Client Alert

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CURRENT ISSUES RELEVANT TO OUR CLIENTS JANUARY 18, 2013

Annual Investment Adviser Compliance and Regulatory Review

The beginning of each year provides an opportunity for investment advisers to review annual compliance and regulatory matters, including issues related to private investment funds and commodity pools. This alert briefly summarizes some of the primary issues that advisers might consider in their 2013 annual review and update processes. *Many of these issues apply to unregistered advisers as well as registered advisers.*

Registration and Disclosure Issues

Form ADV Annual Update. Investment advisers registered with the Securities and Exchange Commission (the "*SEC*") are required to amend their Form ADV each year within 90 days after the end of their fiscal year electronically on the IARD system. Before filing the amendment, the filer's IARD account must be funded with an amount sufficient to cover the IARD filing fees for investment adviser registration. For investment advisers registered with the SEC, for amendments filed from January 1, 2013 through December 31, 2013, the applicable fees are: $40 for advisers with assets under management below $25 million; $150 for advisers with assets under management of at least $25 million but less than $100 million; and $225 for advisers with assets under management of $100 million or more.

Form ADV Part 1. Part 1 of Form ADV was amended in 2011, in part to align with the new eligibility requirements and exemptions under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "*Dodd-Frank Act*"). Form ADV now includes instructions to the Form to implement a uniform method of calculating assets under management ("*AUM*"). Rule 203A-3 was amended to require that the calculation of "assets under management" for purposes of Section 203A be the calculation of the securities portfolios with respect to which an investment adviser provides continuous and regular supervisory or management services regardless of whether these assets are proprietary assets, assets managed without receiving compensation, or assets of foreign clients. Form ADV generally defines "securities portfolio" to include an account that has at least 50 percent of its total value represented by "securities" with cash and cash equivalents treated as "securities" solely for this purpose. Form ADV now eliminates adviser discretion in including (or excluding) these assets from the AUM calculation, which effectively gave certain advisers the ability to opt into or out of state or federal regulation. The current rules differentiate the definition of "regulatory assets under management" in Part 1A of Form ADV from the amount of AUM disclosed to clients in Part 2 of Form ADV (which do not necessarily need to meet Section 203A requirements). Form ADV now requires advisers to provide information on Form ADV about: (i) private funds advised by the adviser; (ii) the adviser's employees, clients, and advisory activities; and (iii) other business activities and financial industry affiliations of the adviser.

Annual Filing and Delivery Requirements for Form ADV Part 2. All advisers registered with the SEC are required to file an updated Form ADV Part 2A (the "*brochure*") annually as part of their Form ADV filing. Form ADV Part 2B (the "*supplement*") should be updated annually and maintained in a firm's files. Both the brochure and supplement should generally be delivered to new and prospective clients before or at the time of entering into an advisory contract. The brochure must also be delivered to existing clients within 60 days of filing. After the initial delivery, advisers may provide to each client a summary of material changes, an offer to provide a copy of the updated brochure and supplement, and information on how a client may obtain the brochure and supplement instead of providing a copy of the updated brochure and supplement. Such a summary would need to be filed on IARD as an exhibit to the brochure as part of the annual updating amendment. It has been a customary practice of many advisers to private investment funds to make an offer or actual delivery of the brochure and supplement to investors in private investment funds managed by the adviser. Advisers should consider delivering the entire brochure and supplement to investors in private investment funds managed by the adviser.

Form ADV Ongoing Updates. In addition to the annual update to Form ADV, SEC-registered advisers must amend Part 1 of their Form ADV promptly during the year if (a) any information provided in response to Item 1, 3, 9 (except 9.A.(2), 9.B.(2) and 9.F) or 11 of Part 1A or items 1, 2.A. through 2.F or 2.I of Part 1B becomes inaccurate in any way or (b) any information provided in response to Item 4, 8 or 10 (including Schedules A and B) of Part 1A or Item 2.G of Part 1.B become materially inaccurate. The brochure and supplement must be updated promptly during the year if any information becomes materially inaccurate except if the material inaccuracies are solely the result of changes in the amount of client assets managed or because the fee schedule has changed.

