JANUARY 2019

Reminder of Annual Requirements for Investment Managers

As we begin the new year, we thought it would be helpful to remind our clients that manage separate accounts or private funds—whether private equity funds, hedge funds, commingled funds, digital asset funds, collateralized loan obligations, or commodity pools—of certain important obligations that may apply to them as "Investment Managers" under various U.S. federal and state laws and regulations. The start of the new year may be a logical time to review and satisfy – or at least schedule and establish a plan to review and satisfy – such obligations, many of which apply to both registered and unregistered investment advisers.

Some of the guidance contained in this memorandum is based on strict requirements imposed by law or regulation, while other guidance takes the form of "best practices" recommendations. We have also included various "practice tips" that you may find useful when reviewing and addressing the compliance obligations discussed in this memorandum.

For your convenience, a table of contents can be found on the following page so that you may more easily reference the information that is relevant to you. Additionally:

- a brief summary of key compliance dates for 2019 and regulatory highlights for the past year can be found at the end of this memorandum in Appendices A (key dates) and B (regulatory highlights);
- a summary of the National Exam Program Examination Priorities for 2019 published by the Office of Compliance Inspections and Examinations ("OCIE") of the U.S. Securities and Exchange Commission (the "SEC") can be found in Appendix C; and
- a summary of certain ERISA-related requirements and best practices can be found in Appendix D.

Please contact Basil Godellas (Co-Chair), Jay Gould (Co-Chair), Glen Barrentine, Christine Edwards, Richard Ginsberg, Beth Kramer, Jerry Loeser, Scott Naidech, Joseph Nesler, Kate Price, Alan Roth, Michael Wu, Zachariah Robert, Aimee Albright, John Alexander, Cole Beaubouef, Shawn Durrani, Daniel Filstrup, Winston Gu, Jacqueline Hu, Molly Jardine, Breanne Long, Ana Núñez Cárdenas, Brad Schlotter, Dania Sharma, Merav Watson, Jon Ammons (CFTC), Francesca Guerrero (International Trade), Rachel Ingwer (Tax), Amy Gordon (ERISA), Sharon Mori (ERISA) or Alessandra Swanson (Privacy) if you have any questions regarding compliance with any of the following or their applicability to your specific situation.

* * *

This memorandum is not intended to provide a complete review of an Investment Manager's obligations relating to compliance with applicable tax, partnership, limited liability, trust, corporate, or securities laws or rules, or non-U.S. or U.S. state law requirements.[1]

1 This memorandum is not intended to be exhaustive, nor is it intended to provide a complete review of compliance obligations under applicable tax, securities, commodities, self-regulatory organization, non-U.S. or U.S. federal, state and local laws, rules and regulations. The memorandum does not necessarily include all annual or periodic obligations applicable to all Investment Managers, and may not provide detailed statements in respect of the specifics of any particular obligation. Similarly, many of the obligations described in this memorandum may not apply to all Investment Managers.

Attorney advertising materials – © 2019 Winston & Strawn LLP

Table of Contents

I. Requirements for SEC-Registered Investment Advisers ... 3
- a. Filings ... 3
- b. Deliveries ... 4

II. Requirements for CPOs and CTAs ... 7
- a. Filings for Registered CPOs and CTAs. ... 7
- b. Deliveries—Privacy Notice ... 8
- c. Other requirements ... 8

III. Generally Applicable Filing Requirements ... 10
- a. Amend Schedules 13G or 13D ... 10
- b. File Form 13F ... 11
- c. Amend Form 13H ... 11
- d. “FBAR” filing requirements and Form 114. ... 11
- e. Form SLT ... 11
- f. Form BE ... 12

IV. Other Requirements or Best Practices (including those relating to unregistered Investment Managers) ... 12
- a. Exempt reporting advisers ... 12
- b. Confirm ongoing new issues eligibility ... 13
- c. Review compliance procedures ... 14
- d. Review U-4 updates (sales practice violations and allegations) ... 14
- e. Review anti-money laundering and OFAC programs ... 14
- f. Review fund offering materials ... 15
- g. Review liability insurance needs ... 16
- h. Comply with state and municipal lobbyist regulations ... 16
- i. Renew Form D and review state blue sky filings ... 17
- j. Bad actor review ... 17
- k. Volcker Rule considerations ... 17
- l. CFIUS Considerations ... 18
- m. Identity Theft Procedures ... 19
- n. GDPR ... 19
- o. Business Continuity/Disaster Recovery Plans ... 20
- p. Cybersecurity Review ... 20

V. ERISA Considerations ... 20
- a. DOL Fiduciary Regulation ... 20
- b. Ongoing ERISA Compliance and Monitoring ... 21
- c. ERISA-Related Requirements and Best Practices. ... 23

Appendix A – Calendar of Key Dates for 2019 ... 25
Appendix B – 2018 Regulatory Highlights ... 27
Appendix C – OCIE National Exam Program Examination Priorities for 2019 ... 33
Appendix D – ERISA Related Requirements and Best Practices ... 35

© 2019 Winston & Strawn LLP

I. Requirements for SEC-Registered Investment Advisers

a. Filings.

i. Update and file Form ADV.

An Investment Manager that is registered with the SEC as an investment adviser (a "Registered Manager") under the Investment Advisers Act of 1940, as amended (the "Advisers Act"), must update and file Parts 1A and 2A (and related schedules) of its Form ADV with the SEC through the Investment Adviser Registration Depository ("IARD") on an annual basis within 90 days after the end of the Registered Manager's fiscal year (March 31, 2019, if the Registered Manager's fiscal year-end is December 31). In addition, a Registered Manager must file an updated Form ADV with the SEC through the IARD promptly if certain information becomes inaccurate.

- ***Practice Tip:*** Note that the SEC has indicated that the IARD will be open on Sunday, March 31, 2019.

ii. Confirm state notice filings/investment adviser representative renewals.

Registered Managers should review their current advisory activities in the states in which they conduct business and confirm that all required state notice filings have been made through the IARD. Registered Managers also should confirm whether any of their personnel need to be registered as "investment adviser representatives" in one or more states and, if so, register those persons or renew such persons' registrations with the applicable states, as needed.

- ***Practice Tip:*** Registered Managers should confirm that their IARD electronic accounts are adequately funded so as to cover payment of all applicable registration renewal fees with both the SEC and with any states. For purposes of funding and scheduling payments from the account, please note that deposited funds may take several days to appear in the IARD account.

iii. Prepare and file Form PF.

Form PF is required of Registered Managers who manage private funds with assets under management attributable to those funds of at least $150 million.

Form PF is due 120 days after the end of the Registered Manager's fiscal year (April 30, 2019, for those with a fiscal year-end of December 31), except that a Registered Manager that is characterized as a "large liquidity fund adviser" or a "large hedge fund adviser" is required to file Form PF within, respectively, 15 or 60 days of the end of each calendar quarter. The rules relevant to Form PF—including what constitutes a "large hedge fund adviser," "large liquidity fund adviser," or "large private equity adviser," and when an adviser must aggregate information about certain funds—can be complex; please contact your usual Winston & Strawn attorney with any questions or for additional guidance. The Form PF Frequently Asked Questions, last updated by the SEC on January 18, 2017, and available here, is also a helpful resource when completing Form PF.

Registered Managers who are dually registered with the Commodity Futures Trading Commission (the "CFTC") will satisfy certain CFTC reporting obligations by filing private fund information on Form PF. Specifically, the dually registered adviser will not need to file Schedules B and C of Form CPO-PQR if the Investment Manager files information on all relevant pools on Form PF. Please see Section II.a.iv. below for a further discussion of CFTC filing requirements.

- ***Practice Tip:*** In June 2018, the SEC announced settlements with 13 Registered Managers who failed to file their annual Form PFs over multi-year periods. See Appendix B – Regulatory Highlights – "SEC Charges Investment Advisers for Failure to File Annual Reports on Form PF."

Registered Managers of private funds with a fiscal year-end of December 31 who are subject to the Form PF filing requirements should begin the process of completing Form PF now, as the information required to be reported will require coordination with the Registered Manager's back office and/or service providers.

© 2019 Winston & Strawn LLP

b. Deliveries.

i. Deliver brochure to clients.

Under the Advisers Act, Registered Managers are required to provide new and prospective clients with a narrative brochure (Part 2A of Form ADV) regarding the firm, as well as brochure supplements (Part 2B of Form ADV) regarding certain of the firm's advisory personnel. Registered Managers must deliver to clients, within 120 days after the end of the Registered Manager's fiscal year (April 30, 2019, for those with a fiscal year-end of December 31), either (i) a free updated brochure that includes, or is accompanied by, a summary of material changes, or (ii) a summary of material changes that includes an offer to provide a copy of the updated brochure and information on how a client may obtain the brochure. Interim amendments must be delivered to clients if the amendment includes information in response to Item 9 of Part 2A (disciplinary information).

ii. Deliver fund's audited financial statements.

Under Advisers Act Rule 206(4)-2, commonly referred to as the "Custody Rule," Registered Managers of private funds that are deemed to have custody of client assets must either comply with the "surprise audit" requirement of the Custody Rule or the Rule's requirements regarding the provision of audited financial statements. To comply with the audited financial statement requirements, Registered Managers must provide audited financial statements for their pooled investment vehicles, prepared in accordance with U.S. generally accepted accounting principles, to applicable investors within 120 days after any such pooled investment vehicle's fiscal year-end (or 180 days for a fund-of-funds) (April 30, 2019 and July 1, 2019, respectively, for pooled investment vehicles with a fiscal year-end of December 31). For Commodity pool operators ("CPOs"), see Section II.a.ii (which requires delivery within 90 days after the pooled investment vehicle's fiscal year end).

- ***Practice Tip:*** In February 2017, the SEC released new "tri-part" guidance regarding Registered Managers having "inadvertent custody" through (i) an IM Guidance Update (the "2017 IM Custody Guidance Update"), which can be found here, (ii) a no-action letter to the Investment Advisers Association, which can be found here, and (iii) a modified FAQ II.4, which can be found here.

Under the 2017 IM Custody Guidance Update, which created a great deal of confusion for Registered Managers, the SEC staff stated that a Registered Manager would be deemed to have custody over client assets if the client's agreement with its custodian empowered the Registered Manager to have any form of access over such assets (for example, by disbursing or transferring funds or securities), even though the Registered Manager was not a party to, and might in fact be unaware of the contents of, the client's agreement with its custodian, and even though the Registered Manager's agreement with its client prohibited that type of access. However, under the no-action letter, the SEC staff stated that it would not recommend enforcement action against a Registered Manager for violating the Custody Rule solely because the manager has limited authority (as described in the no-action letter) to transfer client funds and securities from a client's account pursuant to a standing letter of instruction or similar asset transfer authorization arrangement established by the client with a qualified custodian. Under the modified FAQ II.4, the SEC staff concluded that a Registered Manager does not have custody of a client's assets simply by virtue of having the authority to transfer client funds or securities between two or more of a client's accounts maintained with the same qualified custodian or different qualified custodians, as long as the client has authorized the Registered Manager in writing to make such transfers and a copy of that authorization is provided to the qualified custodians (and as long as, in certain cases, that authorization "specifies" (as described in modified FAQ II.4) the client accounts maintained with the qualified custodians).

On June 5, 2018, the SEC staff effectively withdrew the 2017 IM Custody Guidance Update and issued two new FAQs (II.11 and II.12), which can be found here. New FAQs II.11 and II.12 provide that the Division of Investment Management will not recommend enforcement action under the Custody Rule or Section 207 of the Advisers Act for a Registered Manager's failure to comply with the Custody Rule with respect to a client's account in a situation where the Registered Manager: (i) does not have a copy of a client's custodial agreement, (ii) does not know, or have reason to know, whether that custodial agreement would give the Registered Manager inadvertent custody, and (iii) where the

Registered Manager's custody with respect to that client's account would arise solely on the basis of inadvertent custody. The relief provided in the FAQ is limited only to circumstances where the Registered Manager has not recommended, requested or required the client use a specific custodian. While this clears up some of the confusion, there are still many questions regarding issues related to delivery versus payment that the SEC has yet to address.

Registered Managers should review the custody guidance provided by the SEC in 2017, as modified by new FAQs II.11 and II.12, to determine if they could inadvertently have custody of client funds or securities when (i) the Registered Manager has limited authority to transfer client assets pursuant to a standing letter of instruction or similar asset transfer authorization arrangement established by a client with a qualified custodian, or (ii) the Registered Manager has the authority to move money between the client's own accounts.

If a Registered Manager either (i) possesses a copy of a client's custodial agreement, (ii) knows, or has reason to know, that the client's custodial agreement gives the Registered Manager inadvertent custody over the client's assets, or (iii) has recommended, requested or required the client to use a specific custodian, the Registered Manager must review the client's agreement with the custodian and either: (i) to the extent necessary, negotiate with the client and the custodian to eliminate all provisions of the custodial agreement that are deemed to give the Registered Manager custody over the client's assets or (ii) accept the fact that the Registered Manager has custody over such assets and comply with the Custody Rule with respect to such assets accordingly (including, without limitation, by verifying that the custodian is a "qualified custodian" for purposes of the Custody Rule).

- ***Practice Tip:*** The SEC has brought several enforcement actions against Registered Managers (and, in certain cases, firm CCOs) for failing to prepare and/or timely deliver audited financial statements to fund investors (see, e.g., Hudson Housing Capital LLC (September 25, 2018), which can be found here; Aria Capital Partners, GP LLC (August 22, 2018), which can be found here; New Silk Route Advisors, L.P. (July 17, 2018), which can be found here; Columbia River Advisors, LLC (July 28, 2017), which can be found here; Sands Brothers Asset Management, LLC (November 19, 2015), which can be found here; and Christopher R. Kelly, Esq. (November 19, 2015), which can be found here). Registered Managers should review their practices and work closely with their auditors in order to prepare and deliver audited financial statements to fund investors on a timely basis or, alternatively, comply with the surprise audit requirement.

iii. Privacy Notice.

