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WHITE PAPER

January 2017

U.S. Regulatory Action Items for Investment Advisers (2017)

For investment advisers (registered, exempt reporting, and unregistered), there are myriad recurring obligations and undertakings to keep in mind. As a reminder, we have listed some of them below.

- Part I—describes requirements and practices that may be relevant for any investment adviser, whether registered, filing as an exempt reporting adviser, or unregistered.
- Part II—includes obligations for registered investment advisers.
- Part III—describes some of the obligations of exempt reporting advisers (i.e., those relying on the "private fund adviser exemption" or the "venture capital fund adviser exemption").
- Part IV—reviews certain tax considerations that may be relevant for any investment adviser.

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PART I: ANNUAL OBLIGATIONS AND UNDERTAKINGS POTENTIALLY APPLICABLE TO ANY INVESTMENT ADVISER

Review of and Update to Offering Materials

To ensure compliance with federal and state securities laws (anti-fraud laws in particular), it is a good practice for an investment adviser to periodically review and update the offering documents for its funds that are currently being offered.

In the context of private investment funds, among the types of changes for which an investment adviser may want to consider whether an update is necessary are any modifications that may have occurred (or are being considered) to the description of the fund's investment strategy, instruments in which the fund may invest, service providers to the fund, risk factors related to market conditions, conflicts of interest, and applicable legal, tax, and regulatory matters.

Sometimes, the cases brought by the SEC and speeches by its Staff can provide useful reminders about disclosure topics that may require updating. Here are some from 2015 and 2016: (i) the allocations of broken-deal expenses to co-investors[1]; (ii) the acceleration of future monitoring fees[2]; (iii) the charging of an adviser's operating expenses to fund clients[3]; (iv) the use of the term "market rates" in the context of portfolio-level service fees[4]; (v) fee discounts to investment advisers from vendors that provide services to the adviser and its client funds[5]; (vi) the charging of investment adviser employee compensation to client fund portfolio companies[6]; and (vii) the extent of due diligence conducted on investments.[7]

It would be good practice for each investment adviser to review its practices and fund disclosure documents in the context of the above scenarios to ensure that its disclosure accurately reflects its actual practices.

TIP: If relevant to the offering of a private fund that you manage, make sure that your subscription documents reflect the Dodd-Frank-based adjustments to the accredited investor and qualified client standards, and that you have included any necessary "bad actor" representations in both your subscription documents and placement agent agreement(s). (See "Bad Actor Rule" below for further information.)

"Bad Actor" Rule

Under the "bad actor rule," a fund is not permitted to engage in Rule 506 private securities offerings if the fund (including beneficial owners of 20 percent or more of the fund's outstanding voting equity, directors, certain officers, and affiliated companies or other persons, including the fund's investment adviser and placement agent) had a so-called "disqualifying event." Although violations adjudicated before September 23, 2013, do not result in disqualification from Rule 506, those violations are subject to mandatory disclosure.

See Jones Day's July 2013 *Commentary*, "SEC Approves New Rules Regarding General Solicitation in Certain Private Offerings and Adopts 'Bad Actor' Provisions," for further information regarding the bad actor rules.

TIP: Make sure that your placement agent agreements for Rule 506 offerings contain "bad actor" representations and that you conduct the requisite due diligence on the entities (e.g., placement agent and investment adviser) and personnel at those entities covered by the rule so as to enable the fund to avail itself of the "reasonable care exception."

The SEC has provided guidance about a significant number of issues under the bad actor rule, such as the level of diligence that must be undertaken by an issuer with respect to the bad actor rules, including in the context of placement agents and employees of an investment adviser as well as with respect to ongoing offerings. For example, the following are useful resources to consult: (i) the SEC's adopting release for the bad actor rule; and (ii) the Division of Corporation Finance Compliance and Disclosure Interpretations beginning at Question 260.14.

Lobbyist Registration Requirements

Any investment adviser that solicits monies from public pension plans may be required to make filings in certain jurisdictions under those jurisdictions' lobbying laws. Many jurisdictions require annual (e.g., New York City) or biannual (e.g., California) registration of lobbyists and lobbyist agents.