State Filings. In states where an investment adviser has clients or a place of business, SEC-registered advisers may have notice filing and fee obligations in addition to the federal filing and fee obligations. Advisers typically receive instructions for making such filings and fee payments through the IARD system during the fall. While certain states require only an update and filing of the Form ADV, other states may require the filing of other documents (including the brochure and/or brochure supplement) in addition to their separate fees. Links to the applicable state regulations are available through the North American Securities Administrators Association's website at http://www.nasaa.org.

State Registration of Investment Adviser Representatives. In each state where a representative of an SEC-registered adviser has clients or a place of business, the adviser may be required to make applicable state registrations of such representative. Investment advisers should review all personnel and determine: (a) in which states such personnel have clients or a place of businesses and (b) whether such personnel should be registered as investment adviser representatives in those states. Where applicable, those investment adviser representatives should be registered in the appropriate states.

Registration Requirements for Certain Special Purpose Vehicles of Investment Advisers. In January 2012 in response to a request by the American Bar Association, Business Law Section, the staff of the SEC provided its views on various issues regarding registration requirements for certain investment advisers that are related to investment advisers that are registered with the SEC. In particular, the SEC staff confirmed that, subject to certain conditions, it would not recommend enforcement action to the SEC under Section 203(a) or 208(d) of the Investment Advisers Act of 1940 (the "*Advisers Act*") against a registered adviser or a related special purpose vehicle ("*SPV*") established to act as the general partner or managing member of a private fund managed by the registered adviser if the SPV does not separately register as an investment adviser. While the SEC staff previously commented on this issue in a letter addressed to the American Bar Associations Subcommittee on Private Investment Entities in 2005, the SEC staff clarified certain of these views in light of recent amendments to the Advisers Act pursuant to the Dodd-Frank Act. For more information about the SEC letters including the specific conditions please see our client alert available at http://www.chapman.com/media/news/media.1142.pdf.

Review of Policies and Procedures

Code of Ethics. SEC-registered investment advisers are required to adopt a code of ethics that establishes a standard of conduct in accordance with the adviser's fiduciary duties and that requires that supervised persons comply with the federal securities laws including restrictions on insider trading. SEC-registered investment advisers must review their code of ethics annually for sufficiency and evaluate current business practices for consistency with the code of ethics. In completing this review and evaluation, the adviser should modify the code of ethics as necessary and develop training and/or policies to increase the effectiveness of its implementation.

Pursuant to the applicable code of ethics, certain supervised persons may be required to report current securities holdings to the investment adviser's chief compliance officer upon becoming an "access person" and at least once during each 12-month period thereafter along with making quarterly reports of transactions. Additionally, the applicable code of ethics may require (or, if not, advisers should consider adding a policy requiring) that all employees attest to acknowledgement, receipt and continued compliance with the code of ethics annually. The code of ethics must be provided to any client or potential client upon request. Regardless of whether an entity is registered with the SEC, maintaining and regularly reviewing a code of ethics is an advisable practice.

Compliance Policies and Procedures. SEC-registered advisers must complete a review of their compliance policies and procedures annually, document such review, require their employees to certify their compliance with all policies and procedures annually and modify the policies and procedures as necessary to ensure their effectiveness. The review should address any compliance matters that arose in the last year, any new participation or withdrawal in activities by the company, changes to applicable law and any other developments that may impact the appropriateness of current policies and procedures.

To assist hedge fund managers in their updates of policies and procedures, the Managed Fund Association has published "Sound Practices for Hedge Fund Managers" which provides updates on valuation, risk management, responsibilities to investors, framework of internal policies, practices and controls and may provide considerable assistance in updating internal policies and procedures. The Asset Managers' Committee of the President's Working Group on Financial Markets and the Alternative Investment Management Association have also published guidelines for best compliance practices for fund managers.

Policies Relating to Use of Social Media. The SEC has suggested that SEC-registered investment advisers which use social media should adopt, and periodically review the effectiveness of, policies and procedures regarding social media as part of their obligations related to compliance policies and procedures. Use of social media must comply with the antifraud provisions of the securities laws as well as the compliance and recordkeeping provisions of the Advisers Act. The SEC completed a review of several registered investment advisers of varying sizes and strategies which use social media and in 2012 issued a Risk Alert to highlight certain observations and suggestions that may be helpful to advisers when reviewing compliance policies. For more information please see our client alert available at http://www.chapman.com/media/news/media.1132.pdf.

