Chapman and Cutler LLP

Chapman Client Alert

January 9, 2017

Current Issues Relevant to Our Clients

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 2017 annual review and update processes.

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 Investment Adviser Registration Depository ("*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, 2017 through December 31, 2017, the applicable fees are: $40 for advisers with regulatory assets under management below $25 million; $150 for advisers with regulatory assets under management of at least $25 million but less than $100 million; and $225 for advisers with regulatory assets under management of $100 million or more.

Exempt Reporting Advisers. The Investment Advisers Act of 1940 (the "*Advisers Act*") and SEC rules generally provide exemptions from SEC registration for, among other things, (1) advisers that act as an investment adviser solely to venture capital funds and (2) advisers that act as an investment adviser solely to private funds with regulatory assets under management in the United States of less than $150 million. The Advisers Act and SEC rules require certain initial and ongoing reporting on Form ADV for these "exempt reporting advisers." As a result, exempt reporting advisers, although not registered, are required to file Form ADV and amend their Form ADV each year within 90 days after the end of their fiscal year (or more frequently if required) 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.

Certain events may cause an adviser to no longer remain eligible for exempt reporting adviser status, which will trigger the requirement that the adviser register with the SEC. If a U.S.-based exempt reporting adviser relying on the smaller private fund adviser exemption has regulatory assets under management of $150 million or more, then the adviser will no longer qualify for the exemption and must apply for registration with the SEC within 90 days after the adviser filed its annual updating amendment. During this 90 day period the adviser may continue to advise its private fund clients, provided that the adviser does not accept a non-private fund client until its application for registration has been approved. In addition, if at any time an exempt reporting adviser relying on the smaller private fund adviser exemption accepts a non-private fund client, then the adviser will lose its ability to rely on the exemption immediately and must register with the SEC. Exempt reporting advisers relying on the small private fund adviser exemption who anticipate accepting a non-private fund client should register with the SEC before accepting such a client. Similarly, exempt reporting advisers relying on the venture capital fund exemption must register with the SEC before accepting a client that is not a venture capital fund unless another exemption would apply.

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 the IARD system 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), 9.E. 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 1B 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 here.

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.

Amendments to Form ADV, Reporting and Recordkeeping Obligations. In August 2016, the SEC adopted amendments to Form ADV and other changes to certain aspects of the reporting, disclosure and recordkeeping obligations of registered investment advisers. Among other things, the amendments to Form ADV require investment advisers to collect additional information regarding separately managed accounts and allow for private fund advisers operating a single advisory business through multiple entities to register using a single Form ADV. Among other things, the books and records changes will require advisers to maintain records supporting performance claims in communications that are distributed or circulated, regardless of the number of recipients. The compliance date of these changes is October 1, 2017. For most advisers, this means their first filing using the amended Form ADV will occur in 2018. For more information about the amendments, please see our Client Alert available here. The SEC also adopted disclosure and reporting changes for registered investment companies, which are summarized in our Client Alert available here.

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 supervised persons to 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. The Advisers Act also provides certain exceptions to the personal securities reporting requirements, including for securities holdings or transactions in trusts or accounts over which the access person had no direct or indirect influence or control. In June 2015, the SEC issued guidance regarding that exception described in our Client Alert available here. 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.

Policies Relating to Use of Social Media. The SEC has suggested that SEC-registered investment advisers that 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 that 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 about the Risk Alert, please see our Client Alert available here. In 2014, the SEC published additional guidance for advisers relating to third-party testimonials on social media sites, which is available here. In 2016, the SEC adopted changes to Form ADV that will require reporting of all of an adviser's websites, usage of websites for publicly available social media platforms, and all publicly available social media addresses where the adviser controls the content. Investment advisers should review their policies and practices regarding social media.

Business Continuity, Disaster Recovery and Transition Plans. All advisers should review and test business continuity and disaster recovery plans at least annually. In 2013, the SEC, the Commodity Futures Trading Commission (the "*CFTC*") and the Financial Industry Regulatory Authority, Inc. ("*FINRA*") issued a joint advisory regarding best practices for business continuity planning described in our Client Alert available here. The staff of the SEC has also noted that advisers should consider transition planning for potential challenges they may face in serving client needs while transferring their asset management services to another firm during an adviser's dissolution or during the departure of key personnel. In June of 2016, the SEC proposed a new rule and rule amendments that would require investment advisers to adopt and implement written business continuity and transition plans. These written plans would be required to address business continuity after a significant business disruption and business transition in the event an investment adviser is unable to continue providing investment advisory services to clients. The content of a business continuity and transition plan would need to be based upon risks associated with the adviser's operations and include policies and procedures designed to minimize material service disruptions. For more information about the proposals, please see our Client Alert available here.

