3RD ANNUAL

PRIVATE EQUITY FUND CONFERENCE

Tuesday, June 9, 2015

1. MARKET UPDATE

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1. MARKET UPDATE

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Omoz is a partner at SRZ, where he focuses his practice on the representation of sponsors and investors in the formation and structuring of private equity funds, hedge funds and hybrid funds. He has extensive experience representing sponsors and investors on funds employing credit, distressed investment, structured products, buyout, real estate, activist, multi-strategy and long-short equity strategies. He represents hedge fund managers and investors in the negotiation of seed-capital transactions, and he advises sponsors of private equity firms in the structuring of complex carry-sharing arrangements among principals and employees. Omoz also represents managers and investment teams in spin-outs, joint ventures and other strategic transactions in the alternate investment management sector. Recent representations of Omoz's include institutional sponsors and boutique firms in the formation of private equity funds, hedge funds and hybrid funds; lead investors on their investments in private equity funds; hedge fund managers and investors in seed-capital arrangements; investment managers in joint venture arrangements; and investment managers and investors in the formation of special purpose acquisition and co-investment vehicles.

Recognized as a leading lawyer in his practice area by *The Legal 500 United States*, Omoz regularly addresses investment managers about current developments relating to private investment funds. His recent speaking engagements include presentations on running private equity funds and hedge funds side by side, private equity fund regulatory compliance and current trends in private equity fund terms and governance. He also contributed to the *Fund Formation and Incentives Report* (published by SRZ in association with Private Equity International).

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Joe is a partner at SRZ, where he represents U.S. and international private equity fund sponsors and institutional investors in connection with fund formation, the acquisition of portfolio investments and the implementation of exit strategies. In this capacity, he advises clients on securities, governance, ERISA, Investment Advisers Act and structural issues. He has extensive experience with all alternative asset classes, including venture capital and later-stage growth equity investments, leveraged buyouts, mezzanine investments, real estate ventures and opportunity funds, secondary investments, funds of funds and hedge funds. He also represents many fund managers in connection with spin-offs and consolidations. Joe advises private equity clients in connection with the acquisition and structuring of portfolio investments throughout the United States, Europe, Latin America and Asia. His representation of asset managers in the real estate sector includes advising on REIT offerings and privatizations, partnership roll-ups and cross-border investments. His clients include Arcis Group, Coller Capital, DRA Advisors, DuPont Capital Management, GE Asset Management, Harbert Management Corporation, Hemisfério Sul Investimentos, Intel, Kotak Mahindra Group, LCN Capital Partners, The Praedium Group, Ram Realty Services, REAL Infrastructure Partners, Royalton Partners, The Silverfern Group, Top Tier Capital Partners, Value4Capital, VCFA Group and Westport Capital Partners.

Joe is recognized as a leading practitioner by *Chambers Global*, *Chambers USA*, *The Legal 500 United States* and *The Legal Media Group Guide to the World's Leading Private Equity Lawyers*, and he is a member of the American Bar Association and the New York City Bar Association. His recent publications include contributing to *Fund Formation and Incentives Report* (published by SRZ in association with Private Equity International) and co-authoring "United States Fundraising" in *The Private Equity Review* (Law Business Research Ltd). A frequent speaker on topics of interest to the private funds community, he recently addressed investor needs and expectations, trends in the European real estate fund market, and recent developments in private equity fund compliance.

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Market Update

I. Macro-Level Trends in Private Fund Terms

A. U.S. private equity fundraising accelerated in 2014 and this trend appears to be continuing. Record distributions from existing funds continue to instill confidence among investors while putting them under some pressure to allocate the returned capital. Since the nadir of 2010, when North American-focused funds raised only $161 billion, fundraising activity gradually recovered to $282 billion in 2014.[1] Our anecdotal experience here at SRZ suggests that 2015 will exceed this.

B. Although established investors demonstrate their continued commitment to the PE sector, they are well aware that the balance of negotiating power has shifted since the fundraising peak prior to the Global Economic Crisis. LPs now scrutinize management teams and fund terms in greater detail, consolidate their investments with a smaller number of managers and are engaged in a general "flight to quality." In addition, a new wave of separately-managed accounts and other bespoke investment solutions has augmented the classic commingled approach to private equity fundraising. This has made the aggregation of discretionary capital more difficult for some managers, especially if they are new market entrants or have inconsistent track records.

C. Investors, acutely aware of the current fundraising challenges and impact of their own expanded diligence protocols, have demonstrated that they understand these circumstances by generally approving requests to extend fundraising periods by a further three to six months — or even leaving such extensions to the discretion of fund managers.

D. Conversely, for some managers, fundraising has been easier. In a striking reversal of the trend in recent years, 2014 saw the average fundraising period shorten significantly to 16.5 months, from 18.2 months in 2013.[2] Strongly favored funds are continuing to reach (and often exceed) their targets in under 12 months.[3]

E. The speed and strength of these "best of breed" fundraises, combined with an awareness by LPs of the perils of "adverse selection" (i.e., problems expected to arise from selecting managers primarily on the basis of fund terms, rather than performance), have sustained the relative durability of traditional PE fund terms and conditions.

F. Increased regulatory burdens have also created higher barriers to entry.

G. Larger fund managers, buoyed by the "flight to quality" and their ability to leverage both existing institutional relationships and operational infrastructure, have sought to diversify their platforms by offering new products. These new products frequently exhibit investment strategies complementary to the manager's existing vehicles, or further specialized variants thereof, and can be tailored to the individual requirements of larger investors. Unsurprisingly, such structures have been the subject of intense investor scrutiny in terms of deal flow allocation and potential conflicts of interest, underscoring the need for fund managers to have in place effective and articulable policies and procedures to address these concerns.

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[1] Preqin Private Equity Spotlight (December 2014), p. 2.

[2] Preqin, p. 2 (see footnote 8).

[3] See, for example, *The Wall Street Journal*, "Private Equity Fundraising Topped $266 Billion in 2014," Jan. 13, 2015; *Reuters PE Hub*, "Hellman flies through mega-fundraising on Fund VIII," www.pehub.com/2014/09/hellman-flies-through-mega-fundraising-on-fund-viii (accessed Jan. 26, 2015); *Reuters*, "CD&R private equity fund oversubscribed, raises $6.25 bln," www.reuters.com/article/2014/02/26/cdr-fund-idUSL6N0LV3CT20140226 (accessed Jan. 26, 2015).

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H. Notwithstanding the migration of capital to ever-larger fund management firms, new managers with excellent pedigrees or expertise in innovative market niches can find fundraising success. Many LPs are concerned that larger managers deploying vast sums of capital may be unable to maximize performance. Moreover, many institutions who had once considered themselves to be particularly favored by established managers now find that, in the context of the growth of mega-funds and the new arrival of "mega LPs" (such as sovereign wealth funds), that they no longer command favored terms or access to co-investment opportunities. Accordingly, many of these institutions now have an enhanced appetite to develop relationships with new managers.

I. An additional factor that perpetuates traditional fund terms is the upward pressure on fees created by additional regulatory requirements, demand for investor relations capacity and the investor concern as to whether a fund manager can maintain a stable team of investment professionals. In our experience, many investors refrain from negotiating fees and decline to commit capital until a fund can raise a threshold level of aggregate commitments, so as to be assured that the manager can maintain a sufficient fee stream to conduct operations. To some extent, this phenomenon may result in greater downward pressure being placed on the fees charged by established, rather than new, fund managers.

II. Micro-Level Trends in Private Equity Fund Terms

A. No-Fault Kick-Out and Termination Rights

1. Limited partners are continuing to request a panoply of kick-out and termination rights, both for cause and without cause, with respect to removal of the general partner, dissolution of the fund and termination of the fund's investment period. In particular, limited partners have been requesting no-fault rights to remove general partners, terminate funds' investment periods or dissolve funds. These rights typically require the vote of a supermajority in interest of limited partners not affiliated with the general partner.

2. While many private equity funds have historically granted general partners the right, typically following the vote of a majority in interest, to remove the general partner for "cause," general partners are increasingly acquiescing to also include no-fault removal rights providing for a supermajority of limited partners to be able to vote to remove the general partner. Limited partners argue that they need this right to remove the general partners, without the occurrence of a "cause" event, because typical definitions of "cause" require a court finding of "cause" (i.e., fraud, gross negligence, willful misconduct, material breach of the limited partnership agreement, criminal misconduct, etc.) and too long a period of time to determine. From the limited partners' perspective, provisions that require that the determination of cause by a court should be non-appealable are even worse as they could potentially take years to resolve. In addition, if limited partners believe that (1) a "cause" event has happened, even though a court has not yet found such event to have happened or (2) the general partner has acted in a manner that is not in the best interests of the fund, even if such action is not technically a "cause" event, then limited partners would like to have the right to vote to remove the general partner.

3. There are also circumstances under which the limited partners want to restrict the activities of the general partner but do not want to go as far as to remove the general partner. For example, limited partners may want the general partner to cease making new investments, either because they think the general partner has not been acting in the best interests of the fund (but have decided that the general partner is the person best placed to continue to manage the fund's existing investments) or because they think (and they may have a different opinion from the general partner) that economic or regulatory conditions are not suitable for the fund to continue investing. In anticipation of such

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circumstances, limited partners are increasingly negotiating for the ability to terminate (without cause) the investment period of the fund.

4. Often limited partners simply negotiate for a no-fault dissolution right. In the no-fault scenario, limited partners are typically okay with having the general partner manage the liquidation process (particularly since general partners will often understand the underlying fund assets better than a third-party liquidator). There are, however, a minority of large institutional investors that are very insistent on negotiating for the right to appoint a third-party liquidator even if the right to vote for dissolution of the fund is not triggered by the occurrence of a "cause" event.

5. Accounting deconsolidation requirements may also result in general partners agreeing to include a no-fault dissolution right or general partner removal right in a fund's limited partnership agreement. Inclusion of these no-fault rights allows the general partner/investment manager to avoid having to consolidate its financial statements with those of the fund as would otherwise be required under U.S. generally accepted accounting principles.

6. Definition of Cause/Disabling Conduct: The definition of "cause" that triggers a for "cause" removal of the general partner, termination of a fund's investment period or dissolution of a fund typically requires a finding by a court of competent jurisdiction (or a finding by a regulatory agency) that the general partner has engaged in conduct constituting fraud, gross negligence, willful misconduct or material breach of the agreement. Limited partners have been increasingly insistent that the "cause" definition also cover breach of the general partner's fiduciary duty or standard of care.

B. Indemnity

A typical fund limited partnership agreement exculpates and indemnifies the general partner and its partners, members, officers, affiliates, agents, etc. for all actions or inactions relating to the fund's activities, unless the applicable indemnified party has engaged in specified bad conduct (i.e., fraud, gross negligence, willful misconduct, material breach of the agreement). Sometimes the standard of conduct for exculpation/indemnification includes material violation of securities laws. There has been a trend toward more transparency over exactly what expenses are indemnifiable expenses under a fund's limited partnership agreement. For example, limited partners have been expressly requesting, both in their side letters and in their comments to limited partnership agreements, that expenses such as the legal costs relating to regulatory investigations of the general partner/investment manager and the legal costs relating to defending allegations of breach of side letters be excluded from indemnification. Along with the forgoing limitations on what is indemnifiable have come requests by limited partners for the general partner to disclose to limited partners (or the limited partner advisory committee members of a fund) any material payments made by the fund to indemnified persons pursuant to the indemnity.

C. LPAC

1. The provisions set forth in the limited partnership agreements of private equity funds relating to the operation of limited partnership advisory committees ("LPACs") have been getting increasingly more robust.

2. There is an increased emphasis by limited partners on giving the LPAC the right to hire legal counsel and other advisors (e.g., accountants and valuation agents) at the fund's expense.

3. Limited partners also want to know exactly who their fellow limited partners are and how to contact them. The rationale behind having this right is that otherwise it could be very difficult for limited partners to exercise their rights to vote to remove a general partner, dissolve a fund or terminate a

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fund's investment period. Limited partners want to be able to discuss issues with fellow limited partners and, if necessary, mobilize themselves to take appropriate action by voting to remove a general partner, dissolve a fund or terminate the fund's investment period.

4. Limited partners have been increasingly asking for the LPAC to have the authority to review fund valuations and, in some cases, to the extent the LPAC disagrees with such valuations, hire third-party valuation services to revalue the applicable assets.

5. It is fairly standard now for the LPAC to be expressly covered by indemnity in a fund's limited partnership agreement (usually only to the extent that LPAC members do not act in bad faith). In addition, the typical LPAC provision often includes express language to the effect that LPAC members have no fiduciary duty to other limited partners and are permitted to consider only their own interests when voting on the LPAC.

D. Standard of Care/Exercise of Sole Discretion

Limited partners are increasingly requesting that limited partnership agreements contain express provisions setting forth the standard of care to which the general partner is subject. In addition, limited partners sometimes ask for confirmation (either in side letters or in the limited partnership agreement) that the general partner's fiduciary duties to limited partners and the fund are not eliminated in instances where the general partner is authorized under the limited partnership agreement to act in its sole discretion. The concern here is that the exercise by the general partner of its "sole discretion" could result in the general partner taking only its own interests into account (to the detriment of its fiduciary duty) when making decisions on behalf of the fund.

E. Carried Interest; Management Fees

1. For established general partners who have historically sponsored funds with deal-by-deal waterfalls, there continues to be pressure to convert deal-by-deal waterfalls to "European style" waterfalls. Those general partners able to successfully push back have done so by agreeing to a number of alternatives (to be used individually or in combination): agreeing to interim clawbacks, escrowing all or some portion of the carried interest otherwise distributable to the general partner during the investment period, or agreeing not to receive carried interest unless the fund has "overperformed" by some specified percentage (e.g., the sum of realized proceeds and the fair value of unrealized investments is greater than all capital contributions made to date by some specified percentage).

2. For new or less-pedigreed general partners, "European style" waterfalls are standard. And indeed, many established managers are accepting this as the new paradigm.

3. Also, the type of credit support for clawback obligations is changing. We see fewer escrow arrangements and more guarantees.