Under SEC Regulation S-P, Registered Managers must provide to consumers and customers (each as defined in Regulation S-P) who are natural persons an initial notice describing their privacy policies and procedures and continue to do so on an annual basis; *provided,* that no annual privacy disclosure is required if the Registered Manager (i) does not disclose nonpublic personal information of consumers to third parties, other than disclosure permitted by subsection (b)(2) or (e) of Section 502 of the Gramm-Leach-Bliley Act ("GLBA") or regulations prescribed under GLBA Section 504(b); and (ii) has not changed its policies and practices with regard to disclosing nonpublic personal information from the policies and practices that were disclosed in the most recent privacy disclosure sent to consumers. In addition, all Registered Managers may be subject to state-specific laws regarding consumer privacy.

c. Other requirements.

i. Review required compliance procedures.

Pursuant to Rule 206(4)-7(b) under the Advisers Act, Registered Managers must review their compliance policies and procedures at least annually to assess their effectiveness. This review also should include an assessment of the adequacy of the firm's code of ethics, including an assessment of its effectiveness as implemented. At a minimum, Registered Managers should update their policies and procedures to address legal and regulatory changes (including compliance with any disclosure or reporting standards), all significant compliance matters that arose during the previous year, any significant changes in the business activities of the Registered Manager or its affiliates, and any other changes

© 2019 Winston & Strawn LLP

in regulatory guidance or agency rules (including recent enforcement actions) that would suggest a need to revise the Registered Manager's policies and procedures. As part of this review, Registered Managers should determine whether they need to provide any compliance or ethics-related training to employees, or enhancements in light of current business practices and regulatory developments. Registered Managers should retain written evidence of such reviews.

- ***Practice Tip:*** Registered Managers should pay particular attention to their policies and procedures that relate to areas of recent focus by the SEC, such as valuation, advertising, conflicts of interest, confidentiality of client information, digital assets, cybersecurity and privacy, and insider trading. See Appendix B – Regulatory Highlights for a summary of certain key regulatory developments. Registered CPOs and registered commodity trading advisors ("CTAs") should also refer to Section II.d.vi for a summary of NFA requirements to establish and periodically review their business continuity/disaster recovery plans.

- ***Practice Tip:*** The SEC has issued various Risk Alerts in 2018 that highlight various compliance issues that advisers should continue to focus on, including advisory fee and expense compliance issues, best execution, and cash fees to third-party solicitors (see Appendix B – Regulatory Highlights for a summary of relevant Risk Alerts). In addition, an OCIE Risk Alert from February 2017 continues to be instructive regarding what SEC examiners focus on and deficiencies identified in OCIE examinations of investment advisers, which included, among others, Rule 206(4)-7. The SEC noted the following examples of deficiencies or weaknesses related to compliance with Rule 206(4)-7: (i) the failure to take into account important individualized business practices, such as the Investment Manager's particular investment strategies, types of clients, trading practices, valuation procedures, and advisory fees; (ii) annual reviews were not performed by investment advisers, or, if performed, the reviews did not address the adequacy of an adviser's policies and procedures; (iii) the failure to address or correct problems identified in connection with annual reviews; (iv) a failure to follow stated compliance policies and procedures, including, in particular, practices relating to marketing, expenses, or employee behavior; and (v) a failure to update compliance manuals to eliminate information or policies that are no longer current, such as investment strategies that were no longer pursued or personnel no longer associated with the Investment Manager and stale information about the firm. The Risk Alert is available here.

ii. Business Continuity/Disaster Recovery Plans

Registered Managers should review and stress-test their business continuity/disaster recovery plans no less than annually and make any necessary adjustments, and retain written evidence of these reviews. For a further discussion of this issue, as well as a short description of the SEC's proposed rule published in June 2016 on this topic, please see Section IV.o below. In addition, please see Section II.d.ii for a summary of the NFA's proposed amendments regarding Information Systems Security Programs, which would impose certain enhanced cybersecurity requirements on registered CPOs/CTAs.

iii. "Pay-to-Play" Practices

Rule 206(4)-5 under the Advisers Act restricts the political contribution and solicitation practices of Registered Managers, exempt reporting advisers ("ERAs") (see Section IV.a. below), and certain of their related persons. Specifically, Rule 206(4)-5 prohibits such persons from receiving compensation for providing advisory services to government entities for a specified period of time after making political contributions to people or parties that may have the ability to influence a government entity's decision to employ any such person, while Paragraph (a)(18) of Rule 204-2 specifies various records that must be maintained with respect to Rule 206(4)-5. Annually, Registered Managers and ERAs should (i) make covered employees aware of Rule 206(4)-5 and its requirements and (ii) maintain the records required by Paragraph (a)(18) of Rule 204-2, which records can be broader than the prohibitions of Rule 206(4)-5 might suggest.

Rule 206(4)-5 also bars payments to third parties for the solicitation of advisory business from government entities, unless the third party is a "regulated person" as defined in Rule 206(4)-5(f)(9).

In July 2018, the SEC announced settlements with two registered investment advisers and one exempt reporting adviser relying on the venture capital adviser exemption for violations of the "pay-to-play" rules.

Industry participants also should note the presence of state laws that also address pay-to-play practices.

II. Requirements for CPOs and CTAs

a. Filings for Registered CPOs and CTAs.

i. Review and update NFA registration.

CPOs and CTAs registered with the CFTC must update their registration information via the National Futures Association ("NFA") Online Registration System's annual registration questionnaire, and also must pay their annual NFA membership dues and annual records maintenance fees on or before the anniversary of their registration's effectiveness. The NFA will deem a failure to complete the review of the annual registration questionnaire within 30 days following the due date as a request for withdrawal from registration.

- ***Practice Tip:*** On December 14, 2017, the NFA announced that it was adding two questions to each of the CPO and CTA annual registration questionnaires regarding trading in virtual currencies. Under these new requirements, CPOs and CTAs must notify the NFA if they execute transactions involving any virtual currency (including spot market virtual currency transactions) or virtual currency derivatives on behalf of a pool or managed account. This notification is to be accomplished by amending the firm-level section of the CPO or CTA's annual questionnaire. Any CPOs or CTAs that engage in transactions involving virtual currency or related derivatives are also required to report the number of their pools or managed accounts that executed transactions involving a virtual currency or a virtual currency derivative during each calendar quarter. This information must be submitted to the NFA through the CPO or CTA's questionnaire no later than fifteen days after the end of each quarter. The NFA notice announcing these requirements can be found here.

ii. File and distribute commodity pool certified annual reports.

Registered CPOs must file certified annual reports for their pools with the NFA within 90 days after the pool's fiscal year-end (April 1, 2019, for those with a fiscal year-end of December 31). CPOs of commodity pools that operate as a fund-of-funds may obtain an "automatic" 90-day extension by submitting the information specified by Regulation 4.22(f)(2) to the NFA prior to the original due date. The certified reports must be filed electronically through the NFA's EasyFile system. The registered CPO also must distribute the certified reports to the pool's participants within the above 90-day deadline, unless the NFA grants an extension.

iii. File annual reaffirmation of exemption.

Persons that claim an exemption under CFTC Regulations 4.5, 4.13(a)(1), 4.13(a)(2), 4.13(a)(3), 4.13(a)(5) or 4.14(a)(8), including registered CPOs and CTAs, must annually reaffirm their exemptions. Investment Managers claiming one or more of these exemptions will have 60 days after calendar year-end (March 1, 2019) to reaffirm the notice of exemption through NFA's Electronic Exemption System. Any person that fails to file a notice reaffirming the exemption will be deemed to have requested a withdrawal of the exemption.

iv. CFTC and NFA Form CPO-PQR.

A registered CPO is required to file certain information on CFTC Form CPO-PQR. This filing requirement is based upon the CPO's size and whether the CPO also is dually registered as an investment adviser with the SEC and files a Form PF. CFTC Form CPO-PQR contains Schedules A, B and C. Large CPOs—those with at least $1.5 billion of assets under management—are required to file Schedules A, B and C of CFTC Form CPO-PQR quarterly within 60 days of each quarter-end. Mid-sized CPOs—those with at least $150 million but less than $1.5 billion of assets under management—are required to file Schedules A and B of CFTC Form CPO-PQR annually within 90 days after year-end (April 1, 2019). Small CPOs—those with less than $150 million of assets under management—are required to file Schedule A of CFTC Form CPO-PQR, plus a Schedule of Investments annually within 90 days after year-end (April 1, 2019).

CPOs may also be required to file quarterly NFA Form PQR, which consists of certain questions from Schedule A and step 6 of Schedule B of CFTC Form CPO-PQR. As noted above, CPOs that are dually registered as investment advisers with the SEC may satisfy certain of their CFTC Form CPO-PQR filing obligations by filing Form PF with the SEC. Specifically, a dually registered adviser will not need to file Schedules B and C of CFTC Form CPO-PQR if the Investment Manager files information on all relevant pools on Form PF.

v. CFTC and NFA Form CTA-PR.

All registered CTAs must file CFTC Form CTA-PR annually within 45 days of the end of the fiscal year (February 14, 2019, for those with a fiscal year-end of December 31). In addition, each registered CTA that is an NFA member must also file NFA Form PR within 45 days of each quarter end. NFA Member CTAs can meet their CFTC filing requirement by filing their NFA Form PR for that quarter. CFTC Form CTA-PR and NFA Form PR cover certain identifying information about the CTA, the CTA's trading program, and performance information.

- ***Practice Tip:*** The CFTC and NFA separately issued responses to frequently asked questions regarding their respective Forms CPO-PQR and CTA-PR. The CFTC responses, issued in November 2015, are available at CFTC's FAQs for CPOs and CTAs. The NFA responses are available at NFA's CPO FAQs on Form PQR and NFA's CTA FAQs on Form PR. On October 4, 2018, the NFA provided additional guidance regarding financial ratios to be included in Forms PQR and PR. Specifically, that guidance clarifies that: (1) ratios must be calculated using the accrual accounting method, (2) the "current assets" balance reported on those forms must include only assets owned by the CPO or CTA (not client assets invested in pools or managed accounts), (3) the "current assets" balance must include only the CPO or CTA's current assets, and (4) the total revenue / total expense ratio must be calculated based on the prior twelve months. The Notice to Members regarding financial ratios can be found here.

b. Deliveries—Privacy Notice.

With limited exceptions, the CFTC's consumer financial privacy rules state that every CPO and CTA must provide consumers and customers (each as defined in 17 CFR Part 160) who are natural persons a copy of the CPO or CTA's privacy policy on an annual basis; *provided,* that no annual privacy disclosure is required if the CPO or CTA: (i) does not disclose nonpublic personal information of consumers to third parties, other than disclosure permitted by subsection (b)(2) or (e) of Section 502 of the GLBA or regulations prescribed under GLBA Section 504(b); and (ii) has not changed its policies and practices with regard to disclosing nonpublic personal information from the policies and practices that were disclosed in the most recent disclosure sent to consumers. In addition, CPOs and CTAs may be subject to state-specific laws regarding consumer privacy.

c. Other requirements.

i. Complete NFA self-examination questionnaire.

Under NFA rules, registered CPOs/CTAs must complete and sign the NFA's "self-examination questionnaire" and applicable supplements on an annual basis. The completed questionnaire is not filed with the NFA; instead, registered CPOs/CTAs must retain the questionnaire in their files for five years, with the questionnaire being readily accessible during the first two years. Registered CPOs/CTAs that have branch offices should complete a separate questionnaire for each branch office. As part of this review, registered CPOs/ CTAs should review any established compliance policies and procedures and confirm whether amendments to those procedures, or additional procedures, may be warranted in light of the registered CPOs/CTAs' current business.

ii. Comply with New Cybersecurity Requirements.

On December 4, 2018, the NFA proposed amendments to its Interpretive Notice 9070 regarding Information Systems Security Programs ("ISSPs"). Under these new requirements, which will become effective April 1, 2019, CPOs and CTAs will be required to (among other things):

- Provide prompt notice to the NFA of any cybersecurity incident related to the CPO or CTA's commodity interest business and that results in: (1) any loss of customer or counterparty funds, (2) any loss of the CPO or CTA's own capital, or (3) the CPO or CTA providing notice to customers or counterparties under state or federal law,

- Provide employee training regarding information security upon hiring and at least annually thereafter,

- Include in the CPO or CTA's ISSP a list of the topics covered in such information security training programs, and

- Obtain approval of the ISSP from the CPO or CTA's Chief Executive Officer or other senior level officer with primary responsibility for information system security (or, if the CPO or CTA relies on a consolidated entity ISSP approved by its parent, obtain approval from a senior officer stating that the consolidated ISSP is appropriate for the CPO or CTA's information security risks.

The NFA's proposed amendments can be found here.

iii. Comply with New Internal Controls Requirements.

On December 10, 2018, the NFA proposed a new Interpretive Notice 9021 – Compliance Rule 209 regarding Internal Controls Systems for CPOs. A compliance date has not yet been set for these new requirements, but they will likely become effective on or before April 1, 2019.

In general, these new requirements will require CPO members to implement an internal controls system that is designed to safeguard customer funds, and provide reasonable assurance that the books and records of a CPO's commodity pools are reliable and that the CPO is in compliance with all CFTC and NFA requirements. CPOs will also be required to adopt and implement written policies and procedures that fully explain the CPO's internal controls system, and to maintain records that support the implementation and effectiveness of its internal controls system. The NFA's proposed Interpretive Notice can be found here.

iv. Comply with New Requirements Regarding Promotional Materials for Entities That Engage in Virtual Currency Activities.

On May 17, 2018, the NFA issued an Interpretive Notice containing disclosure requirements for entities engaging in virtual currency activities. This Interpretive Notice became effective on October 31, 2018. In this Interpretive Notice, the NFA described several areas that should be addressed in disclosure documents, offering documents, and promotional material for CPOs and CTAs that engage in virtual currency activities (including spot market virtual currency transactions or derivatives transactions on virtual currencies). The new requirements include, but are not limited to, providing standardized disclosure language addressing the limits of the NFA's oversight with respect to spot market virtual currencies, and addressing the unique features of virtual currencies such as price volatility, increased cybersecurity concerns, and the uncertain regulatory landscape facing virtual currencies. Any promotional materials related to the spot market virtual currency activities of a CPO or CTA distributed or used on or after October 31, 2018 must satisfy the requirements of the Interpretive Notice. Existing disclosure documents and offering documents were required to be reviewed and revised to satisfy the requirements of the Interpretive Notice by November 21, 2018. If a disclosure document has been or is required to be filed with the NFA and is updated to conform to the requirements of the Interpretive Notice, the updated document must be filed with the NFA by November 21, 2018 and accepted by the NFA prior to use. CPOs and CTAs were also expected to provide updated disclosures addressing the requirements set forth in the Interpretive Notice to existing investors by November 21, 2018 and to any solicited prospective investors prior to accepting an investment from such person. The NFA Interpretive Notice can be found here, and the NFA notice of effective date containing more information can be found here.

v. Comply with NFA-required ethics training policy.