Notice of Privacy Policy. The SEC, 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.

Under the Privacy Regulations, a person subject to the regulations must deliver initial notice to its customers of its privacy policies and practices. The Privacy Regulations 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. Advisers and certain other financial professionals no longer need to provide annual privacy notices to their clients subject to certain conditions. An adviser, fund, CPO or CTA does not need to comply with the annual notice requirement if: (i) it only shares non-public personal information with third-parties in a manner that does not require an opt-out right be provided to customers (*e.g.,* only in limited circumstances to service providers, for fraud detection and prevention purposes, etc.) and (ii) has not changed its policies and practices from those disclosed in the most recent disclosure provided to the customer. 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 information as to how they can obtain a list of such proxy votes relating to such client's securities. In 2014, the SEC's Division of Investment Management and Division of Corporate Finance jointly issued a Staff Legal Bulletin providing guidance on the proxy voting responsibilities of advisers available here. The guidance provides examples of how advisers can comply with their fiduciary duties to clients when voting proxies. The guidance also provides SEC staff interpretations of when voting a proxy is not required, the considerations an adviser should take into account when

selecting a proxy advisory firm and an adviser's ongoing duty to oversee any proxy advisory firm it retains. Investment advisers should periodically review their proxy voting policies.

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 a positive factor in assessing penalties for a violation of OFAC regulations. In September 2015, the Financial Crimes Enforcement Network (*"FinCEN"*) proposed rule changes requiring SEC-registered investment advisers to establish AML programs and report suspicious activity to FinCEN. If these rules are ultimately adopted, investment advisers would need to establish AML programs and adopt written policies and procedures reasonably designed to comply with Bank Secrecy Act regulations and to detect and report suspicious transactions. These rules would also require that investment advisers appoint an AML compliance officer, provide AML training for personnel and annually test their AML program. FinCEN has not yet proposed a customer identification program requirement for investment advisers, but anticipates addressing requirements via a joint rulemaking effort with the SEC. For more information on FinCEN's proposed rules, please see our Client Alert available here.

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 general, "NMS securities" include exchange-listed equity securities and standardized options, but do not include exchange-listed debt securities, securities futures, or shares of typical open-end mutual funds, which are not currently reported pursuant to an effective transaction reporting plan. 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 for the first time, the SEC will assign large traders an identification number (an "*LTID*"). Large traders are required to provide their LTIDs to all registered broker-dealers carrying their 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 more than 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, director or beneficial owner 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. 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 are required

to file Form PF with the SEC. The CFTC rule requires CPOs and CTAs 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. The SEC's Division of Investment Management maintains frequently asked questions, available here, regarding Form PF to address a variety of issues, including reported borrowings, reverse repos, fund categorization, parallel managed accounts, investments in other unregistered funds, and calculation of a fund's gross assets.

Treasury International Capital Reporting. The Department of the Treasury's Treasury International Capital ("*TIC*") Form SLT 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 day of the reporting month. The form is 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. Where the securities are held by a U.S.-resident custodian, 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 exceeded and monthly thereafter. The form must be submitted no later than 23rd calendar day of the month following the applicable reporting date. All Form SLTs must be submitted electronically using the Federal Reserve System's "Reporting Central" system, and forms submitted by fax or mail are no longer accepted. Advisers should review whether they have any reporting obligations with respect to Form SLT in connection with any accounts where they act as adviser and/or custodian. As a result of their responses on Form SLT, certain firms may be required to perform additional reporting on annual Forms SHCA and/or SHLA. Firms have no reporting obligations on Form SHCA or Form SHLA unless contacted individually by the Federal Reserve Bank of New York.

The Department of the Treasury now requires certain investment advisers to private funds with significant claims and/or liabilities with non-U.S. entities to report certain information on the TIC Form B series. Investment advisers to private funds are generally required to report on the Form B series if the claims or liabilities of the funds to which they serve as adviser are, on a consolidated basis, at least $25 million in any individual country or at least $50 million aggregated across all non-U.S. geographic areas. The specific forms required to be submitted depend on the types of claims or liabilities exceeding the reporting threshold amounts. The extent of information collected and frequency of reporting vary by form. More information about TIC reporting requirements can be found here.