4. Limited Partners are also very sensitive to the issue of a fund paying management fees following the expiration of the fund's term and often ask for a limitation (e.g., a reduction in the management fee rate and/or a limit on the amount of time during the wind-down and liquidation of the fund that management fees can be charged). This sensitivity to extended management fees also carries over to a reluctance to agree on giving general partners the right to unilaterally extend the term of a fund (in particular beyond one additional one-year extension).

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F. Conflicts

1. While the SEC has been particularly concerned with expense allocations, investors have been more concerned with investment allocations among general partners' various funds and accounts and, specifically, with trying to understand exactly how such allocations are done, including allocations with predecessor funds, successor funds, managed accounts or funds of one, and funds with overlapping investment programs.

2. There has been a continued emphasis on giving the LPAC approval rights over affiliate transactions as well as requiring general partners to disclose all transaction fees (and management fee offset calculations) and services provided by affiliates.

3. AIVs: A certain category of investor (i.e., larger institutional tax-exempt investors) has been particularly concerned with being required to participate in AIVs without their consent. The concern is that the general partner may not necessarily be able to take into account the unique tax constraints/concerns of such investors and therefore such investors need to have a say in the decision to require them to participate in an AIV in order to ensure that the tax impact on such investor is not adverse and/or they are treated in the same manner as other similarly situated investors.

4. Co-Investments: Investors continue to request co-investment rights or, at a minimum, that the general partner acknowledge (in the investor's side letter) that the investor is interested in co-investments. The attraction for limited partners is that co-investments can effectively reduce the fee load such investors pay the manager, as most co-investments are offered on reduced (or completely waived) fee terms. While such requests for co-investment rights will often be negotiated on an investor-by-investor basis (i.e., general partners may be willing to agree with large investors to first offer them co-investment rights or, alternatively, offer all limited partners available co-investment opportunities on a pro rata basis), ultimately whether general partners charge fees/carry will depend on whether the fund needs additional capital to complete a deal or whether the investment in question is a more scalable investment where incremental increases in the size of the investment necessarily are not required to materially increase profitability of the investment in question.

III. Final Observations: Fund Formation Costs — Where "Macro" and "Micro" Meet

A. As demonstrated by this discussion, although fund terms have become somewhat more "LP-favorable" since the Global Economic Crisis, our primary observation is that the fundamental closed-end PE economic model is nothing if not cycle-durable. Perhaps the most telling evidence of this assertion is that caps on fund formation costs have generally not decreased. This reflects an understanding by LPs that, notwithstanding some exceptionally quick fund raises by the most desirable managers, fund-raises usually take longer than ever before, involve more complicated negotiations, cumbersome know-your-customer diligence and other "project management."

B. We have taken an informal poll among our partners and associates who represent GPs, as to the most time consuming issues — not the most important, but the most time consuming — that drive-up fund formation costs. In the context of large fund raises, issues such as Freedom of Information Act compliance, carve-outs to confidentiality, sovereign immunity, the particularities of jurisdiction and venue, and indemnification mechanics all took extremely significant amounts of time to negotiate and document. In the context of small, first-time fund-raises, these very same issues arise, but are augmented by the additional costs of fundamental economic negotiations, as well as the costs of

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negotiating the excess demands sometimes made by established LP's who enjoy an imbalance of negotiating power with new managers.

C. We took the same informal poll of our partners and associates who primarily represent LPs, and learned something even more important: Negotiations became most protracted and expensive where sponsors are represented by counsel who have the least technical skill and market knowledge, and therefore take "off-market" positions or otherwise present technically deficient fund documentation. Conversely, negotiations were most efficient where the parties and their counsel enjoyed a balance of both economic power and technical sophistication.

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2. CO-INVESTMENTS

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Stephanie is co-head of SRZ's Investment Management Group and a member of the firm's Executive Committee. Her practice includes investment management, partnerships and securities, with a focus on the formation of private equity funds (LBO, mezzanine, distressed, real estate, venture) and liquid-securities funds (hedge funds, hybrid funds) as well as providing regulatory advice to investment managers and broker-dealers. She also represents fund sponsors and institutional investors in connection with seed-capital investments in fund managers and acquisitions of interests in investment management businesses, and she represents funds of funds and other institutional investors in connection with their investment activities.

Stephanie is chair of the Private Investment Funds Subcommittee of the International Bar Association, a founding member and former chair of the Private Investment Fund Forum, a member of the Advisory Board of Third Way Capital Markets Initiative, a founding member of the Wall Street Hedge Fund Forum and a former member of its Steering Committee, and a member of the Board of Trustees of 100 Women in Hedge Funds. She is listed in *Chambers USA*, *Chambers Global*, *The Legal 500 United States*, *Best Lawyers in America*, *America's Leading Lawyers*, *Who's Who Legal: The International Who's Who of Business Lawyers* (which ranked her one of the world's "Top Ten Private Equity Lawyers"), *Who's Who Legal: The International Who's Who of Private Funds Lawyers* (which placed her on its "Most Highly Regarded Individuals" list), *Expert Guide: Best of the Best USA* (Investment Funds), *Expert Guide to the World's Leading Investment Funds Lawyers*, *Expert Guide to the World's Leading Women in Business Law* (Investment Funds), *Expert Guide to the World's Leading Private Equity Lawyers* and *PLC Cross-border Private Equity Handbook*. She was named "Private Funds Lawyer of the Year" at the Who's Who Legal Awards 2014 as well as a New York State Bar Association Empire State Counsel honoree in 2014. She was also named one of *The Hedge Fund Journal*'s 50 Leading Women in Hedge Funds and the Euromoney Legal Media Group's "Best in Investment Funds" at the inaugural Americas Women in Business Law Awards. Additionally, Stephanie was recognized by the Girl Scouts of Greater New York as one of 2012's Women of Distinction. Stephanie is a much sought-after speaker on fund formation and operation and compliance issues, and she also regularly publishes books and articles on the latest trends in these areas. She recently contributed to the 2014 *Fund Formation and Incentives Report* (published by SRZ in association with Private Equity International) and co-authored *Private Equity Funds: Formation and Operation* (Practising Law Institute), the leading treatise on the subject. She also contributed a chapter on "Hedge Funds in Private Equity" for inclusion in *Private Equity 2004-2006* (PLC Cross-border Handbooks), contributed a chapter on "Advisers to Private Equity Funds — Practical Compliance Considerations" for *Mutual Funds and Exchange Traded Funds Regulation* (Practising Law Institute, Volume 2), and wrote *New York and Delaware Business Entities: Choice, Formation, Operation, Financing and Acquisitions* (West) and *New York Limited Liability Companies: A Guide to Law and Practice* (West).

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Chris is a partner at SRZ, where he specializes in mergers and acquisitions in the financial industry and shareholder activism matters. He has successfully structured numerous acquisitions of control and non-control stakes in asset managers with varied investment strategies holding collectively over $100 billion in assets under management. Prior to becoming a partner at SRZ, Chris was selected as the only associate in the United States for BTI's Client Service All-Star Team.

Chris' early training was in behavioral economics. He then earned his law degree, *cum laude*, from New York University School of Law, where he concentrated on law and economics. Since 2009, he has been teaching popular courses at the New York University School of Law on the financial and legal aspects of investing in business transactions.

Chris frequently speaks and writes on market trends in corporate law and is on the advisory board of Bloomberg BNA's *Mergers & Acquisitions Law Report* and recently served on an Innovation Board for Bloomberg studying the application of new technology in drafting and dealmaking. He recently published with Bloomberg a study on trends in asset management M&A. Earlier this year, he published through Bloomberg Law a book entitled *Make the Deal: Negotiating M&A Transactions*, which combines insights in negotiating M&A deals with quantitative analysis of trends in the market for key deal terms.

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Jason is a partner at SRZ, where his practice concentrates on corporate and securities matters for investment managers and alternative investment funds. He represents institutional and entrepreneurial investment managers, financial services firms and private investment funds in all aspects of their business. Jason's practice focuses on advising managers of hedge, private equity and hybrid funds regarding the structure of their businesses and on day-to-day operational, securities, corporate and compliance issues; structuring and negotiating seed and strategic investments and relationships and joint ventures; and advising investment managers with respect to regulatory and compliance issues.

Jason has been recognized by *IFLR 1000* in the area of investment funds and by *New York Super Lawyers*. His recent speaking engagements include discussing structuring co-investments and sidecars, information security obligations and expectations, and marketing opportunities and challenges for funds. He co-authored *Hedge Funds: Formation, Operation and Regulation* (ALM Law Journal Press) and was recently interviewed for "Co-Investments Enable Hedge Fund Managers to Pursue Illiquid Opportunities While Avoiding Style Drift (Parts One, Two and Three)" in *The Hedge Fund Law Report*.

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Co-Investments

I. Co-investments: What They Are

A. A co-investment opportunity is an opportunity to invest alongside (or outside of) a private equity fund in an investment that is too large for the private investment fund to complete alone, or as to which co-investment rights have been granted for other reasons — e.g., because an investor demanded them or as a strategic partner (e.g., an operating partner, deal sourcer or financing source).

B. There has been significant general partner (GP) interest in co-investment opportunities. According to a recent survey, 38 percent of GPs have offered co-investment opportunities to investors,[1] and another survey indicates that 53 percent would consider or are currently considering offering such opportunities.[2]

C. North America is the leading continent for co-investment appetite among investors. According to a 2012 survey, 44 percent of investors that seek to make co-investments are based in North America, 31 percent in Europe and the remaining 25 percent in Asia and the rest of the world.[3]

II. Structuring/Terms

A. Structuring

1. Since the tax and regulatory attributes of a particular co-investment are known at the time the investment is structured, the domicile and type of vehicle used can be more precisely tailored to the investment than the blind pool private equity fund.

2. Tax Structuring

(a) The tax considerations in setting up co-investment vehicles are similar to the tax considerations in setting up a private equity fund. The type of vehicle or vehicles used for a co-investment will depend on the type of investment and the expected composition of investors in such co-investment opportunity.

(b) Taxable U.S. investors often prefer investing in an entity treated as a pass-through entity for U.S. tax purposes. As a pass-through entity, a co-investment vehicle is generally not itself subject to U.S. federal income tax, and each partner is required to report separately on its income tax return its distributive share of the co-investment vehicle's income, gain, loss or deduction.

(c) Certain tax-exempt U.S. investors are subject to tax on "unrelated business taxable income" ("UBTI"), which generally includes income that is not related to such tax-exempt U.S. investor's tax-exempt purpose. If a co-investment vehicle utilizes leverage, it may result in UBTI for tax-exempt U.S. investors. If an investment in a pass-through co-investment vehicle may generate UBTI, certain tax-exempt U.S. investors may want to invest through a corporate entity to avoid being directly subject to tax on UBTI. This corporate entity can invest directly in the pass-through co-investment vehicle set up for taxable U.S. investors or on a side-by-side basis with such co-investment vehicle. Other tax-exempt U.S. investors, such as state pension plans, may

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[1] *See* Aksia's 2014 Hedge Fund Manager Survey.

[2] *See* Preqin Global Private Equity & Venture Capital Report (2015).

[3] *See* Preqin Special Report: LP Appetite for Private Equity Co-Investments (2012).

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take the position that they are not subject to tax on UBTI. As a result, such tax-exempt U.S. investors and other tax-exempt U.S. investors that are not UBTI-sensitive may prefer to invest in the same pass-through vehicle in which taxable U.S. investors invest.

(d) The tax treatment for non-U.S. investors will depend on if the co-investment vehicle will be treated as engaged in a trade or business in the United States with respect to its investment. To the extent a co-investment vehicle engages in a U.S. trade or business, a non-U.S. investor will generally be subject to federal income tax on a net basis, with respect to the income that is effectively connected with such trade or business, at the same rates that would be applicable if the investor were a U.S. person. Further, effectively connected earnings from a co-investment vehicle that are allocated to a non-U.S. corporate investor and are not reinvested in a U.S. trade or business may be subject to a "branch profits tax." If a co-investment may generate income effectively connected to a U.S. trade or business, the investment may need to be made through a U.S. corporation so that non-U.S. investors are not directly subject to net income tax or required to file a U.S. tax return.

(e) Managers should also consider the use of non-U.S. investment vehicles for all types of investors in order to efficiently manage any non-U.S. tax consequences related to a specific co-investment.

B. Terms

1. Fees depend on the rationale for the co-investment opportunity.

(a) Investors may have negotiated access to and fees payable on co-investments as part of their original commitment. They may also have negotiated most favored nations (MFN) clauses. Some general partners offer co-investments at no fees, at least for large investors; some GPs just charge carry.

(b) Strategic investors may get preferential terms.

(c) Co-investment rights can be hardwired as a right to a pro rata (or larger) share vs. softer expressions of interest.

2. The governing documents of the co-investment vehicle will control the relationship between the GP and the co-investors. These terms are separately negotiated in each deal, and there is a market for the key terms that get negotiated, such as:

(a) Drag-along rights for the GP to require the co-investors to sell alongside the GP in the event of a sale of control of the co-investment vehicle;

(b) Tag-along rights for the co-investor to require the GP to allow the co-investor to participate in sales by the GP;

(c) Preemptive rights in favor of the co-investor to permit the co-investor to maintain its percentage of the equity (and sometimes debt) in the co-investment vehicle, subject to some exceptions;

(d) Restrictions on transfers by the co-investor of its equity in the co-investment vehicle; and

(e) Voting rights for the co-investor, and veto rights for the co-investors to allow them to prohibit or restrict some limited types of decisions the GP may make.

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3. Other terms of the co-investment vehicle (e.g., GP removal, reporting, amendments) will often parallel the terms of the main fund or be linked to the terms of the main fund, and the main fund limited partnership agreement (LPA) may form the base for drafting the co-investment vehicle LPA.

4. Co-investment opportunities sometimes present themselves on a relatively short timeframe. If a co-investment opportunity is time-sensitive and the GP needs to raise co-investment capital quickly, the manager may offer lower fees to attract capital quickly.