Under the NFA's required ethics training rules, registered CPOs/CTAs should periodically consider whether any of their associated persons are in need of additional ethics-related training.

- ***Practice Tip:*** The NFA stated in Interpretive Notice 9051 that "firms that opt for less formal training such as distribution of pertinent written materials should consider keeping the training on a more on-going basis. More formal

training, such as classroom instruction, could appropriately be offered less frequently but on a periodic basis."

vi. Review NFA-required business continuity/disaster recovery plan.

Under the NFA's Compliance Rule 2-38 and NFA Interpretive Notice 9052, registered CPOs/CTAs are required to establish and periodically "stress test" their required business continuity/disaster recovery plans to assess their effectiveness and make any necessary adjustments. Such plans also should be updated to reflect any material changes to operations. For a further discussion of this issue, please see Section IV.o below.

- ***Practice Tip:*** Although the rule and Interpretive Notice 9052 do not specify how frequently business continuity/disaster recovery plans should be periodically tested, the NFA Self-Examination Questionnaire states that such reviews should be conducted at least annually.

vii. Determine registration status of exempt clients.

NFA Bylaw 1101 prohibits NFA members from carrying an account, accepting an order, or handling a transaction in commodity futures contracts for any non-member of the NFA that is required to be registered with the CFTC. Registered CPOs/CTAs must have written policies and procedures that outline how the firm will determine if a client or investor is required to be registered with the CFTC, and must take reasonable steps to determine the registration and membership status of clients/investors who were previously exempt. Pursuant to NFA Notice I1406, the NFA has made information about pool operators and pools available through the BASIC System, which lists whether individuals either have properly filed an annual notice affirming their exemption under CFTC Regulation 4.5, 4.13(a)(1), 4.13(a)(2), 4.13(a)(3), or 4.13(a)(5) (and 4.14(a)(8) in the case of a CTA) or have withdrawn their exemption.

For any exclusions or exemptions that do not require annual affirmation, proper steps by the NFA member may involve contacting clients to determine whether they have registered or if they intend to file a notice affirming their exemption, as applicable, and obtaining a written representation to that effect.

III. Generally Applicable Filing Requirements

a. Amend Schedules 13G or 13D.

Individuals or entities that have beneficial ownership in excess of 5% of a class of registered equity securities are required to file either Schedule 13D or Schedule 13G (generally for investors with a passive investment purpose). While beneficial ownership determinations can be complex, ownership calculations should include shares held inside client accounts if the Investment Manager has: (i) the power to vote or direct the voting of the shares, and (ii) the power to dispose or direct the disposition of the security. The appropriate Schedule to be filed is determined by the type of investor.

Generally, Registered Managers will meet the criteria of a "Qualified Institutional Investor" under Rule 13d-1(b)(1)(ii)(E)-(I) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and will therefore be eligible to file a Schedule 13G. Depending upon the specific exemption that an individual or firm qualifies for, Schedule 13G may be filed on the following timeline: (i) for Qualified Institutional Investors, within 45 days of the end of the calendar year in which the beneficial owner acquired more than 5% and within 10 days of the end of the calendar month in which the beneficial owner acquired more than 10%; (ii) for "Passive Investors," within 10 days of the acquisition of more than 5% but less than 20%; or (iii) for "Exempt Investors," within 45 days of the end of the calendar year in which the beneficial owner acquired more than 5%.

Individuals or firms unable to meet the definition of a Qualified Institutional Investor, Exempt Investor, or Passive Investor, and who meet the 5% beneficial ownership criteria, must file a Schedule 13D within 10 days of becoming a 5% beneficial owner.

Schedule 13G is shorter, requires less information, and generally must be updated only annually, whereas Schedule 13D must be amended "promptly" upon the occurrence of any "material changes" including, but not limited to, any increase or decrease representing 1% or more in the holdings of a registered voting equity security. Schedule 13G is designed to be less burdensome because it is intended to capture reporting by entities that acquire

© 2019 Winston & Strawn LLP

the securities in the ordinary course of business and not with the purpose or effect of changing or influencing the issuer. Therefore, such investors do not raise the same types of activist shareholder concerns that prompt a Schedule 13D. A Registered Manager or a firm that is registered as an investment adviser under state law will generally be considered a Qualified Institutional Investor and able to file a Schedule 13G.

Investment Managers whose aggregate direct or indirect client or proprietary accounts beneficially own 10% or more of a registered voting equity security also must determine whether they are subject to any reporting obligations, or potential "short-swing" profit liability or other restrictions under Section 16 of the Exchange Act.

b. File Form 13F.

Generally, Investment Managers who exercise investment discretion with respect to $100 million or more in securities, subject to Section 13(f) of the Exchange Act, must file a Form 13F with the SEC disclosing certain information regarding their holdings. As with Schedules 13D and 13G, the determination of whether someone directly or indirectly exercises investment discretion can be complex. The official list of Section 13(f) securities can be found here.

The first filing of Form 13F is due within 45 days after the end of a calendar year (February 14, 2019) during which the Investment Manager reaches the $100 million filing threshold (calculated as of the last trading day of any month in that year), and within 45 days of the end of each calendar quarter thereafter. The reporting obligation continues for so long as the Investment Manager satisfies the $100 million filing threshold (again, calculated as of the last trading day of any month during the year).

c. Amend Form 13H.

Pursuant to Rule 13h-1 of the Exchange Act, Investment Managers and other persons who meet the "Large Trader" definition must update their Form 13H on an annual basis within 45 days after the calendar year-end (February 14, 2019). In addition, if any information in Form 13H becomes inaccurate for any reason, Large Traders must file an amended Form 13H by the end of the calendar quarter during which the information becomes inaccurate. Large Traders must also disclose their large-trader identification number to each broker-dealer effecting covered transactions on their behalf. The definition of a Large Trader and its application can be complex. Investment Managers who may be unclear of their Large Trader status are urged to contact their usual Winston & Strawn attorney for additional guidance.

d. "FBAR" filing requirements and Form 114.

United States persons with "financial interests" in, or signature authority over, "financial accounts" in foreign countries that, in the aggregate, exceed $10,000 in value at any time during the calendar year, must file a Report on Foreign Bank and Financial Accounts ("FBAR") on the Treasury Department's Financial Crimes Enforcement Network ("FinCEN") Report 114 by April 15 of the following year. Investment Managers must evaluate annually whether accounts maintained on behalf of clients, particularly offshore private funds, trigger FBAR filing obligations. An officer or employee of a financial institution that is registered with and examined by the SEC or CFTC is not required to report signature authority over a foreign financial account owned or maintained by the financial institution. Even for those individuals who do not meet the preceding exception, FinCEN extended the due date for filing FBARs by certain individuals—with signature authority over, but no financial interest in, foreign financial accounts of their employer or a closely related entity—to April 15, 2020. See FinCEN Notice 2018-1, available here.

e. Form SLT.

Certain entities are required to complete and submit the Treasury Department's Form SLT, which aims to capture information regarding transactions between United States residents and foreign entities involving long-term securities. Long-term securities are securities without a stated maturity date (such as equities) or with an original term-to-maturity greater than one year. United States entities (including hedge funds, private equity funds, and commingled funds) that either issue long-term securities to foreign residents and/or hold long-term securities issued by foreign entities are required to file a Form SLT if the amount of such securities exceeds $1 billion (and such securities are not otherwise held by a U.S.-resident third party custodian).

© 2019 Winston & Strawn LLP

For private funds that meet these thresholds, the funds' investment manager likely will be the reporting person for purposes of Form SLT. Entities subject to Form SLT reporting requirements must complete and file a Form SLT on a monthly basis. Additionally, once the $1 billion threshold is met in a month, the reporting entity must provide a Form SLT each month for the remainder of the calendar year, regardless of whether the $1 billion threshold is met in later months of that calendar year.

- ***Practice Tip:*** On June 13, 2016, the Federal Reserve sent noncompliance notices to issuers who had failed to file their Form SLTs on time. Entities that fail to comply with the Form SLT reporting requirements may face civil penalties of between $2,500 and $25,000 per month of noncompliance (or, in the case of willful noncompliance, subject to criminal prosecution, with potential sentencing to include up to $10,000 in fines or one year in prison per violation).

f. Form BE.

The U.S. Bureau of Economic Analysis ("BEA") has a variety of forms that are applicable to investors and financial institutions. The following are a selection of forms generally relevant to Investment Managers.

Form BE-13 filings are required for transactions that result in "direct investments" (ownership of a direct or indirect voting interest of 10% or more) by a foreign entity in a newly-established, newly-acquired, or newly-merged U.S. entity. Form BE-13 filings may be made as Form BE-13A, Form BE-13B, Form BE-13C, Form BE-13D, or Form BE-13E, depending on the type of transaction. Entities may also choose to file a Form BE-13 Claim for Exemption if they meet one of the qualifying exclusions. Form BE-13 filings are due within 45 days of establishment of the position or, if the original cost was less than $3 million, then within 45 days of when the investment has increased past that threshold. Additional forms must be filed by qualifying investors on quarterly (BE-605) or annual (BE-15) basis to report on qualifying foreign direct investment in the United States. Every five years, a benchmark survey (BE-12) is also conducted. The most recent survey was in 2017.

U.S. direct investment abroad is also subject to quarterly (BE-577) and annual (BE-11) filing requirements. Benchmark surveys have previously been conducted every five years; however, BEA does not currently indicate if the next survey will be conducted on schedule in 2020.

In 2017, the BEA made important changes to its surveys of direct investments, including Form BE-13, intended to simplify reporting for private funds by characterizing cross-border investments in certain private funds as portfolio investments. As a result, many hedge funds that were subject to BEA direct investment reporting as a result of cross-border voting interests are instead subject to reporting to the U.S. Treasury Department's Treasury International Capital ("TIC") system, which applies to cross-border investments exceeding the much higher TIC reporting thresholds. However, many private equity funds remain subject to BEA direct investment reporting.

IV. Other Requirements or Best Practices (including those relating to unregistered Investment Managers)

a. Exempt reporting advisers.

Advisers advising either (i) solely venture capital funds, or (ii) solely private funds with less than $150 million in regulatory assets under management who wish to avoid registering with the SEC generally must file a report as an ERA by completing certain items on Part 1 of Form ADV. The deadline for submitting this report is within 60 days of initially becoming an ERA. Thereafter, ERAs must update their Form ADV on an annual basis within 90 days after the end of their fiscal year (March 31, 2019 for those with a fiscal year-end of December 31).

- ***Practice Tip:*** Under certain circumstances, advisers that have attempted to rely on the ERA provisions may not rely on the ERA filing provisions if an affiliated entity is registered with the SEC as an investment adviser. For example, in 2017, the SEC brought an enforcement action against two related investment advisers, one of which provided advice to private funds and purported to rely on the private fund adviser exemption and another related adviser that provided advice to individuals with taxable and retirement plan savings accounts. See *Brian Kimball Case*, *Bradway Financial*, *LLC and Bradway*

Capital Management, LLC (July 25, 2017). Similarly, in 2014, the SEC brought enforcement actions against two related investment advisers, one of which provided advice to venture funds and purported to rely on the venture capital exemption and another related adviser that provided advice to funds for which a registration exemption was not available. See *Penn Mezzanine Partners Management, L.P.* (June 20, 2014) and *TL Ventures Inc.* (June 20, 2014).

- ***Practice Tip:*** In connection with the Fixing America's Surface Transportation Act of 2015 (the "FAST Act"), which amended the venture capital fund adviser exemption to registration under the Advisers Act by deeming small business investment companies ("SBICs") to be "venture capital funds" for purposes of the exemption, the SEC implemented a new rule, effective March 12, 2018, to amend the definition of "venture capital funds" in the Advisers Act and the definition of "assets under management" in the Advisers Act to exclude the assets of SBICs. This new rule should increase the number of advisers that would qualify as ERAs. The text of this rule can be found here.

- ***Practice Tip:*** In 2018, Section 3(c)(1) of the Investment Company Act was amended to enable qualifying venture capital funds to have up to (and including) 250 beneficial owners of their securities. For this purpose, a "qualifying venture capital fund" means a "venture capital fund" (as defined in Rule 203(l)-1 under the Advisers Act) that has not more than $10,000,000 in aggregate capital contributions and uncalled committed capital. By way of contrast, a typical fund that relies on Section 3(c)(1) generally may not have more than 100 beneficial owners of its securities.

i. Privacy law.

Investment Managers that are not subject to SEC Regulation S-P or CFTC Rules because they are not registered (or required to be registered) with the SEC or CFTC are subject to Regulation P promulgated by the Consumer Financial Protection Bureau, as well as to the FTC's privacy safeguard rules, which together contain requirements substantially similar to those contained in SEC Regulation S-P.

Under Regulation P, an unregistered investment manager must provide to consumers and customers (each as defined in Regulation P) who are natural persons an initial notice describing their privacy policies and procedures and continue to do so on an annual basis; *provided*, that no annual privacy disclosure is required if the unregistered investment manager (i) does not disclose nonpublic personal information of consumers to third parties, other than disclosure permitted by subsection (b)(2) or (e) of Section 502 of the Gramm-Leach-Bliley Act ("GLBA") or regulations prescribed under GLBA Section 504(b); and (ii) has not changed its policies and practices with regard to disclosing nonpublic personal information from the policies and practices that were disclosed in the most recent privacy disclosure sent to consumers. Like registered Investment Managers, unregistered investment managers may also be subject to state privacy laws that may impose additional requirements.

ii. Business continuity/disaster recovery plans.

Investment Managers not otherwise subject to a requirement that they implement a business continuity/disaster recovery plan should consider promulgating such a plan, stress-testing and reviewing it at least annually, and making any necessary adjustments to the plan based on the results of such review. Written evidence of these reviews should be retained. For a further discussion of this issue, please see Sections I.c.ii and IV.o.

iii. "Pay-to-Play" practices.