Business Continuity and Disaster Recovery Plans. All advisers should review and test business continuity and disaster recover plans at least annually.

Notice of Privacy Policy. The SEC, Commodity Futures Trading Commission (the "*CFTC*") and/or Federal Trade Commission ("*FTC*") regulations governing the privacy of consumer financial information (the "*Privacy Regulations*") require every investment adviser and fund domiciled in the U.S. or having U.S. clients or investors, commodity pool operators ("*CPOs*") and commodity trading advisors ("*CTAs*") to establish policies and procedures to protect the confidentiality of clients and investor records. Such policies and procedures should be reviewed annually and updated according to privacy laws and regulations. Annual notice must be given to each client or investor who is an individual disclosing the types of non-public personal information that the adviser, fund, CPO or CTA collects and the extent of disclosure. Notice of privacy policies and procedures is required under the Privacy Regulations and must be delivered to clients or investors at least once during any twelve-month period. The notice may be provided along with other information so the beginning of the year is generally a good time for delivery (e.g. along with a bill or annual report). The Privacy Regulations were amended in 2009 and now include a model privacy notice form. Persons subject to the Privacy Regulations are provided a safe harbor for the privacy notice delivery requirement if they deliver a privacy notice that conforms to the model privacy notice form. Such safe harbors provided under the sample clauses employed in many current privacy notices expired for notices posted or delivered on or after January 1, 2011. Covered persons must convert to the new model privacy notice form to take advantage of the safe harbor protection. After providing a notice to such client or investor, you may not disclose any non-public information about clients or investors other than as described in the notice without first giving notice to the client or investor describing the proposed disclosure. Parties should obtain legal consultation before obtaining consumer credit reports on clients or sharing investor information with anyone including affiliated entities.

Proxy Voting Policy. SEC-registered investment advisers are required to adopt policies and procedures on proxy voting designed to ensure that securities are voted in accordance with the best interest of their clients and that material conflicts of interest are addressed. Advisory clients must be given a description of such policies, a copy of such policies upon request and informed as to how they can obtain a list of such proxy votes relating to such client's securities.

Anti-Money Laundering ("AML") Policy. AML policies and procedures are recommended and should be maintained, updated periodically and adhered to. Additionally, compliance programs should be reviewed to ensure compliance with the economic sanctions programs administered by the Office of Foreign Assets Control ("*OFAC*"). Maintaining an effective AML program may be considered as a positive factor in assessing penalties for a violation of OFAC regulations.

During remarks in 2012 at the American Bankers Association/American Bar Association Money Laundering Enforcement Conference, the Director of the Treasury Department's Financial Crimes Enforcement Network ("*FinCEN*"), James H. Freis Jr., announced that the Treasury Department was working on a regulatory proposal that would require investment advisers to establish AML programs and report suspicious activity. Current FinCEN regulations apply to banks, broker-dealers, and open-end mutual funds, but not to investment advisers. If FinCEN ultimately adopts rules requiring investment advisers to establish AML programs, investment advisers (who have not already done so) will likely be required to adopt written policies and procedures reasonably designed to comply with Bank Secrecy Act regulations and to detect and report suspicious transactions (including customer identification requirements). These rules would also likely require that investment advisers appoint an AML compliance officer, provide AML training for personnel, and annual testing of the AML program. For more information please see our client alert available at http://www.chapman.com/media/news/media.1125.pdf.

Other Selected State and Federal Filing Issues

SEC Form D and State Blue Sky Filing Requirements. Form D is required to be filed with the SEC by all issuers that sell securities in reliance on Regulation D under the Securities Act of 1933 ("*Securities Act*"). This includes interests in hedge funds, private equity funds or other privately-offered pooled investment vehicles. Form D must be amended on or before the anniversary of the issuer's filing if the offering is continuing at that time. Form D must also be amended to correct any material mistake or error along with certain other changes. Form D and amendments thereto must be filed with the SEC using its electronic filing system. Additionally, Form D and some combination of a Form U-2 and filing fee are generally required to be filed in states where a fund sells interests to U.S. persons. Certain states require the filing of additional disclosure documents while other states may have additional blue sky filing requirements (and exemptions thereto). These requirements should be evaluated and fulfilled as needed prior to offering or selling any interests in a fund to U.S. investors in any new states to ensure compliance.