5. More investor-favorable terms may be necessary if the co-investment is a rescue of an existing portfolio company.

C. Expenses that are specific to a particular co-investment vehicle (such as the vehicle's organizational costs) will generally be borne by the investors in such vehicle. If the expenses are common to the co-investment vehicle and the main fund (and other funds), each vehicle typically will bear its pro rata share of such common expenses.

D. GPs may create annual employee co-investment vehicles through which employees get a slice of deals regardless of whether they are otherwise too large for the fund.

E. Certain investors may co-invest through parallel funds that participate in many or all of the main fund's investments but are separately structured either to meet tax or regulatory objectives or, increasingly, because a large investor wants more control over its investment than the commingled vehicle offers.

III. Conflicts and Regulatory Issues

A. Offering Co-Investments to Investors

1. Investors in the main fund may request the right to participate in co-investment opportunities offered by a GP. GPs should consider contractual obligations (e.g., side letters), investor relations concerns and fiduciary concerns when determining the allocation of co-investment opportunities across funds and investors.[4]

2. Fund documents typically provide GPs with broad discretion to allocate co-investment opportunities and contain concentration limits and target allocations that help a GP determine when excess investment capacity exists in a given deal.

B. Regulatory Scrutiny

1. Regulators have focused on the allocation of co-investment opportunities in their examination activities. In particular, regulators have focused their attention on whether the governing documents of a fund address co-investments, noting that governing documents often lack clearly defined protocols for mitigating conflicts of interest associated with co-investments.[5]

2. One area of focus is the allocation of co-investment opportunities to some but not all investors in the main fund without proper disclosure in the governing documents of the main fund.[6]

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[4] *See* Igor Rozenblit's (co-head of the Private Funds Unit at the SEC Office of Compliance Inspections and Examinations) speech at the Compliance Outreach Program Seminar (Jan. 30, 2014).

[5] *See* Andrew Bowden's (former director of the SEC Office of Compliance Inspections and Examinations) speech at the Private Equity International Private Fund Compliance Forum 2014 (May 6, 2014).

[6] *See* Rozenblit's speech at the Compliance Outreach Program Seminar (Jan. 30, 2014).

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IV. Documentation and Process

A. Offering Materials

1. Co-investments are typically offered using flip books, business plans, financial projections and similar materials involving less formality than an offering memorandum.

2. Co-investments are usually offered only to investors with sufficient business sophistication to evaluate these types of materials independently.

3. Different investors may be approached for different co-investments depending on the size of the opportunity, the investors' ability to act quickly and confidentially, and regulatory concerns (e.g., an FCC-regulated investment may not be appropriate for foreigners).

4. If co-investment rights have been offered to investors (e.g., rights of first refusal), the agreed-upon process must be followed.

V. "Club" or "Pledge" Funds

A. Some GPs raise some or all of their capital through non-blind pool vehicles that are in essence pre-negotiated co-investment arrangements.

B. Club funds can permit GPs to charge some level of fees, and get coverage for expenses, while co-investment opportunities are being sourced.

C. Issues relating to club funds include how deal sizes are allocated among investors in the absence of binding commitments; possible ejection from the club of investors who reject too many deals; allocation of expenses; whether deal P&L will be netted for carry purposes; and details of the deal offer process.

D. Club funds are often an interim step for GPs who have not yet developed a sufficient track record to attract blind pool capital.

VI. Conclusion

A. Large private equity investors increasingly view access to co-investments as integral to their reasons for choosing a particular GP and can use co-investments as a way to achieve lower blended fees.

B. There is nothing wrong with this, but regulators are focused on whether these arrangements have been adequately disclosed, and on the conflicts inherent in deal allocation.

C. The deal teams will have two deals to negotiate: one to buy the portfolio company, and another to agree on how much participation the co-investors will have in governance matters and what liquidity rights, if any, the co-investors will have.

D. Private equity sponsors need to be sensitive to the evolving regulatory landscape and the increased interest in their activities generally and co-investments in particular.

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3. PLEDGE FUNDS AND FUNDLESS SPONSORS

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Anthony is a Principal and the Chief Operating Officer of Hamilton Lane's Co-Investment Funds. In this capacity, Anthony manages all diligence and deal execution resources and processes for the Co-Investment Funds' investment opportunities. He also is responsible for reviewing and negotiating the legal documentation for the Co-Investment Funds' deals.

Previously, Anthony was a member of Hamilton Lane's Legal and Due Diligence Teams, where his primary duties included reviewing and negotiating legal and business terms for a variety of primary fund, secondary fund and co-investment transactions. Prior to joining Hamilton Lane in 2005, he served as in-house legal counsel for BTG International, the U.S. subsidiary of a London-based technology commercialization/venture investment company, and as a transactional attorney for the Philadelphia-based law firm of Drinker Biddle & Reath LLP.

Anthony received a law degree from Northwestern University School of Law, where he served as one of the executive editors of the law school's *Journal of Criminal Law and Criminology*, and a B.A. in Finance from Villanova University. He is a member of the state bar of Pennsylvania.

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Phyllis is a partner at SRZ, where she focuses her practice on the structuring, formation and operation of private equity funds, including buyout funds, venture capital funds, mezzanine funds, distressed funds and real estate funds. She represents both fund sponsors and investors in her practice. In addition to assisting fund sponsors with their internal management arrangements, the creation of internal investment vehicles and succession planning, she has extensive experience with institutional investors and regularly advises on the acquisition and disposition of partnership interests and market terms of investment funds. Phyllis also represents private equity funds in connection with their investments in, and disposition of, portfolio companies.

Phyllis is recognized by *The Best Lawyers in America*, *Expert Guide to the World's Leading Women in Business Law* (Investment Funds), *Expert Guide to the World's Leading Investment Funds Lawyers*, *Expert Guide to the World's Leading Private Equity Lawyers*, *New York Super Lawyers* and *The International Who's Who of Private Funds Lawyers*. A member of the Private Investment Fund Forum, she frequently shares her insights on effective fund formation strategies at industry conferences and seminars. She recently addressed waterfall models of distribution, management fees and expenses, and investor terms and conditions in private equity fundraising. Phyllis is also co-author of *Private Equity Funds: Formation and Operation* (Practising Law Institute), the leading treatise on the subject, and she contributed a chapter on "Advisers to Private Equity Funds — Practical Compliance Considerations" to *Mutual Funds and Exchange Traded Funds Regulation, Volume 2* (Practising Law Institute, 2013).

Phyllis earned her J.D. from Columbia University School of Law and her A.B. from Smith College.

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Pledge Funds and Fundless Sponsors

I. Introduction

A. The structure and operations of a pledge fund are less defined than conventional private equity investment funds; and not surprisingly, the notion of a pledge fund is often subject to confusion. In fact, a pledge fund has nothing to do with "pledging."

B. Although the manager of a pledge fund is a "fundless sponsor," managers of pledge funds work within established contractual relationships. Fundless sponsors seeking capital for a deal without a pledge fund do not generally have any defined contractual arrangements.

C. The key differentiator between pledge funds and customary private equity funds is that investors have the right, and option, to participate in investments made by the fund.

D. There are several motivations behind the establishment of a pledge fund. Most obviously, fundraising is extremely competitive, and therefore it is more difficult for fund managers to obtain capital commitments. Further, pledge funds have been generally seen as an entry point for a private equity fund manager. It is better to have any track record than no track record in order to obtain capital commitments.

E. As the work of private equity managers has evolved, pledge funds serve additional purposes. Mid-stream in a manager's investment career, they can bridge funds and even serve as co-investment funds. At the twilight of such careers, they can be used for managers who no longer want to engage in significant fundraising.

II. Structures and Terms of Pledge Funds

A. The structure of a pledge fund has many similarities to that of committed funds, with the principal exception regarding the right of investors to opt into deals. Thus, investors in pledge funds have committed capital to cover fund expenses and fees. A pledge fund may consist of one or several investors.

1. The duty to offer investment opportunities is usually three years, a much shorter period than the typical five-year investment period of a committed fund. There is less convention on the hold periods for pledge fund investments, but five-year hold periods would not be atypical.

2. If an investor does not participate in a minimum number of deals, usually that investor loses its right to participate in future deals.

3. The timing and information provided to investors is critical to being able to operate pledge funds. There are technical legal and practical considerations at play:

   (a) Since they have to make an investment decision, investors should have simultaneous (or as close as possible) and equal access to information. For instance, there should be agreed upon formats for deal memoranda and for answering questions the sponsor receives from one investor (i.e., address one-on-one or in an open forum for all investors); and

   (b) Like desired co-investors, investors who are able to process information quickly should be targeted for pledge funds.

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B. Pledge funds documents typically consist of: (1) an investment agreement pursuant to which the manager is obligated to offer defined investment opportunities (such as venture capital investments or buyouts) during a set period; and (2) a form of partnership agreement that will be used for investments on a deal-by-deal basis. Fundless sponsors will not need to create documents in advance of receiving commitments to pursue deals.

1. Because the group of investors participating in investments may vary, each investment will be made through an SPV managed by the sponsor.

2. Investors usually have notional capital commitments, which are used to prorate investment opportunities.

3. Each SPV will conduct its own ERISA count to determine if its investors exceed 25 percent of committed capital.

4. Side letters rarely are used in pledge funds.

5. PPMs may be prepared, but not always.

C. Economics

1. Management fees are paid on invested capital, and can be 2 percent, but there is a wide range of fee structures.

2. When a manager has more leverage, it will be able to charge a “commitment fee” for the obligation to show deals to its investors.

3. Like private equity funds, transaction fees paid to managers will trigger offsets to management fees.

4. A carried interest is usually charged to investors on a deal-by-deal basis, and 20 percent is the starting point. In certain cases, a manager may earn more than 20 percent depending on the performance targets of investments (like joint ventures).

5. Clawbacks have become customary in pledge funds. Even though investors can decide whether to invest in a deal, the presumption is that they will, and therefore, investors are generally able to require clawbacks and netting of losses against gains.

6. Recalls of distributions will be more limited in pledge funds and will only relate to losses arising from the actual deal creating the recall.

7. Expenses must be managed carefully, since management fees are not predictable. Notably, deal related expenses are carefully agreed to in advance (unlike committed funds). For instance, a pledge fund investment agreement will address broken deal expenses, and once an investor gives initial approval of its interest in participating in a deal, that investor is usually required to cover broken deal expenses.

8. The sponsor must think about how it will attract and reward operating partners in a pledge fund structure.

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D. Other Pledge Fund Terms

1. *Investor Non-Competes*. If investors don't choose to invest, it is important that they not be able to circumvent the pledge fund to pursue the deal outside the pledge fund.

2. *Exclusivity; Time Commitments*. Assuming that the sponsor can shop deals outside the pledge fund, there should be no traditional "substantially all" time commitment. Additionally, the sponsor should be able to seek other investment capital when investors do not elect to make an investment. The pledge fund may specify that investors electing to participate get a second opportunity to take investment opportunities not chosen by other pledge fund investors. Otherwise, the GP should be able to offer investment opportunities to investors outside the pledge fund or take an opportunity for itself. Where investors have substantial bargaining power, they may require the GP to turn down investments if the pledge fund does not receive support from its investors. This is more likely to occur where the pledge fund has one investor.

3. *Removal and Termination Rights*. Pledge funds have substantially the same termination provisions as committed private equity, although there is no need for investors to have termination rights with respect to the investment period. Key man provisions are more unusual in pledge funds.

4. *Priority Vis-à-Vis Other Managed Funds*. If the sponsor manages other funds/vehicles, the allocation priority should be crystal clear. If the pledge fund is bridging a future fund, clarify the deal-sharing arrangements.

5. Like co-investors, pledge fund investors often seek rights of direct investors in deals. Therefore, pledge fund documents may include private equity investment-type terms, including:

   (a) Pre-emptive rights (i.e., right to make follow-on investments)

   (b) Access to the information provided by the portfolio company to the fund, such as the portfolio company's financial statements

   (c) Access to directors of the portfolio company

   (d) Voting rights

   (e) Co-sale rights/drag rights

III. Regulatory Issues

A. Each SPV formed by a pledge fund will be a "client" under the Investment Advisers Act.

B. The manager must satisfy the custody rules with respect to clients and therefore generally must arrange to have the financial statements of co-investment vehicles audited.

C. Expenses must be properly disclosed and allocated.

IV. Conclusion

A. There is no stigma to running a pledge fund.

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B. Pledge funds facilitate the ability of emerging managers to enter the private equity industry. They also bridge periods between committed funds, and they facilitate ongoing investments by managers who do not necessarily plan to raise any future funds.

C. Pledge funds can result in the same operational burdens on managers as committed funds, such as reporting obligations and disclosure.

D. Pledge funds offer broad purposes. They can be used to start up a business, to bridge investment management businesses and to wind down investment management businesses. Creative approaches to economic terms are more likely to be accepted by investors in exchange for the right of investors to opt into deals.

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4. REGULATORY AND COMPLIANCE

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Jaime is a partner in Ernst & Young's Financial Services Professional Practice Group. She has over 16 years of experience in the asset management industry, including serving asset management clients such as mutual funds, SEC-registered and non-registered hedge funds, private equity funds, business development companies, investment advisers and general partners.

Prior to rejoining EY in 2014, Jaime was the Chief Accountant for the SEC's Division of Investment Management for three and a half years, where her responsibilities included directing the financial reporting, accounting and auditing practices of investment companies in compliance with the federal securities laws and discussing significant investment company accounting and auditing standard-setting matters with the FASB and PCAOB. While at the SEC for nearly seven years, Jaime also worked closely with other divisions and offices within the SEC, including the Division of Enforcement, the Office of Compliance Inspections and Examinations (OCIE), and the Office of the Chief Accountant.

Prior to joining the SEC, Jaime was a Senior Manager at EY and provided assurance services to asset management clients. She also worked in EY's National Professional Practice, where she assisted in providing technical consultations to the asset management practice.

Jaime is a frequent panelist and speaker at industry conferences and meetings, including those sponsored by the AICPA, ICI, SIFMA, Practising Law Institute, Mutual Fund Directors Forum, Independent Directors Council, New York State Society of CPAs, Small Business Investor Alliance, CFA Society, BDC Capital Roundtable and the SEC. She has also served as a guest lecturer at Bryant University and Georgetown University.