ERAs and certain of their associated persons are subject to the same "pay-to-play" restrictions (discussed above) as Registered Managers. Generally, these restrictions place limits on contributions being made to, or solicitation of contributions for, people or parties that may have the ability to influence the decision of a government entity to utilize the Investment Manager's services. Please see Section I.c.iii above for a more detailed discussion.

b. Confirm ongoing new issues eligibility.

In order for Investment Managers to purchase "new issues" for a fund or separately managed client account, Investment Managers should provide their brokers with annual written representations confirming their clients/

© 2019 Winston & Strawn LLP

investors' continued eligibility to purchase new issues under (i) FINRA Rule 5130, which prohibits the sale by broker-dealers of new issues to customers who are "restricted persons" (generally, most broker-dealers and most owners and affiliates of a broker-dealer), and (ii) FINRA Rule 5131, which prohibits the allocation of shares of a new issue to any account in which certain persons have a beneficial interest and such persons have the ability to influence or direct the provision of investment banking services to the FINRA member. The Investment Manager may verify the status of its clients/investors and its funds with annual representations under both Rules 5130 and 5131 through "negative consent" letters.

c. Review compliance procedures.

While most Investment Managers are subject to a mandatory annual review requirement, as a best practice, even Investment Managers not subject to the requirement should still review, at least annually, all established policies and procedures to confirm the policies' continued efficacy in light of the Investment Manager's current business practices, market conditions, and any legal or regulatory changes. Investment Managers, and Registered Managers in particular, should maintain policies and procedures in writing and distribute written policies and procedures to all applicable personnel. This review should include all significant compliance matters that arose during the previous year, any significant changes in the business activities of the Investment Manager or its affiliates, and any other changes in regulatory guidance or agency rules (including recent enforcement actions) that would suggest a need to revise the Investment Manager's policies and procedures.

d. Review U-4 updates (sales practice violations and allegations).

Registered Managers who are also broker-dealers or have affiliates that are broker-dealers should review allegations of sales practice violations made against a registered person in an arbitration or litigation—even in cases where the registered person is not a named party—and amend the registered person's Form U-4 to disclose such information as required.

- ***Practice Tip:*** Supervision of recidivist representatives (i.e., those with a track record of misconduct) was listed by OCIE as an examination priority for 2017, 2016 and 2015, and there is no reason to believe that OCIE no longer considers this to be an important issue. OCIE also published a detailed Risk Alert in September 2016 about the examination of supervision practices of Registered Managers who employ individuals with a history of disciplinary events. The Risk Alert can be found here.

e. Review anti-money laundering and OFAC programs.

Under the standards that are currently in place, Investment Managers generally are only required to comply with certain limited U.S. AML regulations.

Nevertheless, Investment Managers who have agreed with their counterparties, intermediaries (e.g., prime brokers), clients, or other parties to maintain such a program are required to perform those responsibilities.

Investment Managers of mutual funds need to be aware of regulations issued by the Financial Crimes Enforcement Network ("FinCEN") of the U.S. Treasury Department requiring mutual funds to have AML programs, consisting of written AML policies and procedures, an AML officer, periodic training of affected employees, independent testing of compliance, and due diligence on customers; to implement a written customer identification program; to file currency transactions reports and suspicious activity reports ("SARs"); to be alert to transactions structured to avoid currency transaction reports; to keep certain records; and to perform enhanced due diligence on certain customers. The duty to file SARs is a particularly important one, and the SEC has imposed very significant fines on broker-dealers – these fines tend to be 7 to 8 figures.

A number of other ways in which Investment Managers may find themselves subject to certain U.S. AML regulations derive from FinCEN rules that went into effect May 11, 2018. Those rules require certain financial institutions (including mutual funds) to have written procedures to identify and verify beneficial owners of customers that are legal entities at the time that a new account is opened. "Beneficial owners" are defined as those individuals directly or indirectly owning 25% or more of the equity in

© 2019 Winston & Strawn LLP

the customer and a single manager of the customer. This need not be done for customers that are regulated by a federal functional regulator, publicly held firms, registered investment companies, registered investment advisers, registered public accounting firms, or insurance companies. These rules also require banks, broker-dealers, and futures commission merchants ("FCMs") to identify beneficial owners, and accordingly, Investment Managers may be asked about beneficial ownership when they open a new account at a bank, broker-dealer, or FCM.

In addition, all Investment Managers are subject to certain related regulations (e.g., U.S. Treasury Office of Foreign Assets Control ("OFAC") regulations and Internal Revenue Code/Bank Secrecy Act reporting procedures for cash transactions). Prior to entering into an advisory relationship with a client, an Investment Manager should screen the new client's identification information and the proposed transaction against OFAC's list of Specially Designated National and Blocked Persons and applicable OFAC sanctions programs (e.g., sanctions programs in Cuba, Iran and North Korea). Because OFAC imposes sanctions on entities that are 50% or more owned, directly or indirectly, by sanctioned persons, it is also well-advised to screen the identification information of beneficial owners of new clients. Investment Managers should also periodically rescreen such information to see if a client or its beneficial owners have been added to a sanctions list. Investment Managers should take similar care in identifying new investments and counter-parties in the making of such investments to ensure that the target companies and counter-parties are not on OFAC's list or located in sanctioned countries.

In light of these responsibilities, Investment Managers should review their AML programs, including their AML risk assessment, on an annual basis to determine whether the program is reasonably designed to comply with any undertakings to which they have agreed, as well as all related regulations, reporting requirements, and similar obligations to which they may be subject as a matter of law. For Investment Managers who have agreed to comply with AML requirements, this review must be independent of the business unit responsible for the account and may be conducted by an outside professional or by appropriate officers and employees of the Investment Manager who have sufficient knowledge of the applicable regulations and economic sanctions programs.

- ***Practice Tip:*** AML has been listed by OCIE as an examination priority for multiple years (including 2019).

- ***Practice Tip:*** Investment Managers that rely on third-party administrators to conduct AML and know-your-customer due diligence on prospective investors should conduct appropriate due diligence on the AML policies and procedures of their third-party service providers.

f. Review fund offering materials.

Except for commodity pool disclosure documents that are filed with the NFA (unless subject to certain exceptions), private fund offering materials do not automatically "expire" after a certain time period. However, as a general securities law disclosure matter, and for purposes of federal and state anti-fraud laws, Investment Managers must keep their fund offering materials up-to-date and provide all material disclosures that may be required in order for a prospective fund investor to be able to make an informed investment decision. Accordingly, the beginning of the year may be an appropriate time for Investment Managers to review their offering materials for open-ended continuous offerings and determine whether any updates or amendments are needed. Investment Managers should also review their offering materials for closed-ended offerings for any material changes that need to be made. Investment Managers should particularly account for the impact, if any, of recent regulatory reform and tax changes on their funds. Among other things, Investment Managers should review the fund's current investment objectives and strategies, valuation practices, redemption policies, risk disclosures (including, but not limited to, disclosures regarding market volatility, counterparty and cybersecurity risk), actual or potential conflicts of interest, current Investment Manager personnel, relationships with service providers and advisers, allocation policies (including disclosures relating to fees and expenses, and allocation of fees and expenses across managed funds and related investment vehicles), and any relevant legal or regulatory developments.

- ***Practice Tip:*** The SEC has brought several enforcement actions against private fund managers for failing to disclose conflicts of interest in connection with allocations of fees and expenses, and for failure to properly allocate fees and expenses across managed funds in accordance with their governing legal documents. In addition, OCIE

recently published a Risk Alert providing a list of the compliance issues related to advisory fees and expenses charged by Registered Managers (see Appendix B – Regulatory Highlights – "Risk Alert: Overview of the Most Frequent Advisory Fee and Expense Compliance Issues Identified in Examinations of Investment Advisers"). Investment Managers should clearly disclose any conflicts of interests related to compensation in fund offering materials and adopt internal policies relating to the allocations of fees and expenses, and otherwise confirm that all fees are being properly disclosed, and that such allocations are being made in accordance with their funds' governing legal documents.

- ***Practice Tip:*** California Government Code Section 7514.7 requires each alternative investment vehicle (each, a "Subject Fund") in which California public pension plans and retirement systems (collectively, "California Plans") have invested to make certain public disclosures on an annual basis.

  Each Subject Fund is required to disclose the following information relating to its fees and expenses: (i) the fees and expenses that the California Plan pays directly to the Subject Fund, the fund manager (including the general partner), or related parties; (ii) the California Plan's pro rata share of fees and expenses not included above that are paid from the Subject Fund to the fund manager or related parties (the California Plan may independently calculate this information based on information contractually required to be provided by the Subject Fund to the California Plan, but if the California Plan independently calculates this information, then the Subject Fund is not required to provide the information identified in this item (ii)); (iii) the California Plan's pro rata share of carried interest distributed by the Subject Fund to the fund manager or related parties; (iv) the California Plan's pro rata share of aggregate fees and expenses paid by all of the portfolio companies held by the Subject Fund to the fund manager or related parties; and (v) any additional information required to be disclosed under the California Public Records Act.

- ***Practice Tip:*** On December 22, 2017, President Trump signed the bill formerly known as the Tax Cuts and Jobs Act (the "Act"). Subsequently, Treasury and the Internal Revenue Service have issued extensive regulations and other administrative guidance interpreting provisions of the Act. The Act, together with such regulations and other administrative guidance, has far-ranging implications for private investment funds and their investors.

The changes under the Act include a maximum 20% deduction for non-corporate owners of pass-through entities on the qualified business income allocated to them from the entity (the "pass-through deduction"). The deduction does not apply to entities in certain types of service businesses or to investment management or to most categories of investment income (e.g., dividends, interest, capital gains). In addition, the Act imposes new limitations on the deductibility of trade or business interest (which proposed regulations have defined broadly), trade or business losses, and certain investment management fees. The Act also imposes new withholding requirements with respect to transfers of certain partnership interests by non-U.S. persons. In light of the changes imposed by the Act, as well as by such regulations and other administrative guidance, we expect that the tax disclosure set forth in most offering materials should be updated or amended.

g. Review liability insurance needs.

As a general matter, Investment Managers are not required to purchase management liability insurance, such as directors' and officers' liability coverage, fiduciary liability coverage, or errors and omissions liability coverage. Investment Managers that do not have such coverage should periodically assess whether management liability insurance makes sense for them in light of their current business and, if so, the type and amount of coverage. Investment Managers that do have management liability insurance should consider reviewing the adequacy of such coverage.

h. Comply with state and municipal lobbyist regulations.

Investment Managers who provide investment advisory services to state, municipal, or other local government pension or retirement plans ("Government Plans") should consider whether they or their personnel are considered lobbyists in each jurisdiction in which they solicit Government Plans. Traditionally, the regulation of lobbyists at the state and municipal levels has largely

been limited to those individuals or entities that sought to influence legislative or rulemaking actions. However, many jurisdictions have defined lobbying more broadly to include the act of soliciting investment-advisory business from Government Plans.

While each state's lobbying laws are different, those persons or entities that fall within the definition of "lobbyist" are typically required to fulfill some or all of the following requirements: registration with a governmental body and payment of a fee, attending lobbyist education training, and filing periodic reports containing expenditures and other relevant information. Persons who fail to comply with these requirements may be subject to fines, revocation of lobbyist privileges, or other sanctions. As a result, Investment Managers who solicit Government Plans should become familiar with the lobbying regulations for each jurisdiction in which they solicit Government Plans.

- ***Practice Tip:*** In most states, such registration requirements must be met prior to any lobbyist activities taking place. Consider including a provision in your compliance manual that requires employees to notify compliance prior to making any contact with Government Plans.

i. Renew Form D and review state blue sky filings.

Investment Managers of private funds are required to make mandatory annual electronic filings for continuous or ongoing offerings on Form D. In addition, some state securities "blue sky" filings expire on a periodic basis and must be renewed. Consequently, now may be an appropriate time for an Investment Manager to review the securities filings for its funds and determine whether any updated filings, or additional filings, are or will become necessary in the coming year. Please contact your usual Winston & Strawn attorney or BlueSkyTeam@winston.com if you would like assistance from our dedicated "blue sky" team with any necessary SEC or state filings.

j. Bad actor review.

Investment Managers who are engaged in offerings in reliance on Rule 506 of Regulation D are required to obtain the information necessary to confirm that none of the fund's "covered persons" (generally, the fund, the fund's directors, general partners, and managing members, executive officers, and other officers of the fund that participate in the offering, 20% beneficial owners of the fund's voting securities, promoters connected to the fund, and the fund's investment manager and its principals) is a "bad actor" that has had a "disqualifying event." "Disqualifying events" generally include certain (i) criminal convictions; (ii) court/SEC injunctions or stop orders; and (iii) SEC or self-regulatory agency disciplinary proceedings. SEC guidance on the factors used to process bad-actor waiver requests is available here. The SEC has stated that an issuer may reasonably rely on a covered person's agreement to provide notice of a disqualifying event pursuant to a contractual agreement or an undertaking in a questionnaire or certification; however, if an offering is continuous, delayed or long-lived, the issuer must update its factual inquiry periodically.

Rule 206(4)-3 under the Advisers Act makes it unlawful for any Registered Manager to pay a cash fee, directly or indirectly, to a solicitor with respect to client solicitation activities if (among other things) the solicitor is a person (i) who is subject to any SEC order issued under Section 203(f) of the Advisers Act, (ii) was convicted within the previous ten years of any felony or misdemeanor involving conduct described in Section 203(e)(2)(A) through (D) of the Advisers Act, (iii) who has been found by the SEC to have engaged, or has been convicted of engaging, in any of the conduct specified in paragraphs (1), (5) or (6) of Section 203(e) of the Advisers Act, or (iv) is subject to an order, judgment or decree described in Section 203(e)(4) of the Advisers Act. Registered Managers are well advised to seek periodic certifications from their solicitors in which the solicitors indicate that they are not subject to any of the foregoing disqualifications.

k. Volcker Rule considerations.

The "Volcker Rule," more properly known as Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), generally prohibits a bank and its affiliates from engaging in proprietary trading and, more pertinently, from acquiring or retaining any ownership interest in, or sponsoring, a "hedge fund" or "private equity fund". In addition, the Volcker Rule prohibits any banking entity that serves as an investment manager,

© 2019 Winston & Strawn LLP

investment adviser, or sponsor of a covered fund, and any of the banking entity's affiliates, from extending credit to the fund, purchasing assets from the fund, accepting the fund's shares as collateral for a loan to another person, or issuing a guarantee on behalf of the fund.