TIP: Investment advisers should be aware that the definition of "lobbyist" in a jurisdiction (such as a state, city, or municipality) in which they—or their agents—solicit public pension plans as clients or investors may have been revised to explicitly

include placement agents (which in turn may trigger a registration requirement). It is helpful to review the relevant laws and regulations regarding lobbyist registration requirements rather than just the lobbying registration forms, as those forms may not contain the most up-to-date information regarding registration requirements.

Whistleblower Rule Compliance

In 2011, the SEC adopted Rule 21F-17 under the U.S. Securities Exchange Act of 1934, as amended ("Exchange Act"), which provides that "no person may take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement … with respect to such communications." The SEC has since brought various enforcement actions charging violations of Rule 21F-17.[8] In an October 2016 risk alert, the SEC noted that its Staff is examining registered investment advisers and registered broker-dealers, "reviewing, among other things, compliance manuals, codes of ethics, employment agreements, and severance agreements to determine whether provisions in those documents pertaining to confidentiality of information and reporting of possible securities law violations may raise concerns under Rule 21F-17."

TIP: All agreements with employees, and former employees, should be reviewed to ensure that those agreements do not contain the types of provisions referenced in the October 2016 risk alert as violating or potentially violating Rule 21F-17 (e.g., provisions that purport to limit the types of information that an employee may convey to the SEC or require departing employees to waive their rights to any individual monetary recovery in connection with reporting information to the SEC).

Form D Filings

Annual electronic Form D renewal filings for each issuer of securities in a continuous offering is required by the SEC and certain states.[9]

TIP: A mandatory capital commitment call for a private fund does not constitute a new offering but is deemed to have been made as part of the original offering, so no new Form D filing is required.

If a continuous offering has in fact been terminated, in order to reflect that fact, an investment adviser may want to consider filing a final amended Form D with the SEC and with those states that require notification that sales will no longer be made in that state.

Blue Sky and World Sky Laws

Many countries and U.S. states have requirements for filings in respect of private offerings of interests in investment funds.

TIP: Investment advisers should make sure that they have maintained and updated a record of the state and country of residence of each fund investor and that any required blue sky and world sky filings have been made.

TIP: Many blue sky filings must be renewed on a periodic basis (e.g., annually).[10]

Notification to CFA Institute for Use of GIPS

If your firm claims Global Investment Performance Standards ("GIPS") certification, then it will be required to provide a report to the CFA Institute by no later than June 30, 2017. The information required to be provided generally includes the name of the investment adviser, contact details, whether the firm has been verified within the past 24 months, and whether the firm would like to be hosted on the GIPS website.

TIP: The CFA Institute will make available on its website the form to be used for providing the report to the CFA Institute. In addition, the CFA Institute has included an FAQ on its website that provides guidance on a variety of topics.

CFTC—Annual Reaffirmation of CPO/CTA Exemptions

Persons claiming an exemption or exclusion from registration as a commodity pool operator ("CPO") or a commodity trading advisor ("CTA"), 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), must annually affirm their eligibility within 60 days of the calendar year end. Failure to affirm will result in automatic withdrawal of the exemption or exclusion, meaning that you become subject to all applicable CPO or CTA compliance requirements even if you still qualify for the relevant exemption or exclusion.

TIP: The deadline for affirming an exemption or exclusion is March 1, 2017.

TIP: You may affirm your exemption or exclusion by accessing the National Futures Association's Exemption System.

Schedules 13D and 13G

Schedule 13D filings must be amended "promptly" upon the occurrence of any "material changes."

Schedule 13G filings must be updated within 45 days of the end of each calendar year (i.e., February 14), to report any change to any of the information reported in the previous filing (except that no update is necessary to reflect a change in the holder's percentage ownership due solely to a change in the number of outstanding shares).

TIP: Consider whether you may be subject to any reporting obligations, or potential short-swing profit liability, under Section 16 of the Exchange Act.

