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SIDLEY UPDATE

2017 Update for Investment Advisers

Important Annual Requirements; SEC Exam Priorities for 2017; Recent SEC Enforcement Initiatives

Investment advisers registered with the Securities and Exchange Commission (SEC) have certain annual requirements under the Investment Advisers Act of 1940 (Advisers Act); some of these also either apply to exempt reporting advisers (ERAs) or warrant consideration as best practices for ERAs. This Update reminds investment advisers about certain annual regulatory and compliance obligations, including a number of significant 2017 reporting or filing deadlines.

This Update also reminds advisers that are registered as commodity pool operators (CPOs) or commodity trading advisors (CTAs) with the Commodity Futures Trading Commission (CFTC) and members of the National Futures Association (NFA) of certain CFTC and NFA reporting requirements.

Selected recent regulatory developments that may affect an adviser's filing obligations and compliance program are noted, including changes to Form ADV and new recordkeeping requirements. In addition, this Update provides information regarding SEC guidance published in 2016 related to predecessor registration reliance, multi-branch initiatives, whistleblower compliance and supervision practices. This Update also covers SEC examination priorities for 2017 and recent enforcement proceedings that reflect SEC concerns relevant to advisers.

This Update does not purport to be a comprehensive summary of all of the compliance obligations to which advisers are subject; please contact your Sidley lawyer to discuss these and other requirements under the Advisers Act, the Commodity Exchange Act and other regulations that may be applicable to investment advisers, CPOs and/or CTAs.[1]

[1] This Sidley Update does not address non-U.S. regulatory developments. For example, in July 2016, the EU Market Abuse Regulation (MAR) became applicable and replaced the existing EU Market Abuse Directive (MAD) and other existing national laws implementing MAD in EU Member States. MAR's scope of financial instrument coverage is broader than MAD's, making it more likely that market participants will be subject to the EU market abuse regime. Non-EU investment advisers, even if they do not trade directly on EU trading venues, should consider related obligations and resulting changes to their compliance programs based on the MAR framework. *See* Sidley Austin LLP, Sidley Update, "EU Market Abuse Regulation 2016 – Implications for EU and Non-EU Investment Managers" (June 8, 2016), available at: http://www.sidley.com/en/news/2016-06-07-ifad-update. In addition, MiFID II, which is to be implemented on January 3, 2018, will reform the way in which EU markets and their participants operate. In light of this change, investment advisers should review their relevant policies and procedures, and prepare for new documentation which may be required by brokers. *See* Sidley Austin LLP, Sidley Update, "MiFID II 2016 Update – Implications for EU and Non-EU Investment Managers" (July 29, 2016), available at: http://www.sidley.com/en/news/2016-07-29-investment-funds-update.

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Amendments to Form ADV; Brochure Delivery to Clients

Annual Updating Amendment

Each registered adviser must file an annual updating amendment to its Form ADV. The annual amendment must be filed within 90 days of the adviser's fiscal year end; accordingly, an adviser with a December 31, 2016 fiscal year end must file its annual amendment by March 31, 2017. Part 1A and Part 2A (the adviser's brochure) are filed electronically with the SEC via the Investment Adviser Registration Depository (IARD) and are publicly available. Part 2B, the brochure supplement, is not filed with the SEC but must be preserved by the adviser and made available, if requested, to the SEC for examination.

IARD will not accept an annual Form ADV updating amendment without (i) an updated Part 2A brochure; (ii) a representation by the adviser that the brochure on file does not contain any materially inaccurate information; or (iii) a representation that the adviser is not required to prepare a brochure because it is not required to deliver it to any clients. In addition, IARD collects annual fees associated with Form ADV filings. An adviser should ensure proper funding is set up electronically prior to filing its annual amendment.

Annual Delivery of Brochure to Clients

Within 120 days of its fiscal year end, a registered adviser must deliver to each client for which delivery is required either:

- its updated Part 2A brochure and a summary of material changes to the brochure, if any; or
- a summary of material changes, if any, accompanied by an offer to provide the updated brochure which, if requested, must be mailed within seven days or delivered electronically in accordance with SEC guidelines.

