Schulte Roth & Zabel

Private Funds Regulatory UPDATE

Compliance Roundup

July 2020

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SEC Proposal to Substantially Reduce Form 13F Reporting Obligations

On July 10, 2020, the Securities and Exchange Commission proposed[1] increasing the reporting threshold that triggers the filing of a Form 13F from $100-million worth of "13(f) securities" (i.e., most U.S.-listed securities and a defined list of traded derivatives) to $3.5 billion. The $100-million threshold has not changed since Congress amended the Securities Exchange Act of 1934 in 1975 to add Section 13(f) (with the SEC promulgating the corresponding rules in 1978). The proposal would also direct the SEC staff to review the Form 13F reporting threshold every five years and, if appropriate, to recommend an appropriate adjustment to the Commission.

The proposal would also eliminate the ability of covered managers to omit small positions, which is currently permitted for holdings of fewer than 10,000 shares (or less than $200,000 principal amount of convertible debt securities) and less than $200,000 aggregate fair-market value.

The stated purpose for the change is to provide relief for smaller investment managers and to bring the filing obligations back into line with the original intent of capturing only "the largest institutional managers" (the $3.5-billion position was determined to be the 2020 equivalent, by market value, of the 1975 $100-million figure). The proposal asserts that over 90%, by dollar value, of the holdings data currently disclosed through Form 13F will continue to be reported utilizing a $3.5-billion threshold.

This proposal has already proven to be contentious. A strong dissent[2] from one commissioner, Allison Herren Lee, expressed concern about the potential loss of marketplace transparency that could result from the change, noting that the public, private and academic sectors all utilize Form 13F data and that the proposal "would eliminate access to information about discretionary accounts managed by more than 4,500 institutional investment managers representing approximately $2.3 trillion in assets."

[1] https://www.sec.gov/rules/proposed/2020/34-89290.pdf.

[2] https://www.sec.gov/news/public-statement/lee-13f-reporting-2020-07-10.

She also questioned the potential cost savings of the proposal, calling them "greatly overstated and wholly inconsistent with the Commission's past analysis."

Most strikingly, Commissioner Lee noted that Section 13(f)(1) of the Securities Exchange Act sets the threshold for Form 13F reporting of holdings of covered equity securities at $100 million "or such lesser amount" as the Commission may determine. She contends that the proposal "does not wrestle with this language at all, and asserts uncritically" that the SEC has the authority to raise the reporting threshold, while "Congress appears to have said otherwise[.]"

The proposal also contains technical amendments that would:

- Require filers to include CRD and SEC filing numbers;
- Require values be rounded to the nearest dollar (instead of to the nearest one thousand dollars);
- Require values to be expressed as complete, whole numbers in lieu of omitting three decimal places (e.g., a security with a value of $5 million would be reported as $5,000,000, instead of $5,000);
- Remove the 80 character limit imposed on the information filers can include on the cover page and the summary page and the 132 character limit on the information table;
- Remove certain duplicative definitions; and
- Amplify the Form 13F instructions.

Over 150 comments were received within the first week, nearly all of which oppose the proposal on the transparency point.

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BE-180 — Mandatory Survey of Cross-Border Financial Services Transactions

The U.S. Department of Commerce's Bureau of Economic Analysis has begun the process of collecting the 2019 BE-180 Survey of Financial Services Transactions Between U.S. Financial Services Providers and Foreign Persons ("BE-180"). BE-180 information is collected every five years.

U.S. "financial service providers," including U.S. fund managers and U.S. funds, are required to submit a BE-180 if they engaged in *any* transactions with foreign persons in the context of providing investment management services (or other listed categories of financial services) during fiscal year 2019 (note that there was a *de minimis* exemption from filing in 2014, which was removed for this cycle).

Additional reporting is required for U.S. financial service providers that had, during fiscal year 2019:

- Combined purchases of covered financial services exceeding $3 million; ***or***
- Combined sales of covered financial services exceeding $3 million.

Reporting requirements apply regardless of whether a U.S. person has been contacted by the BEA.

BE-180 surveys are due no later than Sept. 30, 2020 (or by Oct. 30, 2020 for respondents that use the BEA's eFile system). Many fund managers currently submit a quarterly companion survey, BE-185, which covers many of the same transactions, but BE-185 reporting is not an exemption from making a BE-180 filing, even if the information is substantially similar.

Information on the BE-180 survey, including copies of the survey and instructions, can be found here. The BEA has stated that it will conduct an informational webinar on BE-180 in August 2020, however, a specific date has not been announced yet.