Form 13F

Institutional investment advisers with investment discretion over $100 million of certain equity securities ("Section 13(f) securities") must file quarterly reports on Form 13F (within 45 days of the end of each calendar quarter). The next quarterly filing deadline is February 14, 2017.

TIP: The official list of current and past Section 13(f) securities is available on the SEC's website.

Form 13H

Annual amendments for "large traders" (persons effecting transactions in certain securities in amounts equal to two million shares or $20 million in one calendar day or 20 million shares or $200 million in one calendar month) are due within 45 days of the end of each calendar year (the next quarterly filing deadline is February 14, 2017).

TIP: If any of the information contained in a Form 13H filing becomes inaccurate for any reason, a large trader must make an amended filing no later than the end of the calendar quarter in which the information became stale. If a large trader files an amended Form 13H to reflect changes that occurred during the fourth calendar quarter, the large trader is still required to file the mandatory annual updated Form 13H.

New Issues Certifications

If a fund is permitted by its investment objectives to purchase "new issues," its broker (or, for funds of funds that invest in funds investing in new issues, the underlying fund(s)) will likely request that the fund complete an annual certification (certifying whether the fund is a "restricted person" under Rule 5130 and/or Rule 5131 adopted by the Financial Industry Regulatory Authority ("FINRA")). In order to complete that certification, the investment adviser to that fund will need to confirm that there has been no change to the status of its investors (i.e., as "restricted" or "unrestricted").

TIP: Make sure that any new issues questionnaire in the subscription documents for the funds that you manage requires representations from investors as to their respective statuses under Rules 5130 and 5131. Be aware that if you fail to respond to a request for annual certification, the broker or underlying fund may deem you to have represented that you are a restricted person under Rules 5130 and 5131.

Department of Commerce Mandatory Foreign Direct Investment Survey—Form BE-13

The U.S. Department of Commerce Bureau of Economic Analysis requires a filing (Form BE-13) in the context of all forms of foreign direct investments in the United States where a foreign entity, or the U.S. affiliate of a foreign entity, acquires, merges with, expands, or establishes a U.S. business. There are exemptions for transactions that do not meet certain thresholds; however, a claim for exemption from filing the complete report must still be filed if the transaction results in direct or indirect foreign ownership of greater than 10 percent of the U.S. business.

TIP: For more information about the requirement to complete and file the Form BE-13, see Jones Day's February 2015 Commentary on the topic, "Department of Commerce Mandatory Foreign Direct Investment Survey BE-13: Information Collection Related to Direct or Indirect Foreign Investment in the United States."

PART II: ANNUAL OBLIGATIONS FOR REGISTERED INVESTMENT ADVISERS

Annual Form ADV Update

Each registered investment adviser is required to update its Form ADV (Parts 1 and 2A) within 90 days of the end of its fiscal year. In 2017, this deadline is March 31 for advisers with December 31 fiscal year-ends.

Unlike the Form ADV Part 2A ("brochure"), the Form ADV Part 2B ("brochure supplement") is not required to be filed with the

SEC or delivered annually to clients (however, the brochure supplement must be updated and delivered to clients should there be material changes to any disciplinary information).

TIP: You should ensure that your IARD account is adequately funded (generally $225 for registered investment advisers, plus any additional amount(s) for newly required state notice filings[11]) well in advance of the filing deadline.

Annual Delivery of Form ADV Part 2

A registered investment adviser must, within 120 days of the end of its fiscal year, deliver to each client either (i) a free updated brochure that either includes a summary of material changes 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.[12]

TIP: You should review your compliance manual to confirm whether it requires you to take the approach in (i) or (ii) above and whether, in respect of any private investment funds that you advise, you must make such an annual delivery only to your "clients" (e.g., the private investment funds that you advise) or also to the investors in those funds.

Form PF

Investment advisers to "hedge funds," "private equity funds," and/or "liquidity funds" (as those terms are defined in Form PF) that had at least $150 million in fund assets under management as of the last day of their most recently completed fiscal year are required to file a Form PF. The frequency and the timing of the Form PF filings are based on the type of funds managed by the investment adviser, the amount of the investment adviser's assets under management in those funds, and the date of the investment adviser's fiscal year-end.