Form 13H "Large Trader" Reporting Obligations. "Large traders" meeting certain definitional thresholds in transactions in NMS securities are required to identify themselves to the SEC and make certain disclosures to the SEC on Form 13H. In addition to an initial filing, all large traders must submit an annual filing on Form 13H within 45 days after the end of the calendar year and submit any amendments promptly after the end of any calendar quarter where information in the form becomes materially inaccurate. Upon receiving Form 13H, the SEC will (or in the case of large traders who have already filed, may have already) assign large traders an identification number (an "LTID"). Large traders are required to provide their LTIDs to all registered broker-dealers carrying its accounts and/or effecting transactions in NMS securities on their behalf. Registered broker-dealers are required to maintain certain records in connection with such transactions and provide such information to the SEC upon request if they (1) are large traders, (2) carry accounts of large traders or (3) effect transactions in NMS securities on behalf of large traders. All registered-broker dealers are also required to perform monitoring of accounts to identify potential large traders that have not identified themselves to the SEC.

Schedule 13D and 13G and Form 13F Filings. Persons (individuals or entities) with the right to exercise investment discretion or voting power over five percent or more of any class of outstanding equity securities of a public U.S. company may be required to file Schedule 13D or Schedule 13G with the SEC. The eligibility, filing thresholds, amendment requirements and timing requirements for each such Schedule varies and persons should review the requirements if they have or are about to cross such threshold with respect to any security. If a person, whether or not a registered adviser, exercised investment discretion over $100 million or more invested in "13(f) securities" (as included on the list published by the SEC) as of the last day of any calendar month, those holdings must be reported to the SEC by filing a Form 13F. Such reports must be filed for year-end holdings for the first year this occurs and quarterly thereafter. Such reports must be filed quarterly within 45 days after the relevant reporting date.

Section 16 Filings. Persons (individuals or entities) that hold a beneficial ownership of ten percent of any class of equity securities registered under Section 12 of the Securities Exchange Act of 1934 (the "*Exchange Act*"), if the person is an officer or director of such issuer, may be required to file Form 3, 4 or 5 regarding crossing certain thresholds, reporting certain sales and making certain annual reports.

Form PF. On October 31, 2011, the SEC and CFTC adopted reporting rules under the Advisers Act and Commodity Exchange Act. The SEC rule requires investment advisers registered with the SEC that advise one or more private funds and have at least $150 million in private fund assets under management to file Form PF with the SEC. The CFTC rule requires commodity pool operators and commodity trading advisors registered with the CFTC to satisfy certain CFTC filing requirements with respect to private funds by filing Form PF with the SEC, but only if those CPOs and CTAs are also registered with the SEC as investment advisers and are required to file Form PF under the Advisers Act. The CFTC rule also allows such CPOs and CTAs to satisfy certain CFTC filing requirements with respect to commodity pools that are not private funds by filing Form PF with the SEC. Advisers must file Form PF electronically, on a confidential basis. Under the reporting requirements, private fund advisers are divided by size into two broad groups: large advisers and smaller advisers. Large private fund advisers include any adviser with $1.5 billion or more in hedge fund assets under management, $1 billion in liquidity fund or registered money market fund assets under management, or $2 billion in private equity fund assets under management. Large private fund advisers must file Form PF on a quarterly basis and must provide more detailed information than smaller advisers. Smaller private fund advisers must file Form PF only once a year within 120 days of the end of the fiscal year, and report only basic information regarding the private funds they advise (starting with fiscal years ending on or after December 15, 2012).