The brochure is required to be delivered to "clients," which the SEC staff has acknowledged does not include fund investors; however, many fund advisers voluntarily deliver the brochure to fund investors. An adviser with a December 31, 2016 fiscal year end must deliver its updated brochure to clients by April 30, 2017.

Importance of Accurate and Complete Form ADV Disclosure

Inaccurate, misleading or omitted Form ADV disclosure is a frequently cited deficiency in SEC examinations. Moreover, Form ADV and Form PF are linked electronically, and disclosure in the two forms must be consistent.

Disclosure points of particular importance include, among others:

- An adviser must accurately calculate its regulatory assets under management (RAUM). RAUM must be calculated on a gross basis, without deduction of any outstanding indebtedness or other accrued but unpaid liabilities, according to specific instructions provided in Instruction 5.b. of Form ADV: Instructions for Part 1A (Part 1A Instructions).[2]

[2] Available at: http://www.sec.gov/about/forms/formadv-instructions.pdf.

- An adviser to private funds (i.e., funds that rely on the exclusion from the definition of investment company provided by Section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940) must provide specific information regarding those funds on Form ADV. Correct classification of the funds advised, according to the specific definitions provided in Instruction 6 of the Part 1A Instructions, is necessary to determine an adviser's Form PF filing category (*see* Form PF Reporting Requirements – Determining an Adviser's Filing Category below).
- An adviser that has added a new private fund as a client since its last Form ADV annual updating (or other) amendment may need to amend Form ADV to add the new fund *before* information regarding the new fund can be reported on Form PF. An adviser in this situation may need to file its annual Form ADV amendment early or file an other-than-annual amendment.[3]

Annual Form ADV Amendment for Exempt Reporting Advisers

Advisers relying on the "private fund adviser" exemption or the "venture capital fund adviser" exemption from SEC registration are ERAs and are required to file reports on Form ADV Part 1A with the SEC through IARD. An ERA, like a registered adviser, must amend its Form ADV at least annually, within 90 days of its fiscal year end, and more frequently if required, as specified in General Instruction 4 to Form ADV. Hence, an ERA with a December 31, 2016 fiscal year end must file its annual updating amendment by March 31, 2017.

An ERA relying on the private fund adviser exemption must calculate annually the private fund RAUM that it manages and report the amount in its annual Form ADV amendment. If a U.S.-based ERA reports in its annual amendment that it has $150 million or more of private fund RAUM or has accepted a client that is not a private fund, the adviser is no longer eligible for the private fund adviser exemption.[4] A private fund adviser that has complied with all ERA reporting requirements but is no longer eligible for the private fund adviser exemption because its RAUM meets or exceeds $150 million must apply for registration with the SEC within 90 days after filing the annual amendment and may continue advising private fund clients during this period. This transition period is not available to an adviser that otherwise would not qualify for the private fund adviser exemption, such as an adviser that accepts a managed account. Rather, an adviser relying on this exemption must be registered with the SEC (or, if pertinent, with one or more states) prior to accepting a non-private fund client. The transition period also is not available to advisers relying on the venture capital fund adviser exemption; such advisers must register under the Advisers Act before accepting a client that is not a venture capital fund.

[3] *See* Form PF: General Instructions, available at: https://www.sec.gov/about/forms/formpf.pdf. A private fund must have an identification number for both Form ADV and Form PF reporting. The instructions state, "If you need to obtain a private fund identification number [obtained by filing Form ADV] and you are required to file a quarterly update of Form PF prior to your next annual update of Form ADV, then you must acquire the identification number by filing an other-than-annual amendment to your Form ADV …. [and] must complete and file all of Form ADV Section 7.B.1 for the new private fund."

[4] An ERA based outside of the United States will lose the exemption if it (i) manages private fund assets of $150 million or more at a place of business in the United States; (ii) advises a U.S. client other than a private fund (e.g., a managed account for a U.S. institution or pension plan); or (iii) manages any non-private fund assets at a place of business in the United States. For purposes of this exemption, a single investor fund or "fund of one" generally will be deemed to be a managed account.