See Jones Day's November 2011 *Commentary*, "SEC Adopts New Risk Reporting Requirements for Certain Registered Investment Advisers to Private Funds (Form PF)," for further information regarding Form PF.

TIP: Many private investment funds that may not typically be considered "hedge funds" (for example, real estate funds) may actually qualify as "hedge funds" under the Form PF definition of "hedge fund" depending upon their level and type of borrowing and short selling. (See the Form PF (page 57) for the definition of a "hedge fund.")

Compliance Review

Registered investment advisers are required to annually perform and document an annual review of their compliance policies and procedures to ascertain their effectiveness under the Advisers Act.

TIP: Review any revisions that have been made to your compliance policies and procedures to determine if they should be reflected in your Form ADV Part 2 and/or offering documents. Also, make sure to review more recent SEC guidance regarding issues that could affect your policies and procedures (for example, the SEC's June 2015 guidance on personal securities transactions reports, the SEC's September 2015 risk alert on cybersecurity, and the SEC's March 2014 guidance on testimonials and social media).

Distribution of Privacy Policy, Proxy Notice, and Code of Ethics

Subject to certain exclusions, each registered investment adviser must annually distribute its privacy policy,[13] its current code of ethics (if distribution is required by the investment adviser's compliance manual), and information as to how to obtain proxy vote records.

TIP: You should refer to your compliance manual to determine who must receive this information/documentation (for example, whether it requires you to distribute your annual privacy notice to all investors or just natural person investors).

Distribution of Annual Audited Financial Statements

If an investment adviser uses the audited financial statement exception to the surprise examination requirements under the Custody Rule in respect of the private funds that it manages (and those funds have December 31 fiscal year-ends), the investment adviser should mark June 29 (for fund of funds) or April 30 (for all other funds) on its compliance calendar as the deadline for distributing 2017 fiscal year audited financial statements to fund investors.

TIP: If you take advantage of the audited financial statement exception, make sure that you satisfy all requirements of

that exception, such as the requirement that the accountant performing the annual audit of the fund be registered with and subject to regular inspection by the Public Company Accounting Oversight Board. For further information on the audited financial statement exception (and the Custody Rule generally), please refer to the SEC's FAQ on the Custody Rule.

PART III: ANNUAL OBLIGATIONS FOR EXEMPT REPORTING ADVISERS

Annual Form ADV Update

Each exempt reporting adviser is required to update its Form ADV Part 1 within 90 days of the end of its fiscal year. In 2017, this deadline is March 31 for advisers with December 31 fiscal year-ends.

TIP: You should ensure that your IARD account is adequately funded ($150 for exempt reporting advisers, plus any additional amount(s) for newly required state notice filings) well in advance of the filing deadline.

TIP: If you are an exempt reporting adviser to a private fund(s) that relies on the "under $150 million" exemption and you report in your annual updating amendment that you have $150 million or more of private fund assets under management, you are no longer eligible for the private fund adviser exemption (and must register with the SEC within 90 days after filing your annual updating amendment, unless another exemption from registration is available).[14]

PART IV: TAXATION

FBAR Filing Requirements for Investment Advisers

Officers and employees of investment advisers who during any year had signature authority or other authority over non-U.S. financial accounts held by private investment funds controlled by such investment advisers must file, by June 30 of the following year, information relating to such accounts with FINCEN utilizing FinCEN Form 114 (the so-called "FBAR form").

TIP: Registered investment advisers who manage offshore accounts should examine their FBAR filing obligations, and should also visit the FinCEN website to obtain more information and, in some cases, to pre-register in order to be eligible to file FBAR forms electronically. There generally are no extensions to the June 30 filing deadlines for FBAR forms, and potentially significant penalties can apply for failures to timely file. Accordingly, investment advisers should address these requirements as early as possible in 2017 so as to avoid last-minute glitches or complications.