A number of exceptions to the Volcker Rule are available, two of the primary exceptions being for (i) banking entity-organized funds that are only offered to customers of such entities, and in which the banking entity only maintains a *de minimis* investment, and (ii) investment funds outside the U.S., that are not offered in the U.S. and where the banking entity is a foreign banking firm (not controlled by a U.S. banking firm) (the "Foreign Fund Exemption").

The first exception is for banking-entity investments in a fund that the entity organizes and offers, to establish the fund with sufficient initial equity to attract investors or to make a *de minimis* investment; by statute, such a seeding investment is to be reduced to no more than 3% of equity of the fund within one year of the establishment of the fund in order to qualify for the *de minimis* exception. The Federal Reserve Board has authority to extend that one-year period for two additional years and, in July 2017, the Federal Reserve Board delegated authority to grant such extensions to the Federal Reserve Banks. To take advantage of this first exception, the original statute and regulations required that the banking entity not share with the covered fund for any purpose the same name or variation of the same name. That requirement was modified in 2018, as discussed below.

In the case of the Foreign Fund Exemption, in July 2017, the five federal agencies responsible for implementation of the Volcker Rule (FRB, OCC, FDIC, SEC, and CFTC) announced that they are coordinating respective reviews of such foreign funds to avoid unintended extraterritorial impact of the Volcker Rule and that they would not take action with respect to qualifying foreign excluded funds for a year, subject to certain conditions.

On May 24, 2018, President Trump signed the Economic Growth, Regulatory Relief, and Consumer Protection Act. Section 204 of that Act generally removed the naming restriction mentioned above. Originally, to qualify for the first exception in the Volcker Rule described above, the banking entity and covered fund could not use a common name or variation thereof; however, the new amended statute now expressly permits a covered fund to share the same name or variation thereof as a banking entity that is an adviser to the fund if the adviser is not a bank, bank holding company, or foreign bank treated as a bank holding company; does not share the same name or variation thereof of a bank, bank holding company, or foreign bank treated as a bank holding company; and the name does not contain the word "bank."

On June 5, 2018, all of the agencies that implemented the Volcker Rule issued a joint Notice of Proposed Rulemaking ("NPR") to amend the implementing regulations.

The NPR, among other things, expressly seeks comment on whether the Volcker Rule's definition of the term "covered fund" is appropriately tailored to identify funds that engage in the investment activities contemplated by the statute, whether the definition has been inappropriately imprecise and, if so, whether that has led to unintended results.

The Foreign Fund Exemption currently provides that, to qualify as being outside of the U.S., no financing for the banking entity's ownership or sponsorship can be provided by any branch or affiliate located in the U.S. or organized under U.S. law. The proposal in the NPR would remove this prohibition, as it has been difficult to comply with in practice. Agency guidance is also to the effect that, to meet the requirement of the Foreign Fund Exemption, no ownership interest in the covered fund be offered for sale or sold in the U.S. or be sold pursuant to an offering that targets residents of the U.S. in which the banking entity or its affiliate participated. The proposal would codify that guidance.

The comment period on the NPR closed October 17, 2018.

I. CFIUS Considerations.

The Committee on Foreign Investment in the U.S. ("CFIUS") has authority to review, for substantial national security issues, transactions under which a foreign person acquires "control" of a U.S. business, i.e. any entity engaged in interstate commerce in the U.S. "Control" is the power, directly or indirectly, whether exercised or not, to determine, direct or decide important matters affecting

© 2019 Winston & Strawn LLP

the U.S. business. In August 2018, Congress passed the Foreign Investment Risk Review Modernization Act ("FIRRMA") which expanded CFIUS authority to review various non-controlling investments that meet certain criteria. New regulations will be proposed and adopted by 2020 to implement this and other authorities.

A "Pilot Program" established in November 2018 imposes mandatory filing of a Declaration for certain investment transactions (as opposed to sale of services or goods) by foreign investors, irrespective of whether control is obtained, in businesses that produce, design, test, manufacture, fabricate, or develop critical technology used in certain industries specified in the Pilot Program. Critical technology includes defense articles, missile technology, weapons or nuclear components, artificial intelligence, cybersecurity, virtual reality, etc. To mandate a filing, the investment must grant the foreign person one of the following: access to material nonpublic technical information; membership, observer or nomination rights to the board of the business; or involvement in substantive decision-making (other than through voting of shares) of the business. There are exceptions to the Pilot Program filing requirements for investment funds that are structured in a way as to prevent the foreign investors from having certain control and influence over the decisions of the fund. These requirements are specified in the Pilot Program regulations.

Investors from countries with a demonstrated or declared strategic goal of acquiring Critical Technology or critical infrastructure that would affect U.S. leadership in areas related to national security (so-called "countries of special concern") may expect a greater degree of scrutiny by CFIUS.

Depending on final regulations, Investment Managers should be aware of CFIUS because the participation of foreign investors in a fund may mean that the fund's investments could trigger CFIUS review.

m. Identity Theft Procedures.

The SEC and the CFTC have adopted rules related to implementation of identity-theft programs by certain entities subject to SEC or CFTC regulation. Also, the FTC has adopted rules related to implementation of identity-theft programs that apply to certain unregistered entities, such as ERAs and private funds. As part of an Investment Manager's annual review of its policies and procedures, an Investment Manager should evaluate whether the identity-theft rules are applicable, and if so, (i) adopt policies and procedures to detect and address identity theft or (ii) if such policies have already been adopted, review and update such policies, as necessary.

- ***Practice Tip:*** In September 2018, a broker-dealer/adviser agreed to pay $1,000,000 to settle SEC charges of violation of the SEC's identity theft red flags rule and privacy safeguards rule after a cybersecurity data breach occurred compromising customer personal information, representing the SEC's first enforcement action for violation of the identity theft red flags rule. See Appendix B – Regulatory Highlights – "SEC Charges Broker-Dealer/Investment Adviser with Deficient Cybersecurity Procedures."

n. GDPR.

On May 25, 2018, the European Union's General Data Protection Regulation ("GDPR") went into effect. The GDPR imposes extensive duties on "processors" (which include persons who obtain, record, or hold data) and "controllers" (persons who determine the purposes for which personal data is processed and decide what is done with it) of personal data if such firms are based in the EU, offer services in the EU, or monitor individuals' EU activities. Those duties include disclosures on how data will be used; limits on retention of data; duties to delete or deliver data to the individual on request by the individual; duties to promptly notify of data breaches (which include accidental destruction, loss, or alteration of data); duties to keep records of data processing and transfers; and duties to obtain freely given, informed, specific, and in some cases explicit, consent for certain data processing activities. Protected data not only includes client data, but also employee data. Investment Managers may be "controllers" of data and often engage "processors" such as fund administrators, payroll firms, stock distribution agents, lawyers, accountants, and even firms hired to dispose of files.

If the Investment Manager has not already done so, it should analyze how the GDPR might apply to its business. The Investment Manager can take steps to do

© 2019 Winston & Strawn LLP

so by looking at whether it is collecting information from individuals who are located in the EU (either directly or from other sources), whether it is advertising its services in the EU and attempting to attract EU customers, or whether it is engaging in website tracking and passively collecting information (e.g., IP addresses, which qualify as personal information under GDPR) from individuals in the EU. In analyzing the applicability of GDPR, the Investment Manager may wish to further consider whether the collection of such information is intentional and significant (as compared to the rest of its client population) or if it is collecting such information on an incidental basis.

o. Business Continuity/Disaster Recovery Plans.

Investment Managers should review and stress-test their business continuity/disaster recovery plans no less than annually and make any necessary adjustments to strengthen their organizational resiliency and minimize potential regulatory risk. In addition, firms should review the business continuity/disaster recovery plans of third-party service providers. Written evidence of these reviews should be retained.

- ***Proposed Regulatory Change:*** On June 28, 2016, the SEC proposed a new rule and rule amendments under the Advisers Act. The proposed rules would require Registered Managers to adopt and implement written business continuity and transition plans, which are reasonably designed to address risks resulting from a significant disruption to the Registered Manager's operations. The proposal would also require Registered Managers to (i) maintain documents related to such plans that are currently in effect, or were in effect in the past five years, and (ii) subject such plans to annual review to account for changes to the Registered Manager's products, services, operations, third-party service providers, structure, client types, location, and any regulatory changes that might significantly alter the risk to the firm or its clients or otherwise suggest a need to revise the plan. However, based on the SEC's most recently published regulatory agenda, which can be found here, it does not appear that the SEC will be proceeding with the proposed rule in the immediate future.

p. Cybersecurity Review.

Cybersecurity has been an area of focus for the SEC for a number of years and has only gained more prominence with the frequent national news coverage regarding infiltration of corporate and government systems. FINRA and the NFA have also recently provided interpretive advice relating to cybersecurity. Cybersecurity continues to be an area of significant concern for the SEC and the CFTC and has been included in the SEC's Examination Priorities in the last few years (see Appendix C – OCIE National Exam Program Examination Priorities for 2019).

- ***Practice Tip:*** In September 2018, the SEC charged a broker-dealer and Investment Manager relating to failures in cybersecurity policies and procedures in connection with a cybersecurity breach. See Appendix B – Regulatory Highlights – "SEC Charges Broker-Dealer/Investment Adviser with Deficient Cybersecurity Procedures."

V. ERISA Considerations

The Employee Retirement Income Security Act of 1974, as amended ("ERISA"), and related Department of Labor ("DOL") regulations are important to Investment Managers who accept clients that are ERISA plans or that manage private funds that are subject to ERISA. Certain important ongoing ERISA compliance considerations are summarized below.

a. DOL Fiduciary Regulation.

We previously reported on the DOL's April 2016 regulation expanding the "investment advice fiduciary" definition under ERISA and modifying several prohibited transaction exemptions in light of the expanded definition (the "Fiduciary Rule"). On March 15, 2018, the Fifth Circuit Court of Appeals issued a ruling vacating the DOL's Fiduciary Rule, and on June 21, 2018, the Fifth Circuit Court of Appeals issued its mandate making the March 15, 2018 ruling effective.

In April 2018, the SEC proposed its own advice reform package and on May 7, 2018, the DOL released Field Assistance Bulletin 2018-02 ("FAB 2018-02"), advising financial professionals that they may still rely on the Fiduciary Rule and its related prohibited transaction exemptions when providing "advice" to ERISA plans.

© 2019 Winston & Strawn LLP

In addition, and despite the Fifth Circuit Court of Appeals' vacating the Fiduciary Rule, according to the DOL's fall regulatory agenda released in October 2018, it plans to issue in September 2019 a revised fiduciary rule to replace the one vacated by the Fifth Circuit Court of Appeals and is "considering regulatory options in light of the Fifth Circuit opinion." That may be one reason why the SEC's advice standard rule is taking longer than expected, and the industry speculates that the DOL and the SEC may produce complementary measures that work in conjunction with each other.

Before reverting back to the prior fiduciary standard, in which a person is a "fiduciary" under ERISA Section 3(21)(A)(ii) by virtue of giving advice for a fee or other compensation, the retirement planning world is currently being cautious, loosely complying with the vacated Fiduciary Rule, and relying on the DOL's temporary enforcement policy under FAB 2018-02 for those who may be acting as fiduciaries.

As a reminder, the Fiduciary Rule provides that a person who offers certain kinds of investment advice for a fee or other compensation, whether direct or indirect, will be a fiduciary if that person "(i) represents or acknowledges that it is acting as a fiduciary, (ii) renders the advice pursuant to a written or verbal agreement, arrangement or understanding that the advice is based on the particular investment needs of the advice recipient or (iii) directs the advice to a specific advice recipient regarding the advisability of a particular management decision with respect to securities or other investment property of the plan or IRA."

The Fiduciary Rule provides several exceptions pursuant to which a person may provide investment advice to an ERISA plan, a private fund that is subject to ERISA, or an IRA but nevertheless will not be deemed to be a fiduciary.

Currently, we await the September 2019 deadline to see what the DOL will propose, perhaps incorporating the SEC rules into a new prohibited transaction exemption for non-discretionary fiduciary advice, and recommend relying on the DOL's FAB No. 2018-02, permitting the continuation of Investment Managers' reliance on a temporary enforcement policy.

b. Ongoing ERISA Compliance and Monitoring.

i. Review private fund compliance with the 25% significant participation test.

Investment Managers managing private funds that seek to satisfy the 25% significant participation test should consider periodically reviewing their processes for best practices. For example, Investment Managers of private funds may wish to reconfirm whether their fund-of-funds investors or other fund investors are "benefit plan investors" subject to ERISA or Section 4975 of the Code for purposes of reconfirming their funds' compliance with the 25% significant participation test (taking into account any new contributions and withdrawals or distributions) and, if so, the extent to which that investor's assets are plan assets. Only the portion of these investors' assets that are subject to ERISA and Section 4975 of the Code need be counted for this purpose. As this percentage can fluctuate over time, we recommend establishing an "upper limit" percentage that the investor will agree not to exceed. As noted in Appendix D, if a fund becomes a plan assets fund, the service provider disclosure regulations require that disclosures be provided to ERISA investors within 30 days of the Investment Manager knowing that the fund is a plan assets fund. Investment Managers should also review fund documents and side letters to comply with any requirements to provide annual certifications to "benefit plan investors" regarding the fund's satisfaction of the 25% significant participation test.

ii. Review private fund compliance with the "operating company" exception.

Investment Managers that have decided to qualify their funds as "venture capital operating companies" or "real estate operating companies" must continue monitoring compliance with the operating company exception on an annual basis, as per the DOL's plan assets regulations until the funds are in their distribution periods. Investment Managers may also wish to consider qualifying their new funds as operating companies. This will permit them to attract more capital from "benefit plan investors" without being subject to ERISA's fiduciary requirements. Initial qualification as a venture capital or real estate operating company is relatively easy to attain for funds that take a controlling interest in their portfolio companies or routinely

© 2019 Winston & Strawn LLP

negotiate for some management rights with respect to the portfolio companies; likewise, ongoing compliance should not be burdensome for such funds. Investment Managers of such funds should exercise the fund's obtained management rights at least once a year.

iii. Comply with Form 5500 fee disclosures.

Form 5500 is the annual report required to be filed by ERISA plans with the Internal Revenue Service ("IRS") and the DOL. In addition, Form 5500 filings may also be filed on a voluntary/elective basis by collective trusts and other private funds, the assets of which are treated as ERISA plan assets.