Jaime is licensed as a Certified Public Accountant in New York and received her B.S. in Business Administration with a concentration in Accounting from Bryant University in Rhode Island.

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Marc is the chair of SRZ's Investment Management Regulatory & Compliance Group. He advises private fund managers on compliance with the Investment Advisers Act of 1940 and other federal, state and self-regulatory organization requirements, including establishing compliance programs, registering with the SEC and CFTC, and on handling SEC and NFA examinations. Marc provides guidance to clients on securities trading matters and represents them in regulatory investigations and enforcement actions, arbitrations and civil litigation. He also regularly leads training sessions for portfolio managers, analysts and traders on complying with insider trading and market manipulation laws, and he has developed and led compliance training sessions for marketing and investor relations professionals. Marc works closely with clients undergoing SEC examinations and responding to deficiency letters and enforcement referrals. He develops new compliance testing programs in areas such as trade allocations and conflicts of interest. He also leads macro-level compliance infrastructure reviews with fund managers, identifying the material risks specific to each particular firm and evaluating the compliance programs in place to address those risks.

The Legal 500 United States, *Who's Who Legal: The International Who's Who of Private Funds Lawyers* and *New York Super Lawyers* have recognized Marc as a leading lawyer in his field. He is a member of the Steering Committee of the Managed Funds Association's Outside Counsel Forum, the American Bar Association's Hedge Funds Subcommittee and the Private Investment Funds Committee of the New York City Bar Association. A prolific writer in his areas of expertise, Marc recently co-authored "SEC Cybersecurity Update: OCIE Risk Alert Provides Insights for Private Fund Managers on SEC Cybersecurity Examinations" and "JOBS Act Update: CFTC Relief Removes Impediment to General Solicitation" for *The Hedge Fund Journal*. He is also a co-author of *Hedge Funds: Formation, Operation and Regulation* (ALM Law Journal Press), the "Protecting Firms Through Policies and Procedures, Training, and Testing" chapter in the *Insider Trading Law and Compliance Answer Book* (Practising Law Institute, 2011-2015) and the "Market Manipulation" chapter in the leading treatise, *Federal Securities Exchange Act of 1934* (Matthew Bender). He also wrote the chapter on "The Legal Basis of Investment Management in the U.S." for *The Law of Investment Management* (Oxford University Press). Marc is frequently invited to discuss current industry-related topics of interest at leading professional and trade association events. He most recently presented on high-risk compliance areas for hedge funds, responding to regulatory enforcement actions, and SEC inspections and examinations of hedge and private equity funds.

Marc received his J.D. from New York University School of Law and his B.A., with honors, from Wesleyan University.

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Scott joined PricewaterhouseCoopers in July 2013 and assists financial services clients — primarily advisers to hedge funds, private equity funds and registered investment companies — in a wide variety of securities regulatory compliance matters. Scott's areas of focus include leading regulatory practices for advisers, SEC examination readiness, compliance program development and risk management, and regulatory reporting.

Scott has deep securities regulatory experience, having served for more than 11 years in the SEC's Division of Enforcement, most recently as an Assistant Director. In that role, he helped form and lead the agency's Asset Management Unit, an 80-person national specialized group focusing on misconduct involving hedge funds, private equity funds and investment companies. Scott collaborated extensively with other SEC divisions and law enforcement agencies on asset management priority areas and emerging risks, and he developed a highly successful initiative to detect hedge fund fraud through the use of proprietary risk analytics. He also supervised a number of significant investigations concerning improper conflicts of interest, valuation, disclosure, fees and trading practices.

Scott holds an LL.M. in Securities and Financial Regulation from Georgetown University, a J.D. from American University, and B.A. from the University of Pennsylvania.

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Regulatory and Compliance

I. Fund Document Updates

A. Subscription Documents

Managers should review their forms of subscription agreements and consider taking the following steps:

1. For funds that use placement agents with Rule 506(e) "bad actor" disclosure obligations,[1] distributing the 506(e) notice with the subscription documents is one way to effect delivery of the required disclosure (but the manager must be sure to confirm that all new subscriptions are preceded by a current version of the subscription documents);

2. Managers considering future use of the Rule 506(c) "general solicitation" placement regime should be considering how they will satisfy the enhanced accredited investor verification requirements that will apply to all 506(c) placements (based on current Securities and Exchange Commission guidance, investor self-certifications in a subscription agreement may not be sufficient);

3. Managers should consider whether Financial Industry Regulatory Authority Rules 5130 and 5131 new issues questionnaires should be updated to enable private fund investors (e.g., funds of funds) to indicate that they qualify as "unaffiliated private funds" entitled to calculate de minimis percentages without regard to non-control person beneficial owners; [2]

4. Managers registered as commodity pool operators or commodity trading advisors should confirm that Bylaw 1101 representations are included in the subscription agreements;[3]

5. Managers claiming a CFTC Regulation 4.7 exemption for a managed fund should confirm that the subscription documents contain appropriate [non-]"U.S. Person" representations for non-U.S. investors (even if managers otherwise previously obtained a "qualified purchaser" or "qualified eligible person" representation);

6. Managers should confirm that, in conjunction with applicable 2014 FATCA registration obligations,[4] updates were made to the subscription documents to obtain appropriate FATCA representations;

7. Managers should: (1) confirm that they have appropriate "U.K. FATCA"[5] self-certification questions in their subscription documents for their funds located in the United Kingdom's Crown Dependencies and Overseas Territories (e.g., the Cayman Islands and British Virgin Islands); and (2) review the U.K. FATCA self-certification forms collected from post-June 30, 2014 investors and fill in any gaps in self-certification as soon as possible;

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[1] The rule requires that a fund "furnish to each purchaser, at a reasonable time prior to sale, a description in writing of any matters that would have triggered disqualification under" the bad actor rule, but for the fact that they occurred prior to Sept. 23, 2013.

[2] Discussed below in detail under "Investor Information and Representations."

[3] Discussed below in detail under "Investor Information and Representations" and "Marketing in Europe."

[4] In order to avoid 30-percent withholding under FATCA, managers should confirm that their non-U.S. funds (where required) registered and entered into information-sharing agreements with the Internal Revenue Service in advance of the June 30, 2014 deadline. Funds located in countries that enter into Model I Intergovernmental Agreements with the United States, such as the Cayman Islands, generally will not be required to enter into an agreement with the IRS; however, they still must register with the IRS. Registration for such funds should have been completed by Dec. 31, 2014.

[5] See our recent *Alert* on U.K. FATCA, "UK FATCA Compliance for Investment Funds."

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8. Managers should confirm that the Internal Revenue Service W-8 and W-9 tax forms appended to their subscription documents are the current versions;

9. Managers should consider including in fund subscription agreements governed by Cayman Islands law language that explicitly allows third-party beneficiaries (such as the manager and others indemnified under such agreements) to enforce their rights under the Contracts (Rights of Third Parties) Law 2014;

10. Managers that are "Alternative Investment Fund Managers" and that are required to file Annex IV reports under the EU AIFM Directive should consider updating their subscription agreements to require each investor to indicate its AIFM Directive investor category (based on the *Guidelines on Reporting Obligations* issued by the European Securities and Markets Authority); and

11. Managers that do not intend to register under the national private placement regimes in the European Economic Area[6] or comply with the new Swiss distribution rules should consider including reverse solicitation (or "own initiative") representations in their subscription agreements.[7]

B. Other Marketing Materials and Disclosures

In conjunction with a review of the offering documents, managers should perform a comprehensive review and update of their other marketing materials (e.g., websites, flip books, due diligence questionnaires, monthly performance or portfolio reports, and investor or client letters). Both the SEC and the National Futures Association have demonstrated an increased interest in granular reviews of and assertive challenges to claims in marketing materials, so this internal review should be rigorous (and outside counsel review may also be warranted). Topics that should be considered in such a review include the following:

1. The accuracy and consistency of each description of the investment program;[8]

2. The degree of readily available objective support for comparative or superlative statements (e.g., "successful management," "superior results," "leading" practices or performance) and a reflection on whether alternate language could be utilized to similar effect;

3. The completeness and accessibility of written records evidencing compliance approvals of marketing materials;

4. The procedures and the degree of review for "one-off" responses to investor requests and the safeguards against their reuse (which could potentially make the response an "advertisement" under the Investment Advisers Act);

5. Whether statements and process-flow diagrams on the investment management or controls processes remain accurate (and whether they contain language indicating that processes are subject to modification without notice in actual trading, are high-level summaries, etc.);

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[6] The EEA comprises the 28 member states of the EU and three additional member states ("*"): Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland,* Ireland, Italy, Liechtenstein,* Latvia, Lithuania, Luxembourg, Malta, Norway,* the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the United Kingdom.

[7] See "Marketing in Europe" below.

[8] In a September 2014 speech, Andrew Bowden, former director of the SEC's Office of Compliance Inspections and Examinations, said that one of the initial tasks examiners carry out is to compare the disclosed investment program to the actual portfolio and activity. As the marketing materials often have a more detailed description of the investment program than the offering documents, the accuracy of the marketing materials should be confirmed.

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6. Compliance with existing rules and guidance on performance presentations (e.g., use of simulations, use of "gross" performance figures, etc.); systematic and quantitative managers using backtests or extracted performance will need to satisfy additional disclosure and legending requirements;

7. Reviewing any mention of specific investments or positions to confirm that there are no "cherry picking" issues;

8. Whether CFTC legends and exemption disclosures conform with applicable rules and whether additional language is needed to comply with specific CFTC or NFA requirements (e.g., specific required statements regarding registration status, risk disclosures and the use of "hypothetical," "pro forma" or backtested results); and

9. Whether all required European marketing disclosures are included.[9]

Separately, managers utilizing publicly accessible websites or investor password-protected web portals that deliver current and historical manager and funds information should perform a top-to-bottom review for compliance with SEC (and, if applicable, NFA) marketing guidance.

Finally, most managers (and many funds) are subject to SEC, CFTC or Consumer Financial Protection Bureau privacy regulations that require initial and annual notices. These are covered below under "Investor Communications to Be Sent in Early 2015."

C. Investor Information and Representations

Managers continue to be obligated to obtain an ever-increasing amount of information from investors, much of which needs to be re-certified on a periodic basis, including:

1. *Rule 506(d) "Bad Actor" Re-Certifications.* The SEC staff released additional Rule 506(d) (the so-called "bad actor rule") guidance in January 2014, which contained clarifications on "look through" requirements and the applicability of traditional "group" concepts in determining "beneficial owner" status under the bad actor rule. There remain, however, a few uncertainties regarding this aspect of Rule 506(d), and managers therefore should continue to consider obtaining [non-]bad actor representations from (or conduct other reviews that satisfy a "reasonable care" standard on) each person that could be deemed a "beneficial owner of 20% or more of the issuer's outstanding voting equity securities."

2. *ERISA Re-Certifications.* Managers should request confirmation in writing from investors of the "plan assets" character of their investments (please contact us if you need a form for this). Managers should also: (1) review their in-house ERISA calculations and compare them to their administrator's data; (2) review their "counting rules," and in particular examine the treatment of affiliated investors and fund-of-funds investors; and (3) review all IRA subscription agreements to confirm that each one has been signed by the custodian — not just by the individual retirement account holder — and that copies of statements and communications are being sent to the custodian.[10]

3. *NFA Bylaw 1101 Certifications (for CFTC-Registered Managers).* Bylaw 1101 prohibits NFA members from conducting customer business with most non-members that are required to be registered with the CFTC as a futures commission merchant, an introducing broker, a commodity pool operator or a commodity trading advisor. Managers that are NFA members should obtain representations from

[9] See "Marketing in Europe" below.

[10] Managers should also review "Securities and Derivatives Trading" below.

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their relevant service providers that they are not required to be registered (or that they hold the requisite registrations); enhanced diligence may be warranted in certain cases. The NFA also interprets Bylaw 1101 as extending to managed account clients and investors in pooled vehicles (i.e., funds) so, if a manager has not already done so, it should verify the CFTC status of its clients and investors. It is also good practice to reconfirm that status on an annual basis by sending a questionnaire to investors or by utilizing the NFA's BASIC database (or both).

4. *Obtain Updated IRS Forms from Each Non-U.S. Investor That Executed the Form More Than Three Years Ago.* An IRS Form W-8, provided by certain non-U.S. persons to certify their non-U.S. status, generally remains in effect for a period starting on the day when the form is signed and ending on the last day of the third succeeding calendar year, unless a change in circumstances makes any information on the form incorrect. Managers should conduct a review of their records and obtain a new applicable IRS Form W-8 where needed, including from indirect investors whose W-8s were submitted as supporting documentation for investors providing an IRS Form W-8IMY (e.g., investors that are non-U.S. partnerships).

5. *Reverse Solicitation Requests*. Make periodic updates to reverse solicitation requests from European investors (see "Marketing in Europe" below).

II. SEC, State and Certain Transactional Filings

A. Form ADV

SEC-registered investment advisers must amend their Form ADV each year within 90 days after the end of the fiscal year.[11] Registered advisers must review and update each item and schedule in the Form ADV, including Part 1A, the Part 2A brochure and the Part 2B brochure supplement. Each manager should also:

1. Review its organizational chart (both the entity chart and the personnel chart) and update the Form ADV (including the Part 2B brochure supplement) accordingly;

2. Obtain certifications and bring-downs (and consider refreshing background checks for key personnel) as support for updating the disciplinary events disclosures within the Form ADV (this can also serve as an opportunity to obtain an internal "bad actor" bring-down certification);

3. Consider whether it is making the appropriate state notice filings on Form ADV;

4. Review its treatment of non-U.S. affiliates on Form ADV;

5. Confirm that none of its employees are acting in a manner that would require registration as an "investment adviser representative"; and

6. Confirm that any reliance on the "relying adviser" concept satisfies all of the requirements of the SEC's Jan. 18, 2012 no-action letter.

B. Exempt Reporting Advisers

[11] Also, advisers must amend Part 1A promptly during the year if: (1) 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 becomes inaccurate in any way; or (2) any information provided in response to Item 4, 8 or 10 of Part 1A becomes materially inaccurate. Part 2 must be amended promptly if any information in it becomes materially inaccurate.