Self-Employment Tax Controversy for Fund Managers

Over the years, many hedge fund management companies have been formed as state law limited partnerships. The sole reason for this structure is an arcane provision of the tax code that since 1977 has exempted most types of distributive shares of a "limited partner" from being subject to federal self-employment taxes. Following a Tax Court decision from a few years ago (*Renkemeyer v. Commissioner* (2011)), the IRS in September 2014 issued a memorandum (ILM 201436049) stating its position that hedge fund managers cannot avoid the self-employment taxes in this manner. The IRS's rationale is based largely on legislative history (cited in the *Renkemeyer* decision) that generally states that the limited partner exemption was meant for truly "passive" partners and that "Congress did not intend to allow service partners in a service partnership acting in the manner of self-employed persons to avoid paying self-employment tax." Practitioners thus far seem to be divided on the question of whether the IRS is correct in its position, with some taking the view that the literal language of the statute exempting "limited partners" should prevail despite any legislative history.

TIP: The upcoming year is likely to see increased IRS audits of hedge fund managers' self-employment tax positions. Renewed focus has been placed on these taxes in the context of hedge fund managers, not just because of the IRS's activities, but also because of the recent enactment as part of the Affordable Care Act of an additional 3.8 percent tax on "net investment income" of individuals with earnings above certain thresholds. Thus, 2017 is good time for hedge fund managers to re-examine their exposure to self-employment taxes and/or the 3.8 percent tax on net investment income. Limited partnership structures for hedge fund management companies may still have some viability in certain contexts, as could other structures as well, such as "S" corporations.

IRS Memo Concludes that Offshore Hedge Fund Was Subject to U.S. Income Taxation Based on "Lending" and "Underwriting" Activities

The IRS has in recently shown an increased attention in examining offshore hedge funds that are engaged in lending activities. For example, in 2015, the IRS released a Chief Counsel Advice memo (CCA 201501013) in which it was concluded that an offshore hedge fund was engaged in a trade or business within the United States (and thus is subject to U.S. income taxation) based on its lending and stock underwriting activities. Although an offshore hedge fund's activities of trading in stocks and securities are generally not considered to be a trade or business for U.S. tax purposes (the so-called "trading safe harbor"), the IRS in this memo held that the fund in question did not qualify for the trading safe harbor based on the following activities (all of which were undertaken by the fund's U.S.-based management company): performing loan due diligence on prospective borrowers; negotiating terms of loans directly with potential borrowers; originating loans with borrowers; and actively soliciting potential new borrowers and receiving fees for these activities. The fund also was engaged (again, through its U.S.-based management company) in various underwriting activities that were also held to fall outside the trading safe harbor.

TIP: Given that the fund involved in this IRS memo was actively engaged in soliciting, negotiating, and originating a large number of loans directly with borrowers, the IRS's conclusion in this memo is not surprising. However, it does indicate an increased interest on the part of the IRS in examining these types of transactions by offshore funds (also see below regarding an expected increase in the number of IRS audits of investment partnerships generally). This also coincides with an increased appetite on the part of offshore hedge funds to engage in direct loan origination activities in search of additional yields. Thus, the coming year is likely to see increased attention on traditional structures utilized in the marketplace to mitigate to U.S. tax exposure for these transactions, including the use of "blocker" entities and so-called "season and sell" strategies, pursuant to which an separate, onshore entity originates the loans and, after some period of time, sells the loans to the offshore investment fund.

New U.S. Federal Tax Procedures for IRS Audits of Partnerships

In November 2015, President Obama signed into law the Bipartisan Budget Act of 2015 ("BBA"). Effective for tax years beginning on or after January 1, 2018, the BBA significantly revises the manner in which the IRS will audit tax returns filed by entities classified for tax purposes as "partnerships." Since many private investment fund vehicles are established as entities that are treated as partnerships for tax purposes, these new rules will undoubtedly affect these vehicles. These rules represent a complete overhaul of the manner in which the IRS may audit, and collect resulting tax adjustments from, entities that are treated as partnerships for U.S. tax purposes. Most notably, these new rules, for the first time ever, will allow the IRS (for tax years being on or after January 1, 2018) to collect any underpayment of U.S. federal income tax (including penalties and interest thereon) owed by the partners as a result of an audit of the partnership directly from the partnership. As such, those persons who are partners at the time the audit is finalized will bear the economic burden of such underpayment even though the underpayment relates to a prior year. However, these new rules do provide an elective mechanism by which a partnership (with certain trade-offs) may shift back the responsibility for the payment of any underpaid amounts to those persons who were partners in the year to which the audit relates.