Form SLT and Form SHC. In 2011, the Department of Treasury adopted Form SLT designed to gather information on cross-border ownership of long-term securities by U.S. foreign residents for use in forming U.S. international financial and monetary policies. The form is required to be filed by all U.S. individuals or entities who qualify as U.S. resident custodians, issuers and/or end-investors and whose consolidated long-term reportable securities exceed $1 billion as of the last business days of the reporting month. Where the securities are held by a U.S.-resident custodian, the Form SLT would be due from the custodian and not from the beneficial owner of the securities. Form SLT is required to be filed based on a reporting date of the last business day of each quarter and as of the last business day of each month in which the $1 billion threshold is exceed and monthly thereafter. The form must be submitted no later than 23rd calendar day of the month following the applicable reporting date. Advisers should review whether they have any reporting obligations with respect to Form SLT with respect to any accounts where they act as adviser and/or custodian.

Hart-Scott-Rodino Filings. Parties to certain transactions (including purchases of publicly traded securities) that meet certain thresholds to file premerger notification forms with the FTC and Department of Justice Antitrust Division may be required to make filings under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "*HSR Act*"). If a fund is making an acquisition that would result in the ownership of voting securities or assets valued above the minimum threshold ($70.9 million for 2013) using the HSR Act's valuation mechanics, legal consultation should be obtained regarding the filing obligations or the availability of applicable exemptions.

FBAR Reporting. U.S. persons having financial interests in, or signatory or other authority over bank, securities or other financial accounts in a foreign country must file a Form TD F 90-22.1 (Report of Foreign Bank and Financial Accounts or "*FBAR*") reporting such relationship by June 30th of the year following that in which the relationship existed. Final regulations governing FBAR were promulgated in 2011. Under these regulations, financial accounts subject to FBAR include accounts with a mutual fund or similar pooled fund which issues shares available to the general public that have a regular net asset value determination and regular redemptions. The final regulations reserve on the treatment of "other investment funds," however, under guidance on the IRS website, hedge funds and private equity funds that do not issue shares to the general public do not fall within the scope of FBAR. The final regulations also provide exceptions to reporting for officers and employees of financial institutions, entities registered with and examined by the SEC that provide services to investment companies registered under the Investment Company Act of 1940 (the "*Investment Company Act*") and certain entities that have equity securities listed on any U.S. national securities exchange or registered under Section 12(g) of the Securities Act, in each case that have signature authority over, but not financial interests in, foreign financial accounts owned or maintained by such entity.

Annual NFA Registration Update. Registered CPOs and CTAs are required to update their National Futures Association ("*NFA*") registration information and pay annual NFA dues on or before the anniversary date the CPO's or CTA's registration became effective. As of the date due, failure to file the update will be deemed a request for withdrawal from registration which will be effective in 30 days after the failure to complete the update.

Annual Affirmation of Exclusions and Exemptions from CPO and CTA Registration. In addition to eliminating and narrowing certain key exemptions from registration for CPOs and CTAs, in 2012 the CFTC adopted rules requiring any person claiming an exemption or exclusion from registration 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) to annually affirm the applicable notice of exemption or exclusion within 60 days of the calendar year end. The first notice affirming these exemptions was due for the calendar year ending December 31, 2012. Failure to affirm an exemption or exclusion will be deemed as a request to withdraw the exemption or exclusion and result in the automatic withdrawal of the exemption or exclusion. These affirmations can be made through the NFAs website.

CPO and CTA Questionnaire. Registered CPOs and CTAs must complete and retain the NFA's "self-examination questionnaire" annually including any pools that have liquidated. This includes CPOs and CTAs that qualify for disclosure exemptions under CFTC Regulation 4.7. As part of this review, CPOs and CTAs should review compliance policies and procedures, confirm whether amendments to those procedures are necessary and determine whether additional procedures may be warranted in light of the occurrences of the previous year.

Commodity Pool Annual Reports. Registered CPOs are required to file annual reports with the NFA and distribute those reports to the pool's participants within 90 days of the pool's fiscal year end. This includes CPOs that qualify for disclosure exemptions under CFTC Regulation 4.7. Filing must be completed electronically through the NFA's EasyFile system. If a CPO that invests in other collective investment vehicles cannot obtain the required information to complete reports such CPO may file notice with the NFA to delay the filing for 90 days. Such notice shall continue to be effective in future years until the CPO files a certificate that it is no longer a fund of funds. Additionally, disclosure documents must be updated regularly as required by CFTC rules and may need to be filed with the CFTC and the NFA. Annual reports may be distributed in hard copy; however, a CPO must obtain a participant's consent prior to distributing the annual report in electronic format.

