaker:
Big Data Compliance

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