Schedule C to Form 5500 requires disclosures of fees and other compensation received by service providers (such as Investment Managers) to ERISA plans. ERISA plans are required to make these direct and indirect compensation disclosures whether or not the fund satisfies the 25% significant participation test. Although the Form 5500 filing is generally the responsibility of the ERISA plan investor, plans will look to Investment Managers to provide the information that is needed for the filing. Investment Managers of plan-asset funds may elect to file Forms 5500s on behalf of the funds, in which case they will need to comply with these additional compensation reporting requirements. ERISA plan investors sometimes request that Investment Managers make such filings, as it relieves the ERISA plan investor from some of its more detailed filing requirements.

In 2016, the DOL issued proposed updates to Form 5500. The DOL accepted comments to the proposed updates through October 4, 2016, and is currently reviewing such comments. The changes may affect how plan sponsors report alternative investments and hard-to-value assets. Also, the changes may affect funds that file as a Direct Filing Entity. Currently, the DOL anticipates that such updates will be effective for the 2019 plan year.

iv. Update and confirm your ongoing ERISA-related compliance generally.

As a best practice, Investment Managers who manage plan assets should periodically review their existing investment policies, investment guidelines, trading practices, and relationships to confirm that they are consistent with current requirements under ERISA. ERISA-related policies and procedures also should be reviewed periodically, such as cross-trading policies, proxy voting policies, and gift and gratuity policies, to reflect changes in the Investment Manager's practices or changes in the law. Investment Managers who rely upon the qualified professional asset manager ("QPAM") exemption or other DOL-prohibited transaction exemptions should review and confirm compliance with these exemptions.

v. Review compliance with ERISA's fidelity bond requirements, if applicable.

Investment Managers with ERISA plan clients or those managing plan assets are required by ERISA to maintain a fidelity bond unless the Investment Manager has determined that it is exempt from ERISA's fidelity bond requirements. Ongoing bonding arrangements should be reviewed on an annual basis to confirm that the Investment Manager is maintaining the bond in the correct amount and with the correct terms to satisfy ERISA's requirements.

Investment Managers may wish to review whether changes in their ERISA plan clients require changes to bonding arrangements (for example, an ERISA plan that did not previously hold employer securities may have acquired employer securities, necessitating a higher bond amount). Changes to a fund's plan-asset status may also dictate changes to the fidelity bond.

vi. Review developments in the law applicable to governmental plan clients.

Investment Managers who manage the assets of governmental plans (which are not subject to ERISA) should review developments in the past year in the law applicable to those plans that may affect plan investments. State or local laws may include restrictions on the use of placement agents, enhanced disclosure requirements for plan service providers, limitations or restrictions on permissible investments such as investments in certain countries, or limits on certain categories of alternative investments. Also, Investment Managers should consider the consequences of a governmental plan's request to be treated as an ERISA plan in a plan-asset vehicle. If an Investment Manager agrees to such a request, the language in the agreement should be carefully tailored so that it is not overbroad and will not trigger unwanted consequences. In their

© 2019 Winston & Strawn LLP

subscription agreements, Investment Managers should require governmental plan investors to disclose any laws or regulations that may govern their investments.

vii. Indicia of ownership requirements.

ERISA requires that the "indicia of ownership" of plan assets be within the jurisdiction of the district courts of the United States. Any fund that holds plan assets and does not satisfy the 25% significant participation test will have to observe this requirement. While this is not a concern for funds that solely hold assets such as securities located in the United States, the DOL has published regulations that generally permit foreign assets to be held outside the United States, *provided*, that the assets are under the management and control of a fiduciary such as a U.S.-domiciled Registered Manager that has total client assets under its management and control in excess of $50,000,000 and shareholders' or partners' equity in excess of $750,000. The above is necessarily a brief description of the somewhat complicated "indicia of ownership" rules. Accordingly, Investment Managers of plan asset funds that trade or intend to trade outside the United States may wish to review their policies.

c. ERISA-Related Requirements and Best Practices.

For information regarding certain additional important ongoing ERISA compliance considerations, please see Appendix D – ERISA-Related Requirements and Best Practices.

* * *

Related Professionals

If you have any questions about the matters contained in this memorandum or would like assistance in complying with any of the above requirements, please contact any of the Winston & Strawn professionals listed below.

Chicago

Megan Devaney
Christine Edwards
Richard Ginsberg
Basil Godellas
Brian Kozlowski
Margaret Lomenzo Frey
Brad Mandel
Andy McDonough
Kate Price
Alan Roth
J. Wade Challacombe
Jerry Loeser
Joseph Nesler
Zachariah Robert
Alessandra Swanson
Aimee Albright
Shawn Durrani
Daniel Filstrup
Winston Gu
Molly Jardine
Dania Sharma
Brad Schlotter

New York

Glen Barrentine
Morton Grosz
Rachel Ingwer
Beth Kramer
Scott Naidech
Greg Weston
Cole Beaubouef
Jacqueline Hu
Breanne Long
Sharon Mori
Ana Núñez Cárdenas
Merav Watson

San Francisco

Jay Gould
Michael Wu
John Alexander

Silicon Valley

John Albers

Washington, D.C.

Michael Loesch
Terry Arbit
Jon Ammons
Francesca Guerrero

These materials have been prepared by Winston & Strawn LLP for informational purposes only. These materials do not constitute legal advice and cannot be relied upon by any taxpayer for the purpose of avoiding penalties imposed under the Internal Revenue Code. Receipt of this information does not create an attorney-client relationship. No reproduction or redistribution without written permission of Winston & Strawn LLP.

© 2019 Winston & Strawn LLP

Appendix A – Calendar of Key Dates for 2019

Due Date	Requirement
Monthly	• Form SLT (must be submitted no later than the 23rd calendar day of the month following the report as of date) • CPOs deliver account statements to pool participants for pools with more than $500,000 in assets at the beginning of the pool's fiscal year-end (within 30 days of end of prior month) unless such pools are exempt under CFTC Regulation 4.7
Quarterly	• Form 13H must be amended promptly after the end of any calendar quarter during which certain information in the Form becomes inaccurate
Quarterly – within 15 days of quarter end	• Form PF (for Large Liquidity Fund Advisers) (based on fiscal quarter)
Quarterly – within 30 days of quarter end	• CPOs deliver account statements to pool participants for (i) pools with less than $500,000 in assets at the beginning of the pool's fiscal year-end or (ii) exempt pools under CFTC Regulation 4.7
Quarterly – within 45 days of quarter end	• CTAs that are NFA members must file NFA Form CTA-PR • Form 13F (February 14, 2019 for the quarter ending December 31, 2018)
Quarterly – within 60 days of quarter end	• CPOs with at least $1.5 billion of assets under management are required to file Schedules A, B and C of CFTC Form CPO-PQR • CPOs with less than $1.5 billion of assets under management (and investment advisers that file Form PF) are required to file NFA's Form PQR for the 1st, 2nd and 3rd quarters • Form PF (for Large Hedge Fund Advisers) (March 1, 2019 for the quarter ending December 31, 2018)
Annually (recommended	• Review of fund offering materials • Assess whether Investment Manager should purchase Director/Officer Liability Insurance, Fiduciary Liability Insurance, or Errors and Omissions Insurance and assess whether current coverage is sufficient.
Annually	• Copy of Privacy Policy to clients who are natural persons, if necessary • Review Compliance Policies and Procedures and retain records of such review • Review Code of Ethics • Review Business Continuity/Disaster Recovery Plans • Review Pay-to-Play Practices • CPOs/CTAs must update registration information and pay annual dues/fees • CPOs/CTAs should complete NFA's Self-Examination Questionnaire and maintain such questionnaire on file for five years • Confirmation from beneficial account owners of continued eligibility to participate in new issues under FINRA Rules 5130 and 5131 (may be obtained through negative consent letters) • Update Form D for private fund offerings and review any necessary state "blue sky" filings for renewal filings (and, in some cases, termination filings)
Annually – 45 days after calendar year end (February 14, 2019)	• Schedule 13G, as needed • Form 13H Annual Amendment • CFTC Form CTA-PR year-end filing (for registered CTAs)

Due Date	Requirement
Annually – within 60 days after calendar year end (March 1, 2019)	• Reaffirm exemptions or exclusions under CFTC Regulations 4.5, 4.13(a)(1), 4.13(a)(2), 4.13(a)(3), 4.13(a)(5) or 4.14(a)(8) • CPOs with at least $1.5 billion of assets under management must file Schedules A, B and C of CFTC Form CPO-PQR
Annually – within 90 days after calendar year end (April 1, 2019)	• CPOs with between $150 million and $1.5 billion of assets under management will be required to file Schedules A and B of CFTC Form CPO-PQR • CPOs with less than $150 million of assets under management (as well as advisers that file Form PF) must file Schedule A of CFTC Form CPO-PQR plus a Schedule of Investments • CPOs must file certified annual reports and distribute such report to pool participants (within 180 days if Fund of Fund)
Annually – within 90 days after fiscal year end (March 31, 2019 if a December 31 fiscal year end)	• File annual amendment to Form ADV with SEC. Form ADV also should be amended promptly upon any material change to certain information in Form ADV
Annually – April 15, 2019	• FinCEN 114, Report of Foreign Bank and Financial Accounts
Annually – within 120 days after fiscal year end (April 30, 2019 if a December 31 fiscal year end)	• Delivery to clients of amended brochure (Form ADV Part 2A), or a summary of the material changes made to the brochure, along with an offer to provide a copy of the brochure • Delivery of Audited Financial Statements to fund investors if there is "custody" of private fund assets (within 180 days (July 1, 2019 if a December 31 fiscal year end) for funds of funds) • Filing of Form PF (for advisers to private funds that are not Large Liquidity Fund Advisers or Large Hedge Fund Advisers)

Appendix B – 2018 Regulatory Highlights

SEC Staff Letter: Engaging in Fund Innovation and Cryptocurrency Related Holdings
On January 18, 2018, the SEC's Division of Investment Management issued a letter to the Investment Company Institute and the Securities Industry and Financial Markets Association raising significant investor protection issues relating to cryptocurrencies and cryptocurrency-related products. In particular, the SEC staff raised questions regarding valuation, liquidity, custody, ETF creation, volatility, lack of regulation, cybersecurity, potential manipulation and other risks. The SEC staff noted that until the questions raised can be answered satisfactorily, it would not be appropriate for fund sponsors to initiate registration of funds that intend to invest substantially in cryptocurrency or related products. The letter is available here. The SEC staff has received several comments on the letter, which are available here.

Online Trading Platforms for Digital Assets May Be Subject to SEC Registration Requirements
In a statement issued on March 7, 2018, the SEC's Division of Enforcement and Trading and Markets offered some considerations for investors using and market participants operating online trading platforms for digital assets. The Division maintained that online trading platforms providing a mechanism for trading assets, including digital assets, may be required to register with the SEC as a national securities exchange, or operate under an exemption from registration, if the digital assets they trade meet the definition of "security" under federal securities laws. The statement is available here.

Risk Alert: Overview of the Most Frequent Advisory Fee and Expense Compliance Issues Identified in Examinations of Investment Advisers
On April 12, 2018, the SEC's Office of Compliance Inspections and Examinations published a Risk Alert providing a list of the compliance issues related to advisory fees and expenses charged by SEC-registered investment advisers that were most frequently cited in deficiency letters. The deficiencies noted in the Risk Alert include the following: fee-billing based on incorrect account valuations; billing fees in advance or with improper frequency; applying incorrect fee rates; omitting rebates and applying discounts incorrectly; issues related to disclosure of advisory fees; and adviser expense misallocations. A copy of the Risk Alert is available here.

SEC Issues No-Action Letter to South State Bank
On May 8, 2018, the SEC responded to South State Bank's request for confirmation that the Division of Investment Management of the SEC would not recommend enforcement action under Sections 206(1), (2) or (4) of the Advisers Act or Rule 206(4)-1(a)(5) promulgated thereunder after South State Bank's restructuring. To improve efficiency, South State Bank sought an internal restructuring where one of its wholly-owned, registered investment adviser subsidiaries, Minis & Co., Inc. ("Minis"), merged with another wholly-owned, registered investment adviser subsidiary, South State Advisory, Inc. ("SSA"). South State Bank planned to have Minis continue to operate within SSA as a separate business and establish a Minis Division within SSA. Because Minis' core business was sufficiently different in both scope and geography from that of SSA, South State Bank wanted to continue using the legacy Minis track record in its marketing of the Minis Division, provided that it would disclose to current and prospective clients that SSA was the legal entity offering the adviser services. The SEC issued a No-Action Letter in response stating it would not recommend enforcement action under the facts presented in South State Bank's letter. A copy of the No-Action Letter is available here and a copy of the incoming letter from South State Bank is available here.

SEC Charges Investment Advisers for Failure to File Annual Reports on Form PF
On June 1, 2018, the SEC announced settlements with 13 registered investment advisers in connection with the investment advisers' failure to file annual reports on Form PF over multi-year periods. The SEC uses the information on Form PF, among other things, to publish quarterly reports to inform the public about the private fund industry. The SEC also provides Form PF data to the Financial Stability Oversight Council to aid in evaluating the systemic risks posed by hedge funds and other private funds. Pursuant to the terms of the settlements, each of the investment advisers agreed to be censured by the SEC and to pay a civil penalty of $75,000. A copy of the SEC's press release is available here.

© 2019 Winston & Strawn LLP

SEC Sanctions Investment Adviser for Failure to Disclose Compensation Arrangements with Outside Asset Managers
On June 4, 2018, the SEC issued an order in which it found that an investment adviser violated the Advisers Act when it failed to disclose the existence of, and payments it received pursuant to, an agreement with two third-party advisers in connection with such investment adviser's placement of its clients' assets in certain funds advised by the third-party advisers. During a 2014 examination, OCIE discovered the existence of this agreement, as well as the terms of the investment adviser's investment management agreements with two of its clients, which obligated the investment adviser to disclose, and/or prohibited the investment adviser from receiving, any benefits derived by the investment adviser from third parties in connection with the investment of the clients' assets. According to the SEC order, the investment adviser did not disclose the existence of this agreement with the third-party advisers to either of its clients, in violation of such investment management agreements. Moreover, the investment adviser did not account on its books and records for the payments owed by the third-party advisers in connection with the agreement. As a result of the conflict of interest created by this agreement, the failure to disclose the conflict to its clients in violation of their investment management agreements, and the investment adviser's failure to accrue receivables associated with this agreement on its books and records, the SEC found that the investment adviser violated Sections 204(a), 206(2) and 206(4) of the Advisers Act as well as Rules 204-2(a)(2) and 206(4)-7 promulgated thereunder. A copy of the order is available here.