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1. *Form ADV*. Exempt Reporting Advisers must file an annual updating amendment within 90 days after the end of the fiscal year. Exempt Reporting Advisers are not required to complete Part 2A, Part 2B and certain items in Part 1A.

2. *State Registration*. Exempt Reporting Advisers are not automatically exempted from state registration and may want to re-confirm their exemptions for U.S. states in which they have an office, employ personnel or conduct substantial activities.

C. Form D and Blue Sky Filings

1. Form D filings are more important than ever;[12] the SEC has indicated that it intends to cite them as reliable market data in future rulemakings and, consequently, has proposed significant penalties for errors or fraud in Form D filings. Managers should review their Form D and state "blue sky" filings to ensure that all subscriptions during the prior year were properly reported and to determine if a new or amended filing is warranted.

2. Managers should also consider whether they are a state law "promoter" for Form D purposes (which could also have Rule 506(d) implications) and the need to make greater disclosure of placement agents on the form.

3. Managers considering future reliance on Rule 506(c), which permits broader advertising and marketing efforts for private funds, should pay particular attention to strict compliance with the Form D and its requirements, given the risk that forthcoming rules will have significant negative effects on issuers with deficient or erroneous Form Ds.

D. State and Local Lobbyist and Solicitation Registrations

1. Managers should look at each state in which a public entity or a public employee retirement plan is an investor (or a potential investor) to determine if the manager or its personnel will be required to register as lobbyists (or in a similar capacity). This may require engaging local counsel with knowledge of the state and municipal laws, regulations and codes.

2. Also, each state or municipality may have its own rules and regulations on gifts and entertainment requirements. These may be non-obvious interpretations under state ethics rules or similar statutory schemes and could require stricter controls than most managers' codes of ethics impose.

E. Form PF

If an SEC-registered investment adviser manages one or more private funds and had at least $150 million in private fund "regulatory assets under management" as of the last day of its most recently completed fiscal year, it must file a Form PF. The timing and nature of the required filings vary depending on the type of private fund and its regulatory assets under management. Each registered adviser should confirm that it falls into one of the following categories:

1. It has successfully made an initial filing and is overseeing a monitoring and reporting structure for subsequent filings;

2. It is completing its implementation process in preparation for an impending initial filing; or

[12] In 2013, the Form D was amended: (1) to distinguish between Rule 506(b) (traditional private placements) and Rule 506(c) (general solicitation); and (2) to insert a mandatory bad actor representation.

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3. It is not obligated to make a filing in the immediate future but is tracking assets on a monthly basis and has an implementation plan in the event it becomes obligated to file on Form PF.

F. Form 13F

Section 13(f) of the Securities Exchange Act requires "institutional investment managers" with investment discretion over $100 million or more of "Section 13F securities" to file quarterly reports on Form 13F (within 45 days of the end of each calendar quarter). An initial Form 13F must be filed following the end of the first year in which an institutional investment manager exceeds the $100-million threshold on the last day of any month.

G. Form 13H

Generally, if a manager transacts in NMS securities and those transactions equal or exceed two million shares or $20 million during any calendar day, or 20 million shares or $200 million during any calendar month, it is considered a "large trader" and must promptly file an initial Form 13H after effecting aggregate transactions equal to, or greater than, the identifying activity level and notify its brokers of its large trader identification number (an "LTID"). Regardless of whether an amended Form 13H was filed during the year (which would be required for any changes), large traders are required to file an annual Form 13H within 45 days after the calendar year's end (i.e., Feb. 16, 2015). Managers should also re-examine which individuals or entities have been designated as "securities affiliates" (an affiliate of the large trader/manager that exercises investment discretion over NMS securities) to confirm whether they are required to be (and that they are) listed on the Form 13H.

H. Schedules 13G and 13D; Forms 3, 4 and 5

1. 2014 was a busy year for enforcement actions under Section 13(d) and Section 16 of the Securities Exchange Act, with dozens of individuals and entities (including investment firms) being charged for filing "delinquencies."[13] Under the Securities Exchange Act, if a manager's (or possibly one or more funds') investment discretion or voting power over a registered, voting class of a U.S. public company's outstanding equity securities exceeds 5 percent, then the manager and/or the fund or funds is generally required to prepare and file a Schedule 13G (or, for certain non-passive holders, a Schedule 13D) with the SEC.

2. Schedule 13Gs have annual updating requirements: If a manager's (or possibly one or more funds') beneficial ownership exceeds 10 percent or, under certain circumstances, it has a designee on the board of directors of a U.S. public company, then there likely is a requirement to file transaction reports on Forms 3, 4 and/or 5, and there may be liability under Section 16 of the Securities Exchange Act for disgorgement of "short-swing profits." Managers should review *all* Section 13 and Section 16 schedules and forms at year's end and file all required amendments.

I. Hart-Scott-Rodino Filings

1. Pursuant to the Hart-Scott-Rodino Act, parties to certain acquisitions of voting securities, assets and/or non-corporate interests: (1) must provide the Federal Trade Commission and the Antitrust Division of the Department of Justice with prior notification of such acquisition; and (2) may not complete a covered acquisition until the statutory waiting period (generally, 30 calendar days) has expired or "early termination" has been granted. In addition to mergers and acquisitions, reportable

[13] See, e.g., "SEC Announces Charges Against Corporate Insiders for Violating Laws Requiring Prompt Reporting of Transactions and Holdings: Nearly Three Dozen Charged in Enforcement Initiative to Root Out Repeated Late Filers," SEC Press Release (Sept. 10, 2014).

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transactions may include or arise from investments in and acquisitions of securities of privately-held and public companies, exercises of convertible securities and restructurings. While a number of other factors must be considered, a transaction may be reportable under the HSR Act if — as a result of such transaction — the acquiring person would hold voting securities, assets and/or non-corporate interests of the acquired person valued above $75.9 million (the "size of transaction" test).[14]

2. Managers should therefore review all fund holdings of issuers that, individually or in the aggregate, approach the size of transaction test figure and consult with counsel *prior* to each additional acquisition of securities (including open market acquisitions) to confirm whether the investing funds or the manager will be subject to the HSR Act waiting period.

J. Non-U.S. Transactional Filings

Many non-U.S. jurisdictions have reporting requirements and other consequences when securities holdings exceed certain thresholds; in addition, many non-U.S. jurisdictions (including the EU member states) have reporting requirements for, and limitations on, short sales of certain securities and financial instruments. For example, there are EU-wide disclosure obligations in relation to long positions (initial reporting thresholds are set as low as 1 percent in some jurisdictions) and short selling disclosure obligations apply in all EU jurisdictions and some non-EU countries, including Australia, Hong Kong and Japan. (See "Securities and Derivatives Trading" below for more information.)

III. CFTC and NFA Filings and Requirements

A. CPO Delegation

Registered CPOs should ensure that CPO delegation agreements that comply with CFTC requirements are in place for their pools' general partners, managing members, directors and trustees; these should be retained as part of the manager's records. There were a number of developments in 2014 on the delegation front, including two pieces of guidance from the CFTC staff that streamlined many aspects of the delegation process. The most recent information (and a table of the latest requirements) can be found in our *Alert* "CFTC Provides Additional Delegation Relief for Private Fund Managers." (http://www.srz.com/CFTC_Provides_Additional_Delegation_Relief_for_Private_Fund_Managers/)

B. Third-Party Recordkeepers

In September of 2014, the CFTC staff expanded the 2013 exemptive relief validating the use of third-party recordkeepers. In a welcome development the CFTC staff also indicated that more comprehensive guidance with respect to certain outdated electronic recordkeeping requirements will be forthcoming. At the moment, registered CPOs that utilize a third-party recordkeeper should seek representations from that third party under, and make a notice filing in accordance with, CFTC Rule 4.23 or Rule 4.7(b)(4), as appropriate.

C. Form CPO-PQR and Form CTA-PR

1. In general, registered CPOs and CTAs have CFTC disclosure obligations under CPO-PQR and CTA-PR, respectively; however, managers that are also SEC-registered advisers will satisfy some of their

[14] HSR valuations, as well as the identification of the "ultimate parent entity" that would be responsible for making the HSR filing, are to be determined in accordance with specific rules.

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CFTC filing obligations by filing on Form PF, although such managers must also file Schedule A and the Schedule of Investments on Schedule B of Form CPO-PQR. (Registered CTAs must still file Form CTA-PR.) For the year-end filing, Form CPO-PQR is due within 60 days of year's end for managers with more than $1.5 billion of assets under management and within 90 days for other managers. Form CTA-PR is due within 45 days of year's end.

2. As a result of a September 2014 CFTC no-action letter,[15] registered CPOs can now file, in respect of a "parent pool" and a wholly-owned trading subsidiary: (1) a consolidated CPO-PQR; and (2) consolidated audited annual financial statements, provided that certain conditions are met. A filing must be made with the CFTC (and, potentially, in the future with the NFA) to take advantage of this relief.

D. NFA and CFTC Updating and Renewal Obligations

Registered CPOs and CTAs must update their NFA registration information and pay their annual dues within 30 days of the anniversary of their registration (Jan. 30 for managers that registered for the first time as of Jan. 1, 2013). Failure to renew in a timely manner is deemed to be a request for withdrawal. All of this is done through the NFA's ORS portal.

E. Reaffirm Exemptions

A manager that is not registering as a CPO in reliance on a Rule 4.13 exemption (or is registered but nonetheless relies on Rule 4.13(a)(3)) must have electronically filed an annual notice of exemption through the NFA's online system within 60 days of year's end. Managers that have historically relied on the Rule 4.14(a)(8) exemption from CTA registration and intend to continue to do so will also need to reaffirm that exemption.

F. NFA Annual Questionnaire

Registered CPOs and CTAs (including those that take advantage of an exemption with respect to their funds) are required to complete an annual questionnaire on the NFA's website.

G. NFA Self-Examination Questionnaire

Registered CPOs and CTAs (including those that take advantage of an exemption with respect to their funds) are required annually to review the NFA's "self-examination questionnaire" and sign a written attestation stating that they have reviewed their operations in light of the matters covered by the questionnaire.

H. Rule 4.7 Reporting Requirements

These include the delivery of:

1. A quarterly account statement to each investor;

2. Annual audited financial statements to each investor, which are due within 90 days of year's end (30-day extensions (90 days for funds of funds) can be requested, but such requests must be made prior to the end of the 90-day period); and

[15] CFTC No-Action Letter No. 14-112 (Sept. 8, 2014).

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3. A quarterly report to the NFA with performance and operating data (i.e., Form CPO-PQR and Form CTA-PR).

IV. Other U.S. Federal Filings

A. TIC Forms

The U.S. Treasury Department gathers statistical information on a wide variety of cross-border investments from U.S. entities, including U.S. fund managers, on its "TIC Forms."[16] The TIC Forms must be filed by U.S. fund managers (without any obligation on Treasury to provide a notice of filing) so long as the conditions and minimums described in the instructions are met. Filings can be made electronically or by mail/fax with the Federal Reserve Bank of New York. A reporter identification number (an "RSSD-ID" number) is required.

[See table on next page.]

[16] The main index of the TIC Forms can be found on the TIC Forms & Instructions page of the Treasury's website.

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The monthly and quarterly reports that may apply to U.S. fund managers are:

	TIC B Form	TIC D Form	TIC S Form	TIC SLT Form
Scope	Requires information on several types of cross-border U.S. dollar and foreign currency claims and liabilities, including loans, deposit balances, brokerage balances and short-term negotiable and non-negotiable securities.[17]	Requires information on worldwide holdings of derivatives.	Requires information on certain cross-border monthly purchases and sales of "long-term securities" (i.e., equities or any security with a term of more than one year).	Requires information on certain cross-border holdings of and positions in long-term securities.
Filers	Fund managers with covered claims and liabilities totaling: (1) over $50 million (overall); or (2) over $25 million (in a single country).	Fund managers with total worldwide (1) notional holdings of derivatives exceeding $400 billion; or (2) net settlements exceeding $400 million.	Fund managers with purchases or sales of $350 million (*formerly $50 million*)[18] or more of long-term securities during a month where no U.S. financial intermediary is otherwise required to report the transactions on TIC S.	Fund managers with holdings/positions of long-term securities of $1 billion or more where no U.S. financial intermediary is otherwise required to report the transactions on TIC SLT.
Frequency	Monthly or quarterly, depending upon the type of claim or liability.	Quarterly.	Monthly.	Monthly. TIC Form SLT must be submitted electronically by using the Federal Reserve's Reporting Central system.
Filing Dates	BC, BL-1 and BL-2: 15th calendar day following the last day of the month. BQ-1, BQ-2 and BQ-3: 20th calendar day following the last day of March, June, September and December.	50 calendar days following the last day of the calendar quarter being reported.	15 calendar days following the last business day of the month in which reporting is triggered.	The 23rd calendar day of the month following the last business day of the month in which reporting is triggered.

There are also several related reports that may need be to submitted on an annual (or less frequent) basis:

[17] These items were previously reported on the TIC C Form, but Treasury has decided to include them, along with additional informational requests, as part of the TIC B Form (which previously was only filed by banking and similar institutions). The instructions to the TIC B Form were revised recently to specify that hedge fund and private equity fund managers are covered by the consolidated TIC B Form.

[18] This is a material change from the prior exemption level of $50 million and took effect in June 2014.

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1. *TIC SHC* is Treasury's quinquennial (every fifth year) benchmark survey of U.S. holdings of foreign securities. It is mandatory for all U.S. entities, including fund managers, that meet its minimum tests. We expect the next TIC SHC Form and instructions, which will likely be updated, to be circulated in early 2016.

2. *TIC SHCA* is the annual version of the TIC SHC; however, only U.S. entities that receive a written request from the government are required to file.

3. *TIC SHL* is Treasury's quinquennial benchmark survey of holdings of U.S. securities by foreign residents. It is mandatory for all U.S. entities, including fund managers, that meet its minimum tests. This filing deadline expired Aug. 29, 2014 (using data as of June 30, 2014). We expect the next due date for this form to be at the end of August 2019.