Hart-Scott-Rodino Filings. Parties to certain transactions (including purchases of publicly traded securities) that meet certain thresholds are required to file premerger notification forms with the FTC and Department of Justice Antitrust Division and 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 (currently $78.2 million) using the HSR Act's valuation mechanics, legal consultation should be obtained regarding the filing obligations or the availability of applicable exemptions. The minimum threshold is adjusted on a yearly basis and will be adjusted in early 2017.

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 FinCEN Report 114 (Report of Foreign Bank and Financial Accounts or *"FBAR"*) reporting such relationship by April 15th of the year following that in which the relationship existed if the aggregate value of all foreign financial accounts exceeds $10,000 at any time during the calendar year. A maximum 6-month extension is also available to FBAR filers. FinCEN Report 114 may only be filed through the Treasury's e-filing system. 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 Internal Revenue Service (*"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 Exchange Act, in each case that have signature authority over, but not financial interests in, foreign financial accounts owned or maintained by such entity.

CPOs and CTAs. 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 of the 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. 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) is required to annually affirm the applicable notice of exemption or exclusion within 60 days of the calendar year end. 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 NFA's website.

Registered CPOs and CTAs must complete and retain the NFA's "self-examination questionnaire" annually including with respect to 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. 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. CPOs and CTAs are subject to certain quarterly and annual reporting requirements absent applicable exemptions. CPOs and CTAs should ensure that their compliance policies and procedures reflect applicable requirements and that applicable reporting to pool participants is being addressed as required.

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 thresholds. 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-day period of non-filing occurring 90 days after an IRS notice of failure to disclose, with a maximum total 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

SEC 2017 Examination Priorities. The SEC's Office of Compliance Inspections and Examinations ("*OCIE*") typically announces its Examination Priorities for each year in mid-January. The Examination Priorities will be available under "Priorities Memos" on OCIE's website. Investment advisers should review the Examination Priorities when available for insight on important SEC exam issues and to allow preparation in the event of an SEC exam in the current year.

Supervision Practices at Registered Investment Advisers. In September 2016, OCIE published a Risk Alert announcing that one of their examination priorities for 2016 would be examining compliance oversight and controls of registered investment advisers employing individuals with a history of disciplinary events, including individuals that have been disciplined or barred from a broker-dealer. The Risk Alert is available here. Firms should review their practices related to supervision of higher risk individuals in light of the Risk Alert.

Examining Whistleblower Rule Compliance. In October 2016, OCIE published a Risk Alert providing additional information concerning its review of investment adviser and broker-dealer compliance manuals, codes of ethics, employment agreements, and severance agreements to determine whether confidentiality and reporting provisions in those documents raise concerns under the SEC's

whistleblower regulations. The Risk Alert is available here. The reviews are intended to assess whether these documents contain provisions that OCIE believes violate whistleblower regulations. This includes provisions that purport to limit the types of information that an employee may convey to the SEC or other authorities and provisions that require departing employees to waive their rights to any individual monetary recovery in connection with reporting information to the government. This issue is especially relevant to confidentiality agreements and firm should consider reviewing any standard employee confidentiality agreements in light of the Risk Alert.

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 arrangements 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).

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 principles and audited by an independent public accountant are delivered to investors within 120 days after the end of a fund's 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 ("*ERISA*") and whether investments by benefit plan investors result in fund assets being characterized as "plan assets" for purposes of ERISA. 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.

Review of "Pay-to-Play" Practices. Under the Advisers Act, an adviser is prohibited from providing advisory services for compensation to a government entity (either directly or through a pooled investment vehicle) for two years if the adviser 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. Applicable rules further 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. Under the rules, advisers are prohibited from paying a third party to solicit government clients on behalf of the adviser unless such party is an SEC-registered investment adviser or a broker-dealer or municipal advisor subject to similar restrictions. In addition to applying to advisers registered under the Advisers Act, these rules apply to exempt reporting advisers and exempt foreign private advisers. The applicable Advisers Act rules prohibit an investment adviser from paying a FINRA member firm to solicit a government entity for investment advisory services unless the FINRA member firm is subject to an equivalent FINRA pay-to-play rule or otherwise meets the definition of a "regulated person" under the Advisers Act rule. In August of 2016, the SEC approved new FINRA pay-to-play rules to regulate FINRA members' distribution or solicitation activities with government entities on behalf of investment advisers. The rules are described in our Client Alert available here. In addition to approving the new FINRA rules, the SEC also issued orders finding that the new FINRA and Municipal Securities Rulemaking Board ("*MSRB*") pay-to-play rules impose "substantially equivalent or more stringent restrictions" than the SEC's as required by Advisers Act Rule 206(4)-5.