Hinman Speech – Digital Asset Transactions: When Howey Met Gary (Plastic)
On June 14, 2018, William Hinman, the Director of the SEC's Division of Corporation Finance, gave a speech at the Yahoo Finance All Markets Summit: Crypto in San Francisco addressing whether a digital asset offered as a security can, over time, become something other than a security. Director Hinman stated that the distributed ledger network on which a digital coin or token functions could potentially become decentralized to a point where disclosures by the issuer or promotor become less meaningful, and, therefore, transactions in the digital asset may no longer be subject to securities law restrictions on trading. Director Hinman noted that based on this view, Bitcoin and Ethereum networks have become decentralized in this manner (and that, accordingly, in his view, Bitcoin and Ethereum are not securities). Director Hinman's speech was not a formal ruling and does not bind the SEC. His speech, however., provides important insight into how the SEC views developments in digital assets – particularly its view on how to apply the *"Howey test"* to digital assets to determine whether they are securities. A copy of the speech can be found here.

SEC Charges Investment Advisers and Representatives for Violating the Testimonial Rule Using Social Media and the Internet
On July 10, 2018, the SEC simultaneously instituted and settled five proceedings against two SEC-registered investment advisers, three investment adviser representatives, and a marketing consultant who committed and/or caused violations of the anti-testimonial provisions contained in Rule 206(4)-1(a)(1) under the Advisers Act through their use of social media and the internet. Those provisions prohibit registered investment advisers from directly or indirectly publishing, circulating, or distributing any advertisement that refers, directly or indirectly, to any testimonial of any kind concerning the investment adviser or any advice, analysis, report or other service provided by the adviser. The SEC found that the registered investment advisers and representatives hired marketing consultants to solicit testimonials from clients and publish them on numerous public social media outlets. The published testimonials all contained information about the firms or representatives and the advice and services they rendered to clients. All of the respondents were required to cease and desist from the unlawful activities and to pay civil penalties to the SEC. A copy of the SEC's press release (which contains links to the SEC's five orders) is available here.

Risk Alert: Compliance Issues Related to Best Execution by Investment Advisers
On July 11, 2018, the OCIE published a Risk Alert identifying the most common deficiencies that the staff has cited in recent examinations of advisers' compliance with their best execution obligations under the Advisers Act. Among other things, the Risk Alert outlined the following deficiencies: not performing best execution reviews; not considering materially relevant factors during best execution reviews; not soliciting and reviewing input from traders and portfolio managers; not seeking comparisons; not fully

disclosing best execution practices; not disclosing soft-dollar arrangements; not properly administering mixed-use allocations; and utilizing inadequate best execution policies and procedures. A copy of the Risk Alert is available here.

SEC Charges Four Advisory Entities for Faulty Quantitative Investment Models

On August 27, 2018, the SEC issued an order in which it found that four related advisory entities violated the anti-fraud provisions of the Securities Act and the Exchange Act as well as various provision of the Advisers Act and the Investment Company Act. The misconduct arose from the entities' use and marketing of faulty quantitative investment models. The quantitative models were developed by an inexperienced analyst, contained errors, and did not work as promised. Although one of the advisory entities discovered the errors in the quantitative models and stopped using the models, it did not inform the investors of the errors. The errors in the models exposed investors to significant hidden risks and prevented them from making informed investment decisions. The SEC imposed civil money penalties totaling more than $35,000,000 on the entities involved in the misconduct in addition to the issuance of ceaseanddesist orders. A copy of the order is available here.

SEC Imposes Monetary Penalty and Issues Cease-and-Desist Order in Connection with False Advertising Claims Made by Investment Adviser

On August 31, 2018, the SEC issued an order in which it found that an investment adviser made material misstatements in its advertising materials and had failed to implement written policies and procedures to prevent such violations, in each case in violation of the Advisers Act. The investment adviser advertised its "blended research" strategy stating that it used both fundamental and quantitative ratings to build an investment portfolio. The investment adviser prepared advertisements, which included a hypothetical portfolio based on its strategy. However, such advertisements failed to disclose that certain of the quantitative ratings used in building the hypothetical portfolio included in the advertisements were determined using a retroactive, back-tested application of investment adviser's quantitative model. In connection with the advertising violations, the SEC also found that the investment adviser violated the Advisers Act by failing to implement adequate policies and procedures to prevent the dissemination of false advertising materials such as the materials at issue. The SEC imposed a civil penalty of $1,900,000 and issued a cease-and-desist order. A copy of the order is available here.

SEC Imposes Monetary Penalty and Issues Cease-and-Desist Order in Connection with Operation of an Unregistered Digital Asset Fund

On September 11, 2018, the SEC issued an order in which it found that an investment adviser offering interests in a cryptocurrency fund constituted the offer and sale of unregistered securities, operation of an unregistered investment company, and violation of the anti-fraud provisions of both the Securities Act and the Advisers Act. The cryptocurrency fund was created to provide an investment vehicle for the purpose of investing in digital assets, but the investment adviser did not register the cryptocurrency fund as an investment company and made a general solicitation of investments in the cryptocurrency fund through the investment adviser's website, social media accounts, and traditional media outlet interviews. In addition, the investment adviser misrepresented to actual and prospective investors that the cryptocurrency fund was the "first regulated crypto asset fund in the United States." The SEC found that the investment adviser's offering of interests in the cryptocurrency fund through means of a general solicitation violated the Securities Act. The SEC further found that the investment adviser's statements regarding the regulated nature of the cryptocurrency fund violated the anti-fraud provisions of both the Securities Act and the Advisers Act. A copy of the order is available here.

SEC Charges ICO Superstore and Owners with Operating as Unregistered Broker-Dealers

On September 11, 2018, the SEC for the first time charged three unregistered broker-dealers for selling digital tokens following publication of the SEC's DAO Report. In an administrative proceeding, the SEC alleged that an unregistered broker-dealer and its two owners promoted its website platform as an "ICO Superstore" through which investors could purchase digital tokens during initial coin offerings ("ICOs") and also engage in secondary trading. The SEC found that some of the 200 different digital tokens handled by the website platform included securities. The SEC declined to identify specific tokens or cryptocurrencies involved, making it difficult to determine which digital coins the regulator considers to be

© 2019 Winston & Strawn LLP

securities. The SEC contended that by facilitating the sales of these digital tokens during their ICOs and in secondary trading, the website platform and its owners were required to registered with the SEC as broker-dealers. The SEC's order is available here.

SEC Charges Broker-Dealer/Investment Adviser with Deficient Cybersecurity Procedures

On September 26, 2018, the SEC charged a firm registered with the SEC as both a broker-dealer and an investment adviser in connection with a cyber-intrusion that compromised the personal information of thousands of customers. This matter was significant both because cybersecurity is an area of heightened concern for the SEC and because this is one of the first cases to bring charges against a registered broker-dealer or investment adviser in connection with a cyber-intrusion by third parties. The SEC charged the firm with violating Rule 30(a) of Regulation S-P (17 C.F.R. § 248.30(a)) (the "Safeguards Rule") and Rule 201 of Regulation S-ID (17 C.F.R. § 248.201) (the "Identity Theft Red Flags Rule"). These rules, respectively, require broker-dealers and investment advisers registered with the SEC to adopt written policies and procedures that are reasonably designed to safeguard customer records and information, and require broker-dealers and investment advisers that offer or maintain covered accounts to develop and implement a written Identify Theft Prevention Program designed to detect, prevent, and mitigate identify theft in connection with the opening of a covered account or any existing covered account. The SEC's order is available here.

SEC Announces the Launch of its Strategic Hub for Innovation and Financial Technology

On October 18, 2018, the SEC announced the launch of a Strategic Hub for Innovation and Financial Technology ("FinHub"). FinHub is designed to serve as "a resource for public engagement on the SEC's FinTech-related issues and initiatives, such as distributed ledger technology (including digital assets), automated investment advice, digital marketplace financing, and artificial intelligence/ machine learning. FinHub also replaces and builds on the work of several internal working groups at the SEC that have focused on similar issues." FinHub is intended to provide a portal for industry and the public to engage directly with SEC staff on innovative ideas and technological developments and provide a means of engaging with the public through publications and events, including a "FinTech Forum" focusing on DLT and digital assets planned for 2019. A copy of the press release is available here.

Risk Alert: Investment Adviser Compliance Issues Related to the Cash Solicitation Rule

On October 31, 2018, the SEC's Office of Compliance Inspections and Examinations published a Risk Alert identifying the most common deficiencies the staff cited relating to Rule 206(4)-3 (the "Cash Solicitation Rule"). Under the Advisers Act, investment advisers are prohibited from paying a cash fee to any third-party solicitor unless the arrangement complies with certain conditions set out in the Cash Solicitation Rule. The Cash Solicitation Rule requires the following: the solicitation agreement between an adviser and a third-party solicitor must obligate the solicitor to provide the prospective client with a copy of the adviser's brochure and a written disclosure document highlighting the solicitor's financial interests; the adviser must receive a signed and dated acknowledgement that the client received the adviser's brochure and written disclosure document; and the adviser must make a bona fide effort to ascertain whether the solicitation agreement was complied with and must have a reasonable basis for believing that the solicitor complied with the agreement. Among other things, OCIE highlighted the following deficiencies: solicitors are failing to provide solicitation disclosure documents to prospective clients or providing incomplete disclosure documents, such as those that fail to disclosure the nature of the relationship, certain compensation terms, or the additional solicitation cost; advisers are failing to receive signed and dated client acknowledgments in a timely manner; advisers are using solicitors without proper or complete solicitation agreements; and advisers are not making bona fide efforts to ascertain whether third-party solicitors have complied with solicitation agreements. We note that, while not mentioned in the Risk Alert, the Cash Solicitation Rule does not technically apply to cash payments made by a registered investment adviser, where such payments are made to a solicitor solely to compensate such solicitor for soliciting investors for a pooled investment vehicle managed by the investment adviser A copy of the Risk Alert is available here.

© 2019 Winston & Strawn LLP

SEC Charges EtherDelta Founder with Operating an Unregistered Exchange
On November 8, 2018, the SEC announced settled charges against the founder of a digital "token" trading platform, EtherDelta. According to the SEC order, the founder caused EtherDelta to operate as an unregistered national securities exchange. According to the SEC order, EtherDelta is an online platform for secondary market trading of ERC20 tokens, a type of blockchain-based token commonly issued in Initial Coin Offerings, and although EtherDelta operated as an "exchange," it was not registered as such with the SEC, was not excluded from the definition of "exchange" under the Securities Exchange Act and did not qualify for an exemption from registration as an exchange by virtue of operating as an "alternative trading system". The SEC's order does not provide any analysis of why the digital tokens traded on the EtherDelta platform constituted securities. The SEC's order is available here.

Three-Division Joint Public Statement on Offers, Sales and Trading of Digital Assets Securities
On November 16, 2018, the SEC's Division of Corporation Finance, Division of Investment Management and Division of Trading and Markets released a joint statement highlighting the recent enforcement actions surrounding the application of long standing federal securities laws to the offer, sale and trading of digital assets. In this public statement, the three SEC Divisions discussed certain of the SEC's recent enforcement actions involving digital assets in order to emphasize that all market participants must adhere to well-established securities laws. The issues covered generally fall into three categories: (i) initial offers and sales of digital assets; (ii) investment vehicles investing in digital asset securities and those advising others about investing in such securities; and (iii) secondary market trading of digital asset securities. While the Divisions supported the development and innovation of beneficial technologies, they recommended that those employing new technologies consult legal counsel regarding the application of federal securities laws. A copy of the joint statement is available here.

Two ICO Issuers Settle SEC Registration Charges for Failing to Register Digital Tokens as Securities
On November 16, 2018, the SEC announced settled charges against two companies that sold digital tokens in initial coin offerings ("ICOs"). According to the SEC orders, both companies raised millions from ICOs, yet neither registered their ICOs pursuant to federal securities laws, nor did they qualify for an exemption from registration requirements. According to the Co-Director of the SEC's Enforcement Division, "companies that issue securities through ICOs are required to comply with existing statutes and rules governing the registration of securities", and these actions signal that those "considering taking similar actions that we continue to be on the lookout for violations of the federal securities laws with respect to digital assets." Both companies were required to return funds to harmed investors, pay civil penalties and register their tokens under the Securities Exchange Act, with the result that each will become a public reporting company under its settlement with the SEC. These are the SEC's first cases imposing civil penalties solely for ICO securities offering registration violations. The SEC's press release is available here.

SEC Issues Cease-and-Desist Against Crypto Fund Manager
On December 7, 2018, the SEC brought an enforcement action against an investment adviser for violating the registration provisions of Section 5 of the Securities Act by causing its digital asset fund to offer and sell limited partnership interests in transactions that were not registered under the Securities Act and that did not qualify for an exemption from such registration. The SEC order did not allege that the digital asset fund operated a unregistered investment company, although the digital asset fund invested in a portfolio of "digital assets." The investment adviser agreed with the SEC to cease and desist from committing or causing any violations and any future violations of Sections 5(a) and 5(c) of the Securities Act, and to pay a civil money penalty in the amount of $50,000. The SEC's order is available here.

Risk Alert: Observations from Investment Adviser Examinations Relating to Electronic Messaging
On December 14, 2018, the SEC's Office of Compliance Inspections and Examinations published a Risk Alert to remind advisers of their obligations under the Advisers Act and the rules and regulations thereunder in connection with permitting their personnel to use electronic messaging for business purposes and to help improve policies and procedures to ensure compliance with the Advisers Act. The staff highlighted best practices for advisers to ensure compliance. Some of the examples of best practices

include placing restrictions on certain forms of electronic communication, requiring personnel to complete adequate training, implementing procedures to monitor social media posts, emails or websites, and requiring employees to obtain approval to access firm email servers or other business applications from personal devices. Overall, the staff encouraged advisers to review their policies and procedures with the goal of improving their compliance with their regulatory requirements. The Risk Alert is available here.