4. *TIC SHLA* is the annual version of the TIC SHL; however, only U.S. entities that receive a written request from the government are required to file.

B. BEA Forms (Excluding BE-10 and BE-13)

Like the TIC Forms, the U.S. Bureau of Economic Analysis has its own set of statistics-gathering surveys that relate to direct investment between U.S. persons and non-U.S. persons. Unlike the TIC Forms, in general, the BEA's direct investment surveys are only required to be filed following notice from the BEA (but see "BE-10 Forms" and "BE-13 Forms" below).

C. BE-10 Forms ("Benchmark Survey of Direct Investment Abroad")

1. By final rulemaking effective Dec. 22, 2014, the BEA made the BE-10 report applicable to all persons subject to the reporting requirements of the BE-10 Form, irrespective of whether they are contacted by BEA. A BE-10 report is required of each U.S. person with a foreign affiliate at any time during the prior fiscal year.

2. A BE-10 "foreign affiliate" exists when the U.S. person owns 10 percent of the voting stock of an incorporated foreign business enterprise, or an equivalent interest in an unincorporated foreign business enterprise. The definition is broad. For example, a foreign limited partnership with a U.S. general partner is a foreign affiliate because a general partner by its legal nature controls the limited partnership, regardless of the general partner's ownership percentage.

3. There is a Form BE-10A, B, C and/or D. The reports vary depending on the size of the U.S. reporter or foreign affiliate and whether the foreign affiliate is minority- or majority-owned. The BEA is considering preparing an FAQ to assist hedge fund managers in filling out the BE-10 forms. The survey questionnaire is being redesigned and is not yet available from the BEA.

D. BE-13 Forms ("Survey of New Foreign Direct Investment in the United States")

1. By final rulemaking effective Nov. 24, 2014, the BEA reinstated the BE-13 report and made it mandatory for each covered U.S. person (whether or not such company is contacted by the BEA).

2. A U.S. entity is required to report if: (1) a foreign direct investment relationship in the United States is created; or (2) an existing U.S. affiliate of a foreign parent establishes a new U.S. legal entity, expands its U.S. operation or acquires a U.S. business enterprise. "Foreign direct investment" is defined for BE-13 purposes as the ownership or control, directly or indirectly, by one foreign person

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of 10 percent or more of the voting securities of an incorporated U.S. business enterprise, or an equivalent interest of an unincorporated U.S. business enterprise.

3. There is a Form BE-13A, B, C, D and Claim for Exemption. The reports vary depending on whether a company is being acquired, established, merged, expanded or an exemption is being filed. The survey is retroactive to Jan. 1, 2014, and the initial due date for 2014 activity was Jan. 12, 2015. In general, the due date is no later than 45 days after a given foreign direct investment acquisition is completed, the new legal entity is established or the expansion is begun.

E. FBARs

A Report of Foreign Bank and Financial Accounts must be filed electronically by any U.S. person who has a financial interest in, or signature or other authority over, any financial account in a foreign country, if the aggregate value of these accounts exceeds $10,000 at any time during the calendar year. Financial accounts that may be subject to FBAR reporting include, but are not limited to, bank accounts, brokerage accounts, mutual funds and other types of foreign financial accounts. An FBAR must be filed by June 30 of the year following the year that the account holder meets the $10,000 threshold. Privately placed funds are generally not FBAR "accounts," but the bank and brokerage accounts of these funds can be foreign accounts for which the manager has signature authority and must file an FBAR. Failure to file this form when required can result in significant civil (and potentially criminal) penalties.

V. FCA Reporting Requirements[19]

A. FCA Disclosure Requirements

Managers that are authorized in the United Kingdom (or that have affiliates authorized in the United Kingdom) should ensure that their Financial Conduct Authority (the successor to the U.K. Financial Services Authority) reporting obligations are up to date and accurate. The FCA should be notified of the following events:

1. The manager failing to satisfy one or more of the Threshold Conditions;[20]

2. Any matter that could have a significant adverse impact on the manager's reputation;

3. Any matter that could affect the manager's ability to provide adequate services or result in serious detriment to a customer;

4. Any matter that could result in serious financial consequences to the U.K. financial system or to other firms;

5. Certain civil claims, disciplinary measures, sanctions, prosecutions, convictions or other investigations involving the manager or its affiliates;

6. A change in the name or address of the manager;

[19] This section is directed primarily at U.S. managers with U.K. operations or affiliates; we have also prepared a checklist tailored to U.K.-based managers that can be obtained from your primary SRZ contact.

[20] The FCA "Threshold Conditions" are the FCA's minimum requirements for an authorized firm to obtain authorization and remain authorized. They include: (1) its legal status; (2) location of its offices; (3) close links; (4) adequacy of its resources; and (5) the suitability of the firm's personnel to act in their capacity as approved persons for an FCA-authorized firm.

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7. The manager becoming subject to or ceasing to be subject to the supervision of another regulator (e.g., the SEC, the CFTC or the Hong Kong Securities and Futures Commission); and

8. Any other matter that the manager believes the FCA would deem relevant (e.g., any material or significant information that affects the manager's business, risk profile or financial stability, or otherwise has a serious regulatory impact on the firm).

Managers authorized as U.K. AIFMs are required to notify the FCA (and, in some cases, obtain prior approval) in relation to any material changes to the conditions for authorization, including new funds, changes to risk management arrangements and leverage limits; new non-controller affiliates must also be notified to the FCA. Prior approval is required for any changes in control of the FCA-authorized manager (including for new holding companies within the group).

B. Periodic Reporting Obligations

1. *Annual Verification of Standing Data.* A manager annually must confirm to the FCA the accuracy of its "standing data" within 30 business days of its accounting reference date.[21]

2. *Annual Controllers Report.* A manager must submit an annual report to the FCA: (1) confirming that it does not have any new controllers (i.e., persons who hold in excess of 10 percent of its shares or voting rights); or (2) disclosing any changes of its controllers or their respective holdings since the submission of its previous report.

3. *Annual "Close Links" Report.* Unless a manager has elected to report close links data to the FCA on a monthly basis, it must submit an annual close links report to the FCA to identify any changes, or to confirm that there have not been any changes, to its close links.[22]

4. *Annual Appointed Representatives Report.* A manager must file an annual report with the FCA confirming whether the manager has any new appointed representatives, or whether the arrangements with any existing appointed representatives have been terminated or have otherwise changed.

5. *Annual Remuneration Disclosure.* Under the FCA's Remuneration Code, managers must make an annual disclosure of their remuneration policy and practices, with information on the link between pay and performance and a breakdown of aggregate compensation by business area, senior staff members, and those individuals whose actions may have a material impact on the risk profile of the manager.[23]

6. *Periodic Financial Disclosures.* Although the frequency of reporting required depends on the authorizations a manager maintains within the FCA, most managers must provide the FCA with their report and accounts annually and other information about their funds semi-annually or quarterly. Managers are required by FCA rules to file financial information with the FCA on a wide range of issues, including with respect to their annual report and accounts, solvency, balance sheet, income

[21] The FCA "standing data" includes: (1) the name of the manager; (2) any alternative trading name(s) of the manager; (3) the registered office address; (4) the manager's principal place of business, if different from its registered office; (5) the manager's website address; (6) the manager's complaints contact and complaints officer; (7) the name and email address of the manager's primary compliance contact; (8) the name and address of the manager's auditor; and (9) the manager's accounting reference date.

[22] "Close links" are links between a manager and any other persons with direct ownership of or control over 20 percent or more of the capital or voting rights of the manager or entities that are in the manager's group.

[23] Disclosure can be made either on the manager's website or in its annual report and accounts, the latter of which is filed at Companies House in the United Kingdom.

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statement, capital statement, credit risk, market risk and operational risk. Managers are also required to make regulatory filings in respect of the funds they manage, including reports as to the amount of assets under management, and those funds' administrators and prime brokers.

7. *Annex IV Filings*. FCA-authorized AIFMs are required to submit Annex IV reports in respect of the relevant funds managed by the AIFM.

C. Location of the AIFM — U.S. Managers with U.K. Affiliates

U.S. managers should ensure that a U.K.-based affiliate is not considered to be the AIFM (i.e., the main manager) for the purposes of the AIFM Directive. This effort can involve the following steps:

1. Internal governance and organizational arrangements should be reviewed in respect of each fund to confirm that sufficient "AIFM substance" exists outside the United Kingdom (e.g., in case of relocation of key portfolio and/or risk manager personnel to the United Kingdom);

2. If the U.K. entity is considered to be the AIFM of any fund, a variation of permission must be obtained from the FCA to ensure that the U.K. entity holds correct authorization to act as an AIFM;

3. Investor disclosures must be reviewed to ensure that the disclosures reflect the location of the AIFM consistent with the above determination; and

4. Managers must review their marketing and investor relations procedures to ensure compliance with the AIFM Directive.

VI. Marketing in Europe

A. AIFM Directive

The AIFM Directive was implemented in a majority of EEA member states in 2013, subject to transitional periods for marketing activities (available in some EU member states) which expired on July 22, 2014. The AIFM Directive is far-reaching in its scope and brings additional regulatory burdens to AIFMs based in the EU and their funds (or "AIFs"). For non-EU managers with non-EU funds, the AIFM Directive will only apply with respect to marketing those funds to EU investors and acquiring control of companies established in the EU (the so-called "asset-stripping rules").[24]

B. Marketing Non-EU Funds in the EU

Although the implementation of the AIFM Directive brought a renewed focus on marketing funds into Europe, for non-EU domiciled funds, marketing will continue to be done under the local national private placement regime of each member state with additional minimum AIFM Directive requirements, including investor disclosures, annual reports and transparency reporting.[25] The AIFM Directive provides a broad definition of marketing, but each member state is allowed to further refine and expand on what is and is not considered marketing in such member state. As the NPPRs, where available, effectively prohibit non-EU funds from being marketed into those jurisdictions without prior registration and compliance with disclosure and transparency requirements, each manager of a non-EU AIF should have in place a policy on how to interact with prospective investors under these jurisdictions (see "Reverse

[24] For more information on investing in EU private companies, please see our *Alert* "Requirements for AIFMs When AIFs Invest in EU Private Companies."

[25] This section applies to marketing in the EU and EEA only. Non-EU, non-EEA countries (e.g., Switzerland) are outside of this guidance.

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Solicitation" below) and understand whether any of its current practices would be deemed to be "marketing." For those managers that wish to market into member states where it is allowed under the relevant NPPR, a filing must be made in each such member state and the requirements of the AIFM Directive for active marketing must be followed (see "Active Marketing" below).

1. *Reverse Solicitation*

(a) The AIFM Directive does not prohibit a professional investor (as defined under the AIFM Directive) located in the EU from investing in an AIF on its own initiative, regardless of where the AIF or AIFM is established. This principle is known as "reverse inquiry" or "reverse solicitation." As several EU member states do not have an NPPR that allows managers to actively market a non-EU fund, managers should have reverse solicitation policies in place. Managers must rely on reverse solicitation for each member state where they have not registered to actively market the fund. Some managers may choose to apply a reverse solicitation policy to all EU member states (as an alternative to registering and complying with the NPPRs).

(b) Managers should consider the following:

(i) As some member states have interpreted what constitutes marketing very broadly (including naming a fund in a newsletter or other promotion material), managers should carefully review all marketing materials and communications sent to existing and prospective investors to ensure that no information that could be construed as marketing for AIFM Directive purposes reaches an EU investor if the manager is not registered under the NPPR in that member state.

(ii) Managers should have a process in place to identify whether prospective investor requests for marketing materials are coming from an EU investor. Upon receiving such a request, written documentation should be received from the investor as early as possible in the process to confirm that the investor has initiated the contact and is a professional investor. The investor relations staff should be instructed not to send documents to EU investors in jurisdictions where the manager is not registered to market prior to documenting a reverse solicitation.

(iii) Distribution lists (including newsletters and other investor or prospective investor communications) should be limited to non-EU persons or EU persons who have requested to be on the list. Managers should consider refreshing the positive request from each "yes" recipient annually.

(iv) Website content should be password-protected and access should only be given to EU investors that have asked for access and have been vetted.

(v) Managers should confirm that any third-party marketers, consultants, cap intro teams or other solicitation agents have comparable controls to those of the manager for ensuring that EU investors are not sought in violation of its internal policies and procedures on communications with EU investors.

(vi) Subscription documents should contain representations by the investor that documentation was provided at the investor's initiative and that the manager has not marketed for AIFM Directive purposes.

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(vii) EEA country selling legends must be reviewed and updated to ensure that no active marketing is permitted without prior NPPR registration.

2. *Active Marketing*

(a) Until the AIFM Directive marketing passport[26] is made available to non-EU funds, such funds must be marketed in compliance with the relevant member state's NPPR and the additional requirements of the AIFM Directive. A notification or registration must be made with the relevant member state regulator before active marketing may commence. The AIFM Directive requires, at a minimum, that certain disclosures are made to investors, annual reports meet the AIFM Directive requirements, and transparency reporting be made to the relevant regulators. Member states may have requirements in addition to the AIFM Directive requirements.

(b) For managers that have commenced marketing into the EU, the following items should be considered:

(i) Article 23 Disclosures

Managers should review the Article 23 disclosures that were made to investors prior to investment to determine whether material changes need to be disclosed. Disclosures that were required to be made prior to investment include:

(1) Investment strategy and objectives;

(2) Legal structure and applicable law;

(3) Key service providers and their duties (e.g., prime broker, auditor, administrator);

(4) Fees, charges and expenses borne by investors;

(5) Side letters and other preferential arrangements with investors;

(6) Subscription terms;

(7) Copy of annual report and latest NAV; and

(8) Historical performance.

In addition to the above disclosures, managers are also required to make certain periodic and recurring disclosures. Managers should ensure that the following disclosures are made to investors at least annually:

(1) The percentage of an AIF's assets subject to special arrangements arising from their illiquid nature (such as gates or side pockets);

(2) New arrangements for managing the liquidity of the AIF;

(3) Current risk profile and risk management systems employed; and

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[26] The passport for non-EU funds and non-EU managers will not be available until the EU Commission "activates" the third-country provisions of the AIFM Directive. This can occur (if at all) in late 2015, at the earliest. To benefit from the EU marketing passport, U.S. managers will be required to register with the relevant EEA member state regulator and comply with all of the provisions of the AIFM Directive (including appointment of a depositary for their funds).