Advisers that currently or may in the future provide advisory services to a government entity should periodically review their current recordkeeping and other practices in light of the applicable restrictions.

Cybersecurity Initiative. OCIE continued to focus on investment adviser cybersecurity in 2016 with a second round of cybersecurity examinations focused on the examinees' governance and risk assessment processes, access rights and controls, data loss prevention, vendor management, training and incident response. In its Risk Alert related to the examinations, the staff provided a sample list of information requests to assist firms in evaluating their own cybersecurity preparedness. For more information on OCIE's cybersecurity examinations, please see our Client Alert available here. Cybersecurity will likely continue to remain a focus for firms in 2017.

Hyperlinks to BrokerCheck. In October 2015, the SEC approved a change to FINRA Rule 2210 which requires members to include a readily apparent reference and hyperlink to BrokerCheck on (i) the initial webpage that the member intends to be viewed by retail investors and (ii) any other webpage that includes a professional profile of one or more registered persons who conducts business with retail investors. The rule does not apply to a member that does not provide products or services to retail investors. It also does not apply to a directory or list of registered persons limited to names and contact information. The rule amendments became effective June 6, 2016.

Qualified Client Revisions. Effective as of August 15, 2016, the SEC adjusted the minimum net worth threshold for investment advisers to charge performance-based fees to clients or investors in 3(c)(1) private funds from $2 million to $2.1 million. The SEC did not increase the minimum dollar amount of the assets under management threshold. For more information on the revised Qualified Client test, please see our Client Alert available here.

SEC's OCIE Share Class Examination Initiative. In July of 2016, OCIE issued a Risk Alert announcing that it would be undertaking an examination initiative focused on registered advisers making conflicted recommendations to their clients. The Risk Alert is available here. OCIE indicated that it was seeking to identify conflicts of interest tied to advisers' compensation or financial incentives for recommending mutual funds and 529 Plan share classes that have substantial loads and/or distribution fees. OCIE staff indicated that it would focus its examination on adviser practices related to fiduciary duties and best execution, disclosures (*e.g.,* Form ADV), and compliance programs. For more information on the share class examination initiative, please see our Client Alert available here.

Department of Labor Fiduciary Advice and Conflict of Interest Rules. In April of 2016, the Department of Labor released its final rule to define the term "fiduciary" and address conflicts of interest in providing investment advice to retirement accounts along with related exemptions. The fiduciary rule generally requires anyone who provides investment advice to individual retirement accounts and ERISA covered employee benefit plans to abide by ERISA's fiduciary standards and prohibited transaction rules, subject to certain limited exceptions. For more information on the final rule, please see our Client Alert available here. Compliance with the new requirements is currently set for April 2017. The Department of Labor issued the first of a series of frequently asked questions on its new fiduciary rule in October 2016, which are available here.

For More Information

To discuss any topic covered in this Client Alert, please contact a member of the Investment Management Group or visit us online at chapman.com.

Chapman and Cutler LLP

Attorneys at Law · Focused on Finance®

This document has been prepared by Chapman and Cutler LLP attorneys for informational purposes only. It is general in nature and based on authorities that are subject to change. It is not intended as legal advice. Accordingly, readers should consult with, and seek the advice of, their own counsel with respect to any individual situation that involves the material contained in this document, the application of such material to their specific circumstances, or any questions relating to their own affairs that may be raised by such material.

To the extent that any part of this summary is interpreted to provide tax advice, (i) no taxpayer may rely upon this summary for the purposes of avoiding penalties, (ii) this summary may be interpreted for tax purposes as being prepared in connection with the promotion of the transactions described, and (iii) taxpayers should consult independent tax advisors.

© 2017 Chapman and Cutler LLP. All rights reserved. Attorney Advertising Material.