SEC Proposes Rule Changes for Fund of Funds Arrangements

On December 19, 2018, the SEC issued a release proposing a new rule (together with proposed amendments to existing related rules) to streamline the regulation of fund of funds arrangements. The proposal would permit a fund to acquire another fund's shares in excess of limits set out in the Investment Company Act without the need to request or obtain an exemptive order from the SEC. A fund that seeks to rely on the new rule would be required to comply with conditions designed to enhance investor protection, including conditions restricting the funds' ability to improperly influence other funds, charge excessive fees, or create overly complex fund of funds structures. As the proposed rule is designed to serve as a comprehensive rule governing fund of fund arrangements, the SEC is also proposing to rescind existing Rule 12d1-2 along with most outstanding exemptive orders that permit fund of funds arrangements. A copy of the release is available here.

SEC Issues No-Action Letter to Madison Capital Funding LLC

On December 20, 2018, the SEC staff responded to a letter sent by Winston & Strawn LLP on behalf of Madison Capital Funding LLC ("Madison") requesting assurance that the Division of Investment Management would not recommend enforcement action under Section 206(4) of the Advisers Act and the Custody Rule thereunder.

Madison provides senior loans to middle-market companies. For most of those loans, Madison organizes and acts as administrative agent to the loan syndicates. In addition, Madison is a registered investment adviser, advising private funds and institutional separate accounts. A single bank account held at a qualified custodian (as defined in the Custody Rule) in Madison's name as agent for the loan syndicates, was used to facilitate the transfer of cash among the lenders and the borrowers of all loan syndicates. The account contained commingled assets of Madison's advisory clients, as well as of third parties. Madison had control over the account, and was authorized to withdraw funds as an agent of the loan syndicates. On its face, this arrangement would appear to violate Section 206(4) of the Advisers Act and the Custody Rule.

In the no-action letter, the SEC staff asserted that it would not recommend enforcement action against Madison under these circumstances, subject to a number of conditions, including, but not limited to, the account being held with a qualified custodian and containing only loan syndicate assets; no cash being transferred, except pursuant to the loan syndicates' credit agreements; that Madison act as an agent to the loan syndicates; and that Madison make appropriate Form ADV disclosures and develop controls and obtain an internal control report by an independent public accountant.

A copy of the no-action letter is available here.

.

© 2019 Winston & Strawn LLP

Appendix C – OCIE National Exam Program Examination Priorities for 2019

On December 20, 2018, OCIE released its annual list of examination priorities for 2019. Investment Managers would be well advised to take these priorities into consideration when designing or updating their supervisory and compliance programs as useful indicators of areas of special focus that may present a higher enforcement risk. As has been true for several years now, OCIE is continuing its focus on issues relating to retail investors, risks specific to elderly and retiring investors, and cybersecurity. Newly added to this year's priority list is a focus on digital assets.

Of course, these priorities are not exhaustive and OCIE's examinations are likely to focus on many areas beyond them. Moreover, OCIE continues to characterize its examination selection process and scope determinations as a risk-based approach that provides it with sufficient flexibility to allow for coverage of emerging and exigent risks as they arise.

Retail Investors, Including Senior Investors and Retirement Investments

Areas of particular focus related to retail investors include:

1. Fees and Expenses. Areas of concern include proper disclosure of fees and expenses and whether fees and expenses are accurately calculated and charged in accordance with relevant disclosures and agreements. With respect to mutual fund share classes, OCIE will continue to evaluate financial incentives that may influence the selection of particular, i.e., more expensive, share classes. With respect to wrap fee programs, OCIE will continue to review the adequacy of disclosures and brokerage practices.

2. Conflicts of Interest. Areas of concern include (i) the use by advisers of affiliated service providers and products, which can present conflicts related to portfolio management practices and compensation arrangements; (ii) securities-backed non-purpose loans and lines of credit; and (iii) borrowing from clients. As with fees and expenses, OCIE intends to review whether registrants have adequately disclosed all conflicts as well as any associated risks.

3. Senior Investors and Retirement Accounts and Products. Investment adviser examinations will continue to cover the services and products offered to seniors and those saving for retirement. OCIE examinations will continue to focus on the appropriateness of investment recommendations to seniors and supervision and compliance programs related thereto.

4. Portfolio Management and Trading. Areas of review will include execution practices, the allocation of investment opportunities among clients, whether investments are consistent with client objectives, and the adequacy of disclosures to clients. Examinations will also consider investment adviser portfolio recommendations to assess whether investment or trading strategies are (i) suitable and in the client's best interest based upon investment objectives and risk tolerance, (ii) consistent with investor disclosures, (iii) accompanied by adequate risk disclosures, and (iv) appropriately monitored for risk.

Other Areas of Focus

1. Never-Before or Not Recently-Examined Investment Advisers. OCIE will continue to conduct risk-based examinations of newly-registered advisers as well as those that have never been examined and will prioritize examinations of advisers that have grown substantially or changed business models since they were last examined.

2. Mutual Funds and Exchange Traded Funds. Because mutual funds and exchange traded funds ("ETFs") are the primary investment vehicle for many retail investors, OCIE will continue to prioritize examinations of these funds. This will include a focus on the activities of their advisers and board oversight practices as well as industry practices and regulatory compliance in areas that may significantly impact retail investors. Particular areas of focus will include (i) risks associated with funds that track bespoke indexes, (ii) ETFs with little secondary market trading volume and smaller assets under management, (iii) funds with higher allocations to certain presumably risky securitized assets, (iv) funds with aberrational underperformance relative to peer groups, (v) funds managed by advisers that are new to managing registered investment companies, and (vi) advisers that provide advice to both RICs and private funds with similar investment strategies.

Digital Assets

New to this year's priority list, OCIE intends to identify market participants offering, selling, trading, and managing digital assets. For firms engaged in the digital asset market, OCIE intends to conduct examinations focused on portfolio management of digital assets, trading, safety of client funds and assets, pricing of client portfolios, compliance, and internal controls.

Cybersecurity

OCIE intends to continue to prioritize cybersecurity across its examination programs. This will include a focus on proper configuration of network storage devices, information securities governance generally, and policies and procedures related to retail trading information security. OCIE also intends to emphasize cybersecurity practices at investment advisers with multiple branch offices, including those that have recently merged with other investment advisers, and to continue to focus on governance and risk assessment, access rights and controls, data loss prevention, vendor management, training, and incident response.

© 2019 Winston & Strawn LLP

Ongoing Plan and Participant Level Disclosures.

i. **Disclosures of service provider compensation**.

The DOL's final regulations requiring written disclosure of compensation and other information by covered service providers to ERISA-governed retirement plans or ERISA-governed funds continue to apply for both existing and new contracts or arrangements between covered plans and covered service providers. These regulations are commonly referred to as the DOL's "408(b)(2)" or "service provider" regulations.

Briefly, covered service providers include those providing fiduciary services directly to an ERISA plan or to a "plan assets" entity (such as a group trust or private investment fund exceeding the 25% "significant participation" test) and those providing investment advisory services directly to a plan, among others. The 408(b)(2) regulations generally require disclosure of all compensation paid to the covered service provider, its affiliates, and/or its sub-contractors.

Disclosure of all compensation includes non-monetary compensation, as well as indirect compensation received from parties other than the plan or plan sponsor. These disclosures must be provided before a contract or arrangement with an ERISA plan takes effect, is extended, or is renewed (and when the disclosed information changes). ERISA plan fiduciaries are required to report to the DOL the failure of covered service providers to provide disclosure no later than 90 days after the ERISA plan fiduciary requests the disclosure. If the covered service provider fails to meet the 90-day deadline, the ERISA plan fiduciary is required to determine whether to terminate or continue the contract or arrangement, and if the failure to disclose relates to future services, the plan fiduciary must terminate the service arrangement as expeditiously as possible. Noncompliant covered service providers may be subject to penalties.

In 2014, the DOL proposed an amendment to the 408(b)(2) regulations that would require covered service providers to furnish a guide with initial disclosures if the initial disclosures are contained in multiple or lengthy documents. The summary guide would comprise a separate document and would specifically identify where each required disclosure would be found in the other document(s) so that the responsible plan fiduciary would be able to quickly and easily find the information. Although the proposal engendered much discussion, the regulation has not been finalized and covered service providers are under no current obligation to provide a guide.

The 408(b)(2) regulations do not apply to funds that satisfy the 25% significant participation test (i.e., funds with "benefit plan investor" participation of less than 25%) or to funds qualifying as "operating companies," such as venture capital operating companies or real estate operating companies. If a fund that was not previously a plan-assets entity becomes one, fiduciaries to that fund must make the required disclosures within 30 days from the date on which the fiduciary knows that the fund is a plan-assets entity.

ii. **Ongoing disclosures to plan participants in ERISA-governed participant-directed plans.**

ERISA plan administrators are required to provide to participant-directed, individual account investors under 401(k) or other defined contribution plans certain investment fee and expense information, among other information under regulations commonly referred to as the DOL's "404(a)" regulations. Many, if not most, plan administrators look to their service providers for much of the required information. A plan administrator will not be liable for the completeness and accuracy of information provided by a plan service provider if the plan administrator relies on that information reasonably and in good faith. Investment Managers who provide products or services to 401(k) or other defined-contribution plans may wish to periodically re-evaluate the manner in which they have provided this information, particularly in response to any questions raised by plan clients.

The regulations require disclosure of certain information about the plan's investment options in a comparative chart format so that all investment

© 2019 Winston & Strawn LLP

options under the plan can be compared in an "apples-to-apples" manner.

CFTC-related considerations for ERISA plans.
Under the Dodd-Frank Act, ERISA-governed retirement plans are not excluded from the CFTC's definition of "major swap participant," although the regulation does exclude swaps "maintained by employee benefit plans for hedging or mitigating risks in the operation of the plan" from certain of the numerical tests proposed to determine "major swap participant" status.

Under the CFTC's business conduct rules, plans are categorized as "special entities" with respect to which a swap dealer may have heightened duties. To avoid these duties, a "swap dealer" (other than a swap dealer also acting as an advisor to an ERISA plan counterparty) must have a reasonable basis to believe that the ERISA plan counterparty has a representative that is an ERISA fiduciary. The rules also include a safe harbor that provides that a swap dealer will not be acting as an advisor to an ERISA plan counterparty if the ERISA plan counterparty represents in writing that it has an ERISA fiduciary to evaluate the swap transactions and the ERISA fiduciary represents in writing that it will not rely on the swap dealer's recommendations, among other representations. The International Swaps and Derivatives Association's industry-wide standard protocol (specifically, the ISDA August 2012 DF Protocol) includes representations and covenants for special entities designed to assist swap dealers in meeting the safe harbor.

Update on the Trilantic Case.
Previously, we reported that in September 2017, Trilantic Capital Partners ("Trilantic") filed a complaint in the Southern District of New York seeking a declaratory judgment that they are not jointly and severally liable for withdrawal liability of their portfolio company, citing that they are not part of a "trade or business" under "common control" as set forth in ERISA. The court has not yet reached a decision on Trilantic's complaint, but Investment Managers should continue to carefully consider the structure and nature of their portfolio company investments to assess any potential exposure for pension-withdrawal liability.

Update on Proxy Voting Guidance.
Under ERISA, an Investment Manager for a plan (including an Investment Manager of a pooled fund) may be delegated the duty for proxy voting and exercising shareholder rights. Over the years, the DOL has issued guidance on proxy voting for ERISA plan fiduciaries, including Interpretive Bulletin 94-2 ("IB 94-2") and Interpretive Bulletin 2008-2 ("IB 2008-2"), which replaced IB 94-2. In December 2016, the DOL issued Interpretive Bulletin 2016-1 ("IB 2016-1"), which withdrew the guidance issued under IB 2008-2 and reinstated the guidance originally issued under IB 94-2, with certain minor modifications. The DOL stated that it was concerned that IB 2008-2 had been interpreted too restrictively, so as to prohibit ERISA plans from exercising shareholder rights, including voting of proxies, unless the plan performed a cost-benefit analysis and determined that such voting would have a "quantifiable increase on the economic value of the plan's investment." In IB 2016-1, the DOL acknowledged that while the economic interests of participants and beneficiaries may not be subordinated to unrelated objectives in voting proxies or exercising other shareholder rights, in some cases there may be a reasonable expectation of enhancing the value of a plan's investment through activities intended to monitor or influence the management of corporations in which the plan holds stock (after taking into consideration the costs involved). The DOL noted that such reasonable expectations may exist, for example, if such corporate stock is held as a long-term investment. Such active monitoring and communication activities may include a variety of issues, including but not limited to issues relating to the independence and expertise of candidates for the corporation's board of directors; governance structures and practices, including those involving board composition, executive compensation, transparency, and accountability in corporate decision-making; responsiveness to shareholders; the corporation's policy regarding mergers and acquisitions; the extent of debt financing and capitalization; the nature of long-term business plans, including plans on climate change; governance and compliance policies and practices for avoiding criminal liability; policies and practices to address environmental and social factors that have an impact on shareholder value; and other financial and non-financial measures of corporate performance.

On April 23, 2018, the DOL issued Field Assistance Bulletin 2018-01 ("FAB 2018-01") providing further guidance regarding proxy voting and shareholder engagement and

© 2019 Winston & Strawn LLP

clarifying earlier interpretations set forth in IB 2016-01. It is increasingly common for Investment Managers to include proxy voting and shareholder engagement guidelines in their investment policy statements. FAB 2018-01 clarifies that IB 2016-01 should be read in the context of the DOL's understanding that proxy voting and other shareholder engagement typically does not involve a significant expenditure of funds by individual plan investors because the activities are generally undertaken by institutional Investment Managers that are appointed as the responsible ERISA plan fiduciary.

Such managers often engage consultants and proxy advisory firms to further reduce individual plan costs of researching proxy matters and exercising shareholder rights. The DOL cautions that IB 2016-01 was not intended to signal that it is appropriate for an individual plan investor to routinely incur significant expenses to engage in direct negotiations with the board or management of publicly held companies with respect to which the plan is just one of many investors. Additionally, IB 2016-01 was not meant to imply that Investment Managers should routinely incur significant plan expenses to, for example, fund advocacy, press, or mailing campaigns on shareholder resolutions, call special shareholder meetings, or initiate or actively sponsor proxy fights on environmental or social issues relating to such companies.

© 2019 Winston & Strawn LLP