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(4) Total leverage employed (calculated via gross and commitment methods set forth in the AIFM Directive).

(ii) Fund Annual Reports

AIFM Directive-compliant annual reports (which include audited financial statements, material changes to Article 23 disclosures and remuneration disclosures) must be made available to investors within six months following a fund's financial year's end and must be provided to the local regulator on request.

(iii) Annex IV Reporting

(1) All EU-based managers authorized as an AIFM and all non-EU managers marketing a fund into the EU must file an Annex IV report with the applicable regulator (EU managers will only need to file with their home regulator). A non-EU manager will have to make a report to the applicable regulator of each member state in which it is authorized to market. Non-EU managers that are not marketing a fund into the EU (including those accepting investors solely through reverse solicitation) are exempt.

(2) The timing and nature of the required filings vary depending on the type of investments made, assets under management and whether leverage is utilized. Each EU manager or managers marketing into the EU should confirm the frequency of its filings and the first due date of its filings. Managers are advised to begin collecting information well in advance of the due date.

(3) Filings are made using the standard template produced by the European Securities and Markets Authority or the form provided by the local regulator (if any).

(iv) Investing in EU Private Companies

(1) Managers should consider the scope of the provisions set out in Article 26 of the AIFM Directive.

(2) Managers should comply with the notification and disclosure obligations set out in Articles 27 and 28 of the AIFM Directive.

(3) Managers should consider and comply with the specific provisions regarding the annual report of AIFs which exercise control of non-listed EU private companies set out in Article 29 of the AIFM Directive.

(4) Managers should comply with the asset-stripping restrictions and requirements set out in Article 30 of the AIFM Directive.

C. EU AIFMs Managing Non-EU AIFs

EU managers that are authorized as an AIFM are subject to AIFM Directive requirements, including: maintenance of regulatory capital based on the level of assets under management, conduct of business, conflicts of interests, valuation of assets and other operational rules. EU managers should ensure they are in compliance with their new obligations. In addition, particular care should be taken in the oversight of other entities to whom the AIFM has delegated responsibilities (such as delegation of management functions or valuation functions) under the AIFM Directive.

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1. *Annex IV*. See "Annex IV Reporting" above. For EU managers that were authorized as AIFMs in July 2014.

2. *Marketing*. To the extent EU AIFMs intend to market their non-EU AIFs to EU investors, the Article 23 disclosure requirements will apply as set forth above and agreements with "depo lite" providers must be put in place.

3. *Remuneration*. AIFMs should have in place a remuneration policy in compliance with the AIFM Directive. The policy should ensure that remuneration paid to those categories of staff whose professional activities have a material impact on the risk profiles of the funds that they manage is consistent with sound and effective risk management.

D. U.S. Managers Managing EU AIFs

U.S. managers of non-UCITS funds established in Ireland, Luxembourg or other EU jurisdictions must note the expiration of local transitional provisions in respect of AIF-management activities. Depending on the status of the AIF under local law, an EU-regulated AIFM may need to be appointed (or the board of the AIF must assume the role of the EU AIFM — with corresponding "AIFM substance" requirements).

E. Asset-Stripping Rules

1. U.S. managers that register their funds under NPPRs will be required to comply with the so-called "asset-stripping rules" in the AIFM Directive in respect of acquisitions of control (i.e., 50 percent or more of the voting rights) of non-listed companies established in the EU.[27]

2. The asset rules impose:

   (a) Certain restrictions on distributions (e.g., dividends), capital reductions, share redemptions and acquisitions of its own shares by the EU company within the first 24 months following the acquisition of control by the manager; and

   (b) Certain disclosure and transparency obligations on the manager (including the provision of information to the company, its other shareholders, employees and the relevant regulator). (Note: These disclosure and transparency obligations also apply to issuers of shares admitted to trading on EU markets.)

F. Swiss Distribution Rules

1. A new regime governing the distribution of non-Swiss funds to Swiss investors came fully into force on March 1, 2015 (when the transitional period expired).

2. The new regime segments Swiss investors into three categories: (1) unregulated qualified investors (pension plans, corporates, family offices, family trusts and high-net-worth individuals); (2) regulated qualified investors (a more restricted list of Swiss regulated financial entities, such as banks, securities dealers, fund managers and insurance companies); and (3) non-qualified investors (effectively retail).

Managers that were distributing their funds to unregulated qualified investors in Switzerland on or after March 1, 2015 must have complied with the new requirements by that date. These include, among other

[27] For more information on investing in EU private companies, please see our *Alert* "Requirements for AIFMs When AIFs Invest in EU Private Companies."

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things, a requirement for the fund to appoint a Swiss-licensed representative and a Swiss bank as a paying agent and for the fund's manager to enter into a distribution agreement with the appointed Swiss representative.

VII. AML, OFAC and FCPA Obligations

A. AML and OFAC

1. Although the Anti-Money Laundering program rules under the USA PATRIOT Act are not yet applicable to investment advisers or private investment funds, many managers have adopted risk-based AML policies and procedures as a result of: (1) applicable law, including the Money Laundering Control Act, the Bank Secrecy Act, economic sanctions enforced by Treasury's Office of Foreign Assets Control, and local AML law requirements applicable to the fund; (2) industry best practices; (3) investor expectations; (4) counterparty expectations; and (5) desire to mitigate reputational risk.

2. Managers should have AML policies in place and should review their AML program annually to make sure the program is sufficient and is being implemented. Reasonable review steps could include:

   (a) Reviewing the subscription agreement forms with counsel to ensure that all required materials and information are being requested;

   (b) Reviewing the AML procedures of each fund's administrator, and if applicable, obtaining annual certifications from the administrator as to its procedures and compliance with the requirements of the manager as set forth in the subscription documents;

   (c) Confirming with the administrator that regular OFAC checks are being performed and that screening procedures are regularly updated to capture changes to the OFAC lists, such as recent sanctions in light of the crisis in Russia and Ukraine;

   (d) Reviewing side letter provisions or certifications made to investors and counterparties to ensure that each managed fund is complying with its AML commitments;

   (e) Confirming with the administrator that AML and OFAC training is provided to appropriate personnel; and

   (f) Confirming with the administrator that a qualified individual is designated to monitor day-to-day AML compliance.

B. FCPA

In recent years, the SEC and the DOJ have closely scrutinized compliance with the Foreign Corrupt Practices Act and many managers have adopted policies and procedures designed to ensure compliance with the FCPA. Managers should consider amending their gifts and entertainment policies in order to prohibit contributions, gifts or entertainment to any non-U.S. government officials, candidates, political parties or relatives of government officials without pre-clearance. Managers should also conduct regular training in this area, particularly if they are raising capital from sovereign wealth funds or doing business or making private investments overseas in jurisdictions that are at a higher risk for FCPA issues. Compliance officers should conduct ongoing monitoring in this area to ensure that no gifts were made to foreign officials and that all gifts comport with their firm's gifts and entertainment and (if separate) FCPA policies and procedures.

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VIII. Cybersecurity Issues

On April 15, 2014, the SEC's Office of Compliance Inspections and Examinations circulated a Risk Alert[28] that included a sample document request to registrants. In a later speech, an SEC Commissioner[29] indicated that the agency is exploring regulations to address cybersecurity in a larger sense. While this is a developing area, managers should evaluate which practices make sense for their individual businesses and exposures. Initiatives and efforts that may be useful in this area include:

A. *Enterprise-Level Risk Assessments.* The SEC is concerned with firms' vulnerability to cybersecurity risks in general, including "misappropriation of funds, securities, ... [and] Firm information[.]" Managers should accordingly review existing related policies, such as controls on processing redemption requests and IT safeguards, in a cybersecurity context.

B. *Industry Guidelines.* In addition to the SEC's Risk Alert, there are various sources of industry intelligence and best practices (e.g., the National Institute of Standards and Technology's "Framework for Improving Critical Infrastructure Cybersecurity") that can help in structuring a cybersecurity review. A manager should be prepared to explain how it designs and maintains its infrastructure, its incident response plan and its training for employees. Third-party security firms can assist in this effort.

C. *Cybersecurity Personnel*. Compliance officers should be familiar with the technology department's personnel and their functional specialities.

D. *Vendors and Other Third Parties*. Managers should review their exposure to third parties with possession of or authorized access to the firm's systems or information (including fund administrators, prime brokers and consultants). In many cases, contracts with these vendors should have representation and undertakings regarding cybersecurity, and supplemental diligence may be warranted.

E. *Records of Cybersecurity Incidents*. The SEC Risk Alert includes a request for a list of incidents such as when "[t]he Firm received fraudulent emails, purportedly from customers, seeking to direct transfers of customer funds or securities," or when "[a]ccess to a Firm web site or network resource was blocked or impaired by a denial of service attack." Managers should begin working these kinds of oversight and reporting functions into their processes. Following an incident, counsel should be consulted to formulate a response and, in many cases, to oversee the preservation of evidence.

F. *Disaster Recovery*. Managers should review their existing disaster recovery plans in order to ensure that they are up to date with firm operations and that they take into account cybersecurity and identity theft prevention policies.

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[28] SEC, Office of Compliance Inspections and Examinations, Risk Alert: OCIE Cybersecurity Initiative (April 15, 2014). Topics covered in the Risk Alert included:

- Cybersecurity governance policies and procedures;
- Protection measures for firm systems and networks;
- Safeguards for confidentiality of firm information;
- Procedures for remote computer access;
- Safeguards for fund transfer requests;
- Cybersecurity protections for interactions with vendors and third parties; and
- Detection and protection measures for unauthorized access to firm systems and networks.

[29] Luis A. Aguilar, Commissioner, SEC, "Boards of Directors, Corporate Governance and Cyber-Risks: Sharpening the Focus," "Cyber Risks and the Boardroom" Conference, New York Stock Exchange (June 10, 2014).

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IX. Annual Compliance Review

A. All SEC-registered investment advisers are required by Rule 206(4)-7 to review, no less frequently than annually, the adequacy of their compliance policies and procedures, as well as the effectiveness of the implementation of such policies and procedures. Many investment advisers that are not registered with the SEC also have policies and procedures that require an annual compliance review. In addition, as discussed above, CFTC-registered CPOs and CTAs are required annually to review the NFA's self-examination questionnaire.

B. The annual compliance review must provide an assessment of the adequacy of the manager's compliance policies and procedures and the effectiveness of their implementation. It should be robust and comprehensive and should include matters like a report on changes in the adviser's business and in the applicable laws and regulations over the prior year, an assessment of high and low risk areas in the compliance framework (and changes in relative risk), the results of a stress test of the business continuity plan, and issues, challenges and proposed areas of change or improvement. A written record of the review should be prepared and retained by the manager. To the extent you need assistance in planning or carrying out a review, please feel free to contact us.

C. Policies of particular interest include:

1. *Insider Trading.* The implementation of policies on the prevention of insider trading (including the use of a restricted list). (See "Securities and Derivatives Trading" above.)

2. *Identity Theft.* Managers should review their identity theft program (which, if applicable, should include policies and procedures designed to identify, detect and respond to patterns, practices or specific activities (i.e., "red flags")) to reflect any manager experiences or industry guidance in 2015.

3. *Custody Rule.* Managers should review their Custody Rule policies and procedures in light of the June 2014 IM Guidance Update ("Private Funds and the Application of the Custody Rule to Special Purpose Vehicles and Escrows" https://www.sec.gov/investment/im-guidance-2014-07.pdf);[30] this guidance should be reviewed to determine whether investments in special-purpose vehicles trigger an obligation for a separate audit (or a surprise audit) under the Custody Rule.

4. *Expenses.* Expenses continue to be an area of regulatory interest. Managers should review their internal controls on expenses and consider questions such as:

   (a) Does legal or compliance review the individual line items intra-year with a finance professional?

   (b) Are the expense items reviewed annually at the management committee or is the allocation process running on "auto pilot"?

   (c) Is the rationale for non-pro rata expenses documented, defensible and consistent with the disclosures in the Form ADV, the DDQ and the offering documents? And, for pro rata allocations, is there some indication of how pro rata percentages are calculated (On a pre- or post-leverage basis? Including side pockets or not? On commitments or contributed capital?).

D. *Pay-to-Play.* With fundraising for the next election cycle in full swing, campaign donation and support requests will likely increase as well. Managers should plan ahead and discuss potential issues with local

[30] While these are not new, it may also be useful to review: (1) the August 2013 relief regarding the custody of privately offered securities granted by the Division of Investment Management of the SEC; and (2) the March 2013 Risk Alert issued by the SEC's National Examination Program.

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counsel in states where there is likely to be internal interest at the manager. State and local campaign contributions and activity should be examined under applicable local law, in addition to the SEC's pay-to-play rules.

E. *Social Media.* Managers should confirm that their policies and training clearly delineate where the line lies between permissible public statements (e.g., listing title and employer) and compliance violations. Managers should also review their electronic communications surveillance and retention practices in light of the social media explosion.

F. *Side Letter Compliance.* A review of the terms of each fund's side letters and the fund's record of complying with them is also a useful element of many reviews.

G. *Code of Ethics.* Reviews of code of ethics matters (e.g., personal trading) is a mandatory element of an SEC annual compliance review.

H. *Conflicts.* An annual compliance review can also be used to address conflicts more generally, such as gifts and entertainment policies and practices, political contributions, allocations of expenses and investment opportunities, and outside business activities, as well as issues such as AML compliance, the U.S. FCPA and the U.K. Bribery Act 2010.

I. *Use of Solicitors.* Two different 2013 SEC initiatives highlight the issues that continue to accompany any use of paid solicitors. The first was a coordinated trio of actions involving Ranieri Partners[31] that made clear the SEC can and will impose liability on an adviser for knowingly using an unlicensed broker in placing fund interests. The prominence of this issue was further underscored in an April 2013 speech by the chief counsel of the SEC's Division of Trading and Markets, where he highlighted broker-dealer registration concerns raised by sales of interests in private funds. The second initiative related to the "bad actor" rule discussed above, where a sponsor's or a placement agent's bad actor status can imperil an issuer's ability to utilize Regulation D. Managers should carefully review their use of paid and unpaid solicitors in light of these developments.