TIP: Because it will now be much easier and simpler for the IRS to conduct audits of partnerships and collect resulting taxes (i.e., the IRS now may only have to collect from one party—the partnership—rather than having to pursue many partners for collection), it should be expected that the rate at which the IRS conducts federal income audits of all partnerships, including private investment vehicles, will increase significantly beginning in 2018. Also, all existing investment funds that are classified as partnerships for U.S. tax purposes should review their partnership agreements for needed updates, to potentially include contractual provisions regarding not only the conduct of such partnership-level audits but also the manner in which the partners will share such resulting obligations. Thus, many partnership agreements likely will now require detailed indemnity/reimbursement agreements whereby all partners (and former partners) agree to indemnify or reimburse the partnership and other partners for their allocable shares of these obligations.

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ENDNOTES

1 *In the Matter of KKR*, IA Release No. 4131 (6/29/15); discussed in Andrew Ceresney, Director, SEC's Division of Enforcement, "Private Equity Enforcement," Speech for Securities Enforcement Forum West 2016 (5/12/16).

2 *In the Matter of Apollo Management V, LP*, IA Release No. 4493 (8/23/16).

3 *In the Matter of Clean Energy Capital LLC and Scott A. Brittenham*, IA Release No. 3955 (10/17/14); discussed in Julie M. Riewe, Co-Chief, SEC's Asset Management Unit, Division of Enforcement, "Conflicts, Conflicts Everywhere," Speech at the IA Watch 17th Annual IA Compliance Conference: The Full 360 View (2/26/15).

4 Mark Wyatt, Acting Director, OCIE, "Private Equity: A Look Back and a Glimpse Ahead," Speech for Private Equity International (5/13/15).

5 *In the Matter of Blackstone Management Partners L.L.C.*, IA Release No. 4219 (10/7/15).

6 *In the Matter of Blackstreet Capital Management, LLC*, IA Release No. 4411 (6/1/16).

7 *In the Matter of Total Wealth Management Inc.*—SEC Order (4/15/14) and ALJ Initial Decision (8/17/15).

8 *See, e.g.*, *In the Matter of BlackRock, Inc.*, Release No. 34-79804 (January 17, 2017).

9 Form D must also be amended (for any offering) to correct a material mistake of fact or error in the previously filed notice and, subject to certain exceptions, to reflect a change in the information provided in the previously filed notice.

10 *See* footnote 11 with respect to state notice filing renewals for the adviser itself.

11 The state notice filings are made through an investment adviser's IARD renewal account.

12 Advisers may deliver their brochures electronically—*see* SEC interpretive guidance on delivering documents electronically.

13 The exclusions from the annual distribution of privacy policies include where the financial institution: (i) does not share nonpublic personal information with nonaffiliated third parties (other than as permitted under certain enumerated exceptions, e.g., to service providers who perform services on behalf of the financial institution, or as necessary to administer a transaction requested or authorized by an individual); and (ii) has not changed its privacy policies and practices from the policies and practices that were disclosed in the most recent privacy notice sent to individuals. *See* CFPB, "Amendment to the Annual Privacy Notice Requirement Under the Gramm-Leach-Bliley Act (Regulation P)."

14 If your private fund assets under management meet or exceed $150 million during your fiscal year, you are not required to register with the SEC during that fiscal year. There is no transition period for: (i) exempt reporting advisers that are no longer able to rely on the "venture capital adviser" exemption; (ii) exempt reporting advisers to private funds that rely on the "under $150 million" exemption and that accept a client that is not a private fund; or (iii) exempt report advisers that have not complied with all of their reporting requirements under the "under $150 million" exemption.

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