Selected CPO/CTA Compliance Considerations. At least annually, CPOs and CTAs must also test disaster recovery plans and adjust as necessary, deliver privacy policies to every current participant, provide ethics training as described in the CPO/CTA's written ethics training procedures and update disclosure documents.

Changes to the FINRA Entitlement Program. In 2010, Financial Industry Regulatory Authority, Inc. ("*FINRA*") began introducing changes to the FINRA Entitlement Program which provides access to investment advisers' IARD accounts. One change is that each adviser is required to designate an authorized employee or officer as the Super Account Administrator ("*SAA*") who is able to create, modify and delete account administrator and user accounts for FINRA applications used by the adviser. Additionally, the SAA can manage his or her own access to those FINRA applications. More information about the FINRA Entitlement Program along with information available to account administrators, system users and SAAs is available at http://www.finra.org /Industry/Compliance/Entitlement/.

Reporting for "Exempt Reporting Advisers". Dodd-Frank Act rules require certain reporting related to advisers relying on the venture capital fund and smaller private fund adviser exemptions ("*exempt reporting advisers*"). As a result, exempt reporting advisers, although not registered, are required to amend their Form ADV each year within 90 days after the end of their fiscal year electronically on the IARD system and pay a filing fee of $150. Exempt reporting advisers are only required to provide information relating to certain items in Form ADV.

Specified Foreign Financial Assets. U.S. citizens and residents are required to file Form 8938 under U.S. Internal Revenue Code Section 6038D to report an interest in a "foreign financial asset" if the aggregate value of all such assets exceeds certain threshold. Nonresident aliens are also required to file if they make an election to be treated as a resident alien for purposes of filing a joint income tax return or if they are a bona fide resident of American Samoa or Puerto Rico. A reportable foreign financial asset for this purpose includes financial (deposit and custodial) accounts held at foreign financial institutions, foreign stock or securities not held in a financial account, foreign partnership interests, foreign mutual funds, foreign hedge funds and foreign private equity funds. An "interest" exists when any income, gain, loss, deduction, credit, gross proceeds, or distribution from holding or disposing of the account or asset would be required to be reported on an income tax return. The threshold for filing varies based on filing status and whether the individual lives within the United States. For example, an unmarried taxpayer living within the United States must file if the aggregate value of the foreign financial assets is more than $50,000 on the last day of the tax year or more than $75,000 at any time during the tax year. The initial penalty for failure to file is $10,000, plus $10,000 for each 30 days of non-filing after an IRS notice of failure to disclose, with a maximum penalty of $60,000.

Change of Address or Agent Filings. Upon moving office locations, amendments to an entity's certificates of limited partnership, articles of incorporation, articles of formation and all other documents on file with the applicable state of organization should be updated to ensure accuracy.

Other Issues

Addition of "Swaps" to the Definition of Commodity Pool and Elimination and Narrowing of Key Exemptions for CPOs and CTAs. As a result of Dodd-Frank Act amendments to the Commodity Exchange Act (the "*CEA*"), a person operating a pooled investment vehicle that trades "swaps" is now required to register as a CPO or otherwise will need to rely on some exclusion from the definition of CPO or exemption from registration and any person advising such a pooled investment vehicle with respect to swaps will be required to register as a CTA or otherwise claim an exemption from registration. The term "swap" is broadly defined under the CEA to include most over-the-counter derivatives other than "securities-based swaps".

In addition to the expansion of the definitions of CPO and CTA to include "swap" activity, in 2012 the CFTC proposed a number of amendments to the CFTC rules relating to exclusions from the definition and exemptions from registration available to CPOs and CTAs. The CFTC also changed and proposed certain other rules to disclosure and certification obligations. Among the changes to the exclusions and exemptions were the addition of certain trading and marketing restrictions for the Rule 4.5 exclusion from the definition of CPO for registered investment companies and the elimination of the Rule 4.13(a)(4) exemption (generally available to operators of certain private funds that were offered only to sophisticated investors).