J. *Information Security and Disaster Recovery.* Potential investors and regulators are both interested in actual testing results and the manager's experience in disasters such as Hurricane Sandy. This may be part of the annual compliance review that the firm's legal/compliance team delegates to the technology group and can be dual-purposed to cover cybersecurity and other information security issues.

K. *Proxy Voting.* Investment Advisers Act Rule 206(4)-6 requires that all registered investment advisers "[a]dopt and implement written policies and procedures" reasonably designed to ensure that the adviser "vote[s] client securities in the best interest of clients[.]" These procedures must address material conflicts, disclose how clients may obtain voting information and describe the adviser's proxy voting policies and procedures (and furnish a copy upon request). This is a long-standing annual requirement, but on June 30, 2014, the SEC's Division of Investment and Division of Corporate Finance jointly released Staff Legal Bulletin 20, which contains new guidance for investment advisers on demonstrating compliance with Rule 206(4)-6, both overall and with a particular focus on the oversight of proxy advisory firms. All registered advisers should arrange for a review of their proxy voting policies in light of the new guidance.

[31] In the Matter of Ranieri Partners LLC and Donald W. Phillips, Securities Exchange Act Release No. 69091, Investment Advisers Act of 1940 Release No. 3563, Administrative Proceeding File No. 3-15234 (March 8, 2013); In the Matter of William M. Stephens, Securities Exchange Act Release No. 69090, Investment Company Act of 1940 Release No. 30417, Administrative Proceeding File No. 3-15233 (March 8, 2013).

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Managers that have "plan assets" funds or accounts should also perform reviews that are focused on compliance with the ERISA rules. (ERISA reminders appear throughout this outline, including under "Securities and Derivatives Trading.")

Other elements to consider in the annual compliance review[32] include:

A. Ensuring that testing and monitoring programs are in place and that the reviews are being performed on a regular basis, with exceptions being logged and addressed;

B. Reviewing the lists of "access persons," "control persons" and Rule 506(d) covered persons and updating as necessary;

C. Mapping committee meetings actually conducted and materials actually circulated against the relevant language in the marketing materials;

D. Reviewing valuation committee minutes;

E. Reviewing marketing materials (including the firm's website) for substantive compliance with regulatory guidance;

F. Conducting a books and records audit;

G. Determining whether existing policies and procedures satisfy the manager's representations and obligations under the Dodd-Frank and ISDA Protocols (discussed above);

H. Ensuring all required training was done (and providing "make ups" to any absent personnel);

I. Reviewing custody rule compliance by asset class; and

J. Meeting with firm personnel to discuss potential compliance issues during the past year.

Annual Reviews of Key Service Providers. On examination, managers are often asked to provide information on the due diligence processes they employed in engaging service providers for clients. Managers should consider documenting this process, both at the initiation of the engagement and annually thereafter (this can be a part of the annual compliance review). Managers that are NFA members can combine these reviews with their NFA Bylaw 1101 obligations (discussed above). In addition, managers may be required, as part of the administration of an identity theft prevention program, to exercise oversight of certain service providers (e.g., administrators).

X. Other Useful Steps

A. Preparations for Employee Certifications and Acknowledgements

It is important to prepare the various certifications and acknowledgements that will be required from manager personnel in the first quarter:

1. Under the Investment Advisers Act, registered advisers *must* obtain from all "access persons": (1) a personal trading transactions report within 30 days of the close of each calendar quarter; and (2) an annual securities holdings report (which is usually required as of year's end);

[32] More information on many of these substantive topics is included in the various reminders inserted throughout this outline.

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2. Many managers require annual updates to the firm's records regarding information such as lists of employee personal securities accounts, records of political contributions, disclosures of outside business activities and names of relatives holding positions that could pose conflicts (e.g., employees of clients, brokers or service providers) or other concerns (e.g., relatives who sit on the boards of public companies);

3. Most managers also require that employees submit annual certifications that they have read, understand, have not violated and will continue to comply with the firm's code of ethics and other compliance policies; and

4. Managers should consider obtaining "bad actor" representations and "bringdowns" from their employees (generally on an annual basis) to ensure continued eligibility under Regulation D.

B. Review Director Agreements

It is a good practice to review the agreements that each managed fund has with its directors. Particular attention should be paid to indemnification and other provisions that, over time, may have become inconsistent with the fund's governing or disclosure documents or with side letter agreements. Also, if the directors are independent of each other, then the various agreements should be harmonized. Directors should also be required to provide written confirmation that they have no Rule 506(d) ("bad actor") events to disclose.

C. Background Checks on Key Individuals

Some managers will perform an annual background check (either by engaging a third-party service provider or by using a service such as World-Check) on senior personnel of the manager and of the funds (i.e., the directors).

D. Review the Administration Agreement

Similarly, the administration agreement should be reviewed and checked against the fund disclosures and representations made to investors. Particular attention should be paid to confirming that the allocation of responsibility for the valuation of the portfolio accords with the corresponding disclosures in the private placement memoranda and the Form ADV. The manager should confirm that all AML/OFAC checks are being performed regularly and should receive documentation that cybersecurity defenses are in place.

E. Revise and Review the Compliance Manual

Based on the results of the annual compliance review and the overall experiences of the manager throughout the year, an annual updating of the compliance manual is sometimes necessary. (Registered advisers must retain a copy of the superseded manual, and this is a best practice for all managers.)

F. Begin Preparing Training and Educational Materials

Frequent education and training efforts, tailored for the organization and its personnel, are also a best practice (and are generally expected by institutional investors).

1. Compliance training sessions should specifically address the manager's operations and their content. They should: (1) address any weaknesses identified in the annual compliance review, any recent regulatory developments and any changes in the manager's business; (2) include

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explanations of any changes to the code of ethics or other firm compliance policies; and (3) be supplemented, when appropriate, by less formal interactions and communications on recent developments. Holding separate customized training sessions for the various functional specialties in the firm is also a good idea in larger organizations.

2. Registered CPOs and CTAs should also ensure that the compliance training syllabus includes material that will satisfy the NFA's ethics training requirements (which cover all "associated persons"). Procedures should also be in place addressing who will provide the training, how it will be provided and how frequently it will be provided. Records of attendance at these training sessions should also be maintained. To the extent that third-party providers of NFA-required ethics training are employed, they should have a minimum of three years of industry experience, have passed a Series 3 and have no disciplinary history that would render them unfit to provide this training.

G. Non-U.S. Issues

Managers that have a presence or are registered (either directly or that have a foreign management affiliate) outside of the United States should consider how local regulatory developments will or should influence the policies, procedures and business of the overall enterprise. For example, the AIFM Directive will cause changes in a number of compliance processes for both EU managers and for non-EU managers marketing AIFs in the EU. The key areas where managers should focus their attention are marketing, investor disclosure, the AIF's annual accounts, regulatory reporting and investing in EU private equity.

H. Review Your Insurance Policies

Managers should consider their needs in respect of directors and officers ("D&O") and errors and omissions ("E&O") coverage. Prior to entering into a new binder, most managers will consult their counsel for a review of the coverage terms to ensure that the policy covers all products and activities of the manager and to maximize the coverage for informal inquiries. Managers may also want to consider whether their coverage, if any, for information security breaches (including cybersecurity breaches) is consistent with their level of exposure.

XI. Investor Communications Sent in Early 2015

A. Deliver Updated Form ADV Part 2

Generally, an SEC-registered investment adviser must provide to each of its "clients" (i.e., each managed account client and private fund that it advises), no later than 120 days after the end of the fiscal year, either: (1) a copy of its current (updated) Part 2A and 2B; or (2) a summary of material changes that includes an offer to provide a copy of its current Part 2A and 2B. As a best practice, many managers will deliver the entire ADV to investors at least annually.

B. Deliver Audited Financial Statements to All Investors

1. If an SEC-registered manager is deemed to have custody over a private fund's assets, it must have the fund's audited financial statements distributed to fund investors within 120 days of the end of the fund's fiscal year or meet other custody rule obligations. (Note that registered CPOs must distribute the statements and file them with the NFA within 90 days of the end of the fund's fiscal year, although CPOs may apply for a 30-day extension.)

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2. Managers of non-U.S. funds should also be cognizant of the GAAP reconciliation requirements that may apply for U.S. investors under the Custody Rule.

C. Clear Hurdles for Electronic Delivery of Schedules K-1

IRS Revenue Procedure 2012-17 describes the procedures that partnerships must follow if they intend only to electronically deliver Schedules K-1 of Form 1065 to their partners. Specific consents and disclosures are required prior to sending Schedules K-1 electronically, and managers of domestic U.S. partnerships who have not resolved these issues should focus on them if they (or their administrators) intend to distribute Schedules K-1 solely by email or other electronic means.

D. Privacy Notices

1. Many managers and funds are subject to SEC, CFTC or Consumer Financial Protection Bureau privacy regulations enacted pursuant to the Gramm-Leach-Bliley Act (e.g., Regulation S-P, CFTC Reg. § 160.1, and Regulation P). These privacy regulations require every covered manager and fund to provide initial and annual notices[33] to each client or investor who is an individual (or the alter ego of an individual) disclosing the types of nonpublic personal information that the adviser or fund collects, describing the extent to which it discloses such information and informing individuals of their right to opt-out of certain information sharing practices, including with third parties for the third parties' marketing purposes.[34] These generally are part of or accompany the subscription agreement, the annual distribution of the ADV Part 2A and/or the fund's audited financial statements.

2. Pursuant to 2003 amendments to the Fair Credit Reporting Act, businesses must allow for individuals to opt-out of having their information shared with affiliates of such businesses for such affiliates to market their own products or services to the individuals (the so-called "affiliate marketing opt-out"). The affiliate marketing opt-out is typically included with the privacy notice.[35]

3. Regulation S-P and Reg. § 160.1 also significantly overlap with the new focus on cybersecurity (discussed above), and these policies should be reviewed alongside those policies, information system appropriate use policies and disaster recovery policies.

E. Investor-Specific Reporting

Some side letters require that specific disclosures and customized reporting be provided to certain clients and investors. Managers should confirm that they are in compliance with all of these obligations and consider integrating these reports into broader disclosures to clients and investors where appropriate.

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[33] Initial and annual notices may take the form of the "model privacy notice" form, which was jointly adopted by eight federal regulators in 2009. Use of the model privacy notice form is voluntary; however, a manager or fund that chooses to provide the model form to individuals in a manner consistent with the form's instructions will be deemed to be in compliance with the disclosure requirements for privacy notices under the GLBA.

[34] Managers operating in the EU are reminded that the EU Data Protection Directive (the "DP Directive") protects EU citizens' right to privacy. The DP Directive restricts the use or "processing" (which can include merely holding) of an EU citizen's personal data (any information that can identify a natural person) to the EU; only if the EU citizen has consented can the data be transferred outside the EU for use or processing. Although FCA-authorized managers are not required to maintain privacy policies in the same manner that U.S. managers are, the FCA's Senior Management Arrangements, Systems and Controls Rules require that all FCA-authorized managers must take reasonable care to establish and maintain such systems and controls as are appropriate to its business — including controls to prevent the loss or misuse of client/customer/investor data. The FCA views the loss of client/customer/investor data as a very serious failing by a regulated firm and has fined firms for such failings, so managers should be aware of their systems and controls in this area and enhance them if necessary.

[35] Pursuant to an October 2014 amendment to Regulation P, managers and funds subject to the CFPB's privacy rules may be able to use an alternative delivery method for annual privacy disclosures in certain circumstances; however, the amendments do not extend to managers and funds regulated by the SEC or the CFTC.

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F. Expense Allocation Issues

1. In a May 4, 2014 speech titled "Spreading Sunshine in Private Equity," Andrew Bowden, then the director of the SEC Office of Compliance Inspections and Examinations, stated that the SEC exam staff believes there to be significant compliance issues to address with respect to private equity fund managers in connection with fees and expenses. The staff found that more than 50 percent of the private equity fund managers examined violated the law or had material internal control weaknesses with respect to fees and expenses — a "remarkable statistic." The SEC exam staff is continuing to focus on issues surrounding private equity fees and expenses, including whether the private equity manager has properly disclosed such fees and expenses to its limited partners or members and whether those fees and expenses have been charged or allocated correctly. There are reports that certain large private equity managers have been required to provide additional disclosures on Form ADV or otherwise to investors on fees and expenses and reimburse their funds for certain amounts as result of SEC examinations of fees and expenses. Further, the SEC has brought actions recently against advisers for misallocation of expenses. *See In re Clean Energy Capital, LLC*, Investment Advisers Act Release No. 3955 (Oct. 17, 2014); *In re Lincolnshire Management, Inc.*, Investment Advisers Act Release No. 3927 (Sept. 22, 2014).

2. In an action against Clean Energy Capital ("CEC"), the SEC found that CEC misallocated certain expenses between the funds it managed because CEC allocated the majority of expenses applicable to more than one fund ("split expenses") across all of its funds identically based on each fund's net capital contributions, although the actual expense may not have been incurred by a particular fund. For eight (8) of CEC's funds, the offering and operating documents did not disclose that such funds would bear the split expenses and CEC's Forms ADV also did not disclose the sharing of expenses between the funds. The SEC further found that by allocating the majority of the CEO's compensation to CEC's funds, CEC and the CEO breached their fiduciary duties to the funds because the allocation of these expenses to the funds constituted a conflict of interest that was not expressly disclosed in the funds' governing documents.

3. In the action against Lincolnshire Management, Inc. ("LMI"), the SEC found that LMI misallocated expenses between two portfolio companies (which were operationally integrated but separate legal entities owned separately by two LMI funds) because LMI did not follow its expense allocation policy. This resulted in one portfolio company paying more than its share of certain expenses that benefited both companies. The SEC further noted that there was no written agreement between the portfolio companies relating to sharing or allocating expenses.

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