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CFTC Actions on Automated Trading

On June 25, 2020, the Commodity Futures Trading Commission issued a rulemaking proposal addressing the risks of electronic trading causing disruptions in the commodity futures, options and swaps markets.[3] The proposed regulations would impose new obligations upon exchange operators to take steps to prevent, detect and mitigate market disruptions associated with electronic trading; exchange operators would also be required to implement pre-trade risk controls for electronic orders; this proposal would not apply directly to private fund managers and other market participants, but all market participants could be affected by the efforts of exchange operators to ensure upstream compliance with the new rules.

Relatedly, on the same date, the CFTC withdrew a contentious 2015 proposal ("Regulation AT") that would have imposed prescriptive risk management measures, new registration requirements and source code production obligations upon market participants employing algorithmic trading software.[4]

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[3] https://www.cftc.gov/sites/default/files/2020/07/2020-14381a.pdf.

[4] https://www.cftc.gov/sites/default/files/2020/07/2020-14383a.pdf.

CFTC Conditions Rule 4.13 Eligibility on Absence of Statutory Disqualifications

On June 4, 2020, the CFTC amended Rule 4.13, which contains a fund-level registration exemption that is frequently claimed by private fund managers, to require a manager seeking to claim a Rule 4.13 exemption to represent that neither it nor any of its principals is subject to a statutory disqualification listed in Section 8a(2) of the Commodity Exchange Act (with only limited exceptions). Private fund managers should consider confirming that their internal diligence processes encompass these CEA statutory disqualifications, which might not be in the scope of the representations that they currently solicit from key employees or within the scope of the background checks currently performed.

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Reminder: Swaps Proficiency Requirements for Associated Persons

Managers that are registered with the CFTC and are members of the National Futures Association should note that compliance with the NFA's new swaps proficiency requirements is required by Jan. 31, 2021. As we previously noted,[5] the "short track" of these online training modules will apply to Associated Persons of all NFA-registered CPOs and CTAs that engage in swaps activity. The modules may be completed via any internet-connected computer, and involve a modest time commitment (about four hours). There is no waiting period to retake should an AP fail a module. NFA members that have not already done so will need to designate an "SPR Admin" to provide access to the swaps proficiency courseware to their APs.[6] Instructions for accessing and completing the swaps proficiency requirements are available online.[7]

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[5] *See SRZ Alert*, "NFA Updates FAQs on Swap Proficiency Requirements," (Sept. 20, 2019), available here.

[6] The NFA's SPR Admin portal is accessible here.

[7] Step-by-step instructions for accessing the NFA's swaps proficiency requirements are available here.

EU Shareholder Rights Directive

The implementation of the EU Shareholder Rights Directive[8] will, among other things, introduce a new regulatory framework enabling EU issuers to identify their shareholders. From Sept. 3, 2020, EU-based "intermediaries" (such as custodians and prime brokers) will be required to respond to requests from issuers to identify clients with holdings over a stated percentage of shares or voting rights (specified in the local law of the relevant EU country). EU intermediaries will also be subject to a new framework requiring them (i) to transmit certain information on corporate actions to their clients and (ii) to facilitate the exercise of the voting rights by their clients.

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[8] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017L0828&from=EN.

Implementation of the New Marketing Regime in Switzerland

The Swiss financial regulator, FINMA, has recently approved several investor complaint mediation bodies to serve as ombudsmen for financial services disputes. As a result, managers that offer their funds in Switzerland are required to join a financial ombudsman organization by Dec. 24, 2020.

The approval of the financial ombudsmen represents the next phase of implementation of the new regime for distribution of funds in Switzerland, which initially came into effect on Jan. 1, 2020 (but which is subject to a compliance transition period lasting until Dec. 31, 2020). Other key elements of the new regime applicable to foreign managers marketing in Switzerland include client classification (i.e., pre-qualification of investors) and enhanced investor disclosure obligations.

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CISA Releases First Installment of its 'Cyber Essentials' Toolkits

Earlier this year, the U.S. Department of Homeland Security's Cybersecurity and Infrastructure Security Agency issued the first[9] of a series of six cyber essentials toolkits ("Cyber Essentials Toolkits"), as a follow-up to CISA's November 2019 release of CISA's Cyber Essentials. On July 1, CISA published the second toolkit on its website.[10]

The Cyber Essentials Toolkits break down the 2019 Cyber Essentials into business-friendly, bite-sized actions for IT and C-suite leaders. Fund managers should consider reviewing each chapter of the Cyber Essentials Toolkits as they are released in order to enhance their cyber readiness and to improve their internal capacity in this area.

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[9] https://www.cisa.gov/news/2020/05/29/cisa-releases-new-cyber-essentials-toolkit.

[10] https://www.cisa.gov/publication/cyber-essentials-toolkits.

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