Operators or advisers to funds that trade "swaps" (with that term defined broadly to include most over-the-counter derivative contracts), futures or commodity interests should review their activities and the updated list of exclusions and exemptions to determine whether they now fall within the definition of CPO or CTA and whether they are eligible for an exclusion or exemption. The exclusions and exemptions are not self-executing and require a notice filing with the NFA. Those falling within the definition of CPO or CTA that are unable to rely on an exemption or exclusion from registration were required to apply with the NFA for registration on or before December 31, 2012. For more information and details about the changes to the available exemptions and exclusions, see our client alert available at http://www.chapman.com/media/news /media.1165.pdf.

Restricted New Issues. Members of FINRA are prohibited from selling "new issues" to any client unless such member receives a representation from the client within the past 12 months that the client is not a "restricted person" and restricted persons do not have more than a de minimis ownership interest in the client (e.g., a hedge fund) pursuant to FINRA Rule 5130. Investment advisers must reconfirm the "restricted person" status at least annually. This annual certification may be obtained through a negative consent letter.

Private Investment Funds. In addition to the foregoing, offering documents for any private investment fund should be updated at least annually to reflect any changes in the business or operations of the fund, such as changes in investment strategies, personnel, risks, performance data, annual financial information, soft dollar arrangement and other brokerage practices and tax and legal matters. If registered investment companies are owners of a fund, such registered investment companies should be reviewed at least annually to determine if such funds are "affiliated persons" under the Investment Company Act (e.g., if they own five percent or more of the fund). Exceptions from the definition of "investment company" under section 3(c)(1) of the Investment Company Act should be reviewed on an ongoing basis to confirm that investors do not exceed the 100 beneficial owner limit for section 3(c)(1) purposes (including the application of look-through rules for certain corporations, partnerships, trusts, funds and other companies) for section 3(c)(1) purposes. The Dodd-Frank Act and resultant rulemaking has significantly impacted advisers to "private funds," including changes to the registration, reporting and recordkeeping requirements.

FACTA Witholding. Part of the Hiring Incentives to Restore Employment Act (the "HIRE Act") passed into law in 2010 was the introduction of a 30 percent withholding on payments to non-U.S. entities. This is generally referred to as The Fair and Accurate Credit Transactions Act ("FACTA") withholding. FACTA withholding has two major parts:

- *Payments to foreign financial institutions ("FFIs")*: Payments to FFIs will be subject to withholding unless the FFI enters into an agreement with the IRS to determine whether the entity has any direct or indirect U.S. account holders. The agreement will also obligate FFIs to withhold on pass thru payments made by the FFI.

- *Payments to non-financial foreign entities ("NFFEs"):* Payments to NFFEs will be subject to the new withholding unless the NFFE certifies that it has no direct or indirect U.S. owners of more than 10 percent of the NFFE's equity (or provides information about those that it has).

Most offshore funds will likely be treated as FFIs and subject to these rules unless further guidance is issued exempting them from the provision. Through a series of notices and proposed regulations, the IRS has delayed the implementation of FACTA. Assuming the final rules are consistent with the guidance to date, in general, the new withholding applies to payments after December 31, 2013. The new rules apply to dispositions and pass thru payments after December 31, 2016. Final regulations are expected to be released shortly. For more information about FACTA withholding including the delays and effective dates associated with certain provisions please see our client alerts available at:

http://www.chapman.com/media/news/media.1045.pdf,

http://www.chapman.com/media/news/media.1047.pdf, and

http://www.chapman.com/media/news/media.1154.pdf.

Annual Audit Requirement. SEC registered advisers deemed to have custody of client assets are generally required to contract with an independent public accountant for an annual surprise audit to verify client assets. SEC registered advisers to hedge funds and other pooled investment vehicles are generally exempt from the annual surprise audit requirements if financial statements prepared in accordance with U.S. generally accepted accounting principals and audited by an independent public accountant are delivered to investors within 120 days after the end of the funds' fiscal year (180 days in the case of funds of funds). Advisers relying on this exemption should ensure that financial statements are delivered to investors in the form and at the time required.

Liability Insurance. Given the environment of investor lawsuits and increasing focus on the regulation of fund managers, investment advisers should regularly review the adequacy of all their insurance coverage. The annual review is a good time to consider obtaining management liability insurance or review your existing coverage.

ERISA Review. Investment advisers to private funds should consider whether they need to reconfirm whether any of the investors in their funds are "benefit plan investors" under the Employee Retirement Income Security Act of 1974, as amended ("ERISA") and whether investments by benefit plan investors result in fund assets being characterized as "plan assets" for purposes of ERISA and the Internal Revenue Code of 1986, as amended (the "Code"). In particular, advisers should review benefit plan investors' investments in investment funds managed by the adviser to determine whether participation in the fund by "benefit plans" is "significant" (i.e. whether it qualifies for the 25% "significant participation" exemption under ERISA). This may be particularly important where a significant amount of assets have recently been withdrawn or redeemed.

"Pay-to-Play" Practices. On June 30, 2010, the SEC adopted to measures intended to prevent "pay-to-play" practices by investment advisers seeking to manage funds for state and local governments. The rules aim to prevent investment advisers from making campaign contributions and related payments to elected officials in order to influence the awarding of lucrative contracts for the management of public pension plan assets and similar government investment accounts. The new rules prohibit an investment adviser from providing advisory services for compensation (either directly or through a pooled investment vehicle) for two years if the advisers or certain of its executives or employees make a political contribution to an elected official who is in a position to influence the selection of the adviser. The new rules also prohibit an advisory firm and certain executives and employees from soliciting or coordinating campaign contributions from others for elected officials (or to political parties in the state or locality where the adviser is seeking business) in a position to influence the selection of the adviser. The new rules also prohibit an adviser from paying a third party to solicit government clients on behalf of the adviser unless such party is an SEC-registered investment adviser or broker-dealer subject to similar restrictions. In 2011, the SEC adopted amendments to the pay-to-play rules which 1) synchronized the rules with the results of the Dodd-Frank Act by extending the application to exempt reporting advisers and exempt foreign private advisers, 2) added registered municipal advisors as a type of "regulated person" that may be compensated by covered investment advisers for soliciting state or local government entities provided that they are subject to restrictions at least as stringent as the "pay-to-play" rules and 3) extended the date by which covered investment advisers must comply with the ban on third-party solicitation to June 13, 2012. This June 13, 2012 deadline was subsequently extended to nine months from the compliance date of a final rule adopted by the SEC by which municipal advisor firms must register under the Exchange Act.

JOBS Act. On April 5, 2012, the Jumpstart Our Business Startups Act *(the "JOBS Act")* was signed into law which, among other things, directed the SEC to remove prohibitions on general solicitations and general advertising for certain private securities offerings. For more information on the JOBS Act please see our client alert available at http://www.chapman.com /media/news/media.1171.pdf.

As directed, in August the SEC proposed rules which, if adopted, would permit the use of general solicitation and advertising to offer and sell securities under Rule 506 of Regulation D under the Securities Act provided that the issuer takes reasonable steps to verify that the purchasers of the securities are accredited investors and all other terms and conditions of Regulation D are satisfied. In its proposal the SEC made clear that, if the rules are adopted, general solicitation and advertising pursuant to the proposed changes to rule 506 would not be deemed a public offering under the federal securities laws and private funds relying on Section 3(c)(1) or 3(c)(7) of the Investment Company Act would not lose their status as private funds if they were to engage in such general solicitation or advertising.

Advisers and sponsors of private funds relying on CFTC Rules 4.7(b) and 4.13(a)(3) will need to wait for additional guidance as to how general solicitations or advertising would impact the availability of those provisions. While these rules regarding general solicitations and advertising have been proposed they have not yet been adopted. All registered investment advisers will still be subject to applicable advertising regulations under the Advisers Act. You should continue to monitor developments in the SEC rulemaking process and, if adopted, reassess subscription and offering documents. For more information about the SEC rule proposals please see our client alert available at http://www.chapman.com/media/news/media.1206.pdf.

If you would like to discuss any of the issues discussed in this Client Alert, please contact any attorney in our Investment Management Group or visit us online at chapman.com.