Annual Compliance Program Review

Rule 206(4)-7 under the Advisers Act (Compliance Rule) requires an SEC-registered adviser to designate a Chief Compliance Officer (CCO) and adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder by the adviser and its supervised persons. The Compliance Rule does not enumerate specific elements that must be included in the compliance policies and procedures.[5] Rather, the SEC staff has indicated that it expects a registered adviser's policies and procedures to be based on an assessment of the regulatory and compliance risks present in the adviser's business that may result in violations of the Advisers Act (a risk assessment) and a determination of controls needed to manage or mitigate these risks.

Periodic and Annual Review

The Compliance Rule also requires a registered adviser to review at least annually the adequacy of its policies and procedures and the effectiveness of their implementation. The required annual review may be conducted in stages throughout the year or all at once, depending on what works best for the adviser; as a matter of "best practices," however, it is recommended that an adviser conduct periodic reviews throughout the year. The SEC staff has stated that an adviser's compliance program should continue to evolve over time in conjunction with an ongoing risk assessment (and re-evaluation) process.

The annual review should include consideration of any developments during the year that might suggest a need to revise the adviser's compliance program, including, among other things:

- the results of any SEC examinations of the adviser;
- review of material compliance matters that arose;
- changes in the adviser's business activities or operations (for example, entering into a new line of business);
- recent enforcement actions; and
- changes to applicable laws, rules or regulations.

The review process should incorporate reasonable "forensic" (i.e., looking at trends over time) and "transactional" (i.e., spot) tests to detect gaps in the compliance program or instances in which the adviser's policies and procedures may have been circumvented or are not operating effectively. Any issues identified in the testing process should be accompanied by a strategy for remediation and the results of any remediation efforts.

The adviser should document the annual review, as well as steps taken to revise or enhance the compliance program to reflect the results of the review. Upon examination, the SEC will require the adviser to produce

[5] In the adopting release for Rule 206(4)-7, "Compliance Programs of Investment Companies and Investment Advisers," IA-2204 (December 17, 2003), the SEC staff stated that an adviser's policies and procedures, at a minimum, should address the following issues to the extent they are relevant: portfolio management processes; trading practices; proprietary and personal trading; accuracy of disclosures; safeguarding of client assets; recordkeeping; marketing advisory services; valuation; privacy; and business continuity plans.

documentation evidencing the required annual review. Failure to conduct a timely annual review is an often-cited violation in addition to other charges brought by the SEC's Division of Enforcement.

Report to Management

As a best practice, an adviser's senior management, at least annually, should convene a special meeting to review the effectiveness of the adviser's compliance policies and procedures. A formal written report summarizing the conclusions of senior management should be filed in the adviser's compliance records, together with a memorandum summarizing the responses, if any, made to perceived deficiencies or inadequacies, as well as evaluating the approach taken to any specific compliance problems that may have occurred during the year. The failure to escalate compliance issues to senior management properly may lead to individual liability for compliance professionals. Senior management should be engaged as frequently as necessary during the year to assist in establishing and maintaining a culture of compliance within an adviser's organization.

Training and Annual Certification

The SEC staff has emphasized the importance of advisers educating their supervised persons concerning the general principles as well as the specific requirements of the adviser's compliance program. Pertinent training should take place on at least an annual basis and more frequently as convenient or necessary, such as when a new employee joins the firm or when the testing of policies and procedures demonstrates a lack of understanding of the policies and procedures.

An adviser's compliance policies and procedures should be documented in a compliance manual that is distributed to all supervised persons. All supervised persons should be required to execute and deliver, at least annually, a certificate stating that they have read (or have re-read) and understand the provisions in the compliance manual (including any revisions or updates), including the code of ethics and the adviser's policies and procedures designed to detect and prevent insider trading. Many firms also utilize an annual certification to remind supervised persons of their specific disclosure obligations, such as the obligation to disclose outside business activities, that assist the adviser with complying with its fiduciary duties under the Advisers Act.

Exempt Reporting Advisers

An ERA, as an unregistered adviser, is not required to adopt a comprehensive compliance program pursuant to the Compliance Rule or to comply with most other rules under the Advisers Act. Unregistered advisers, however, are still subject to the anti-fraud provisions of the Advisers Act. An ERA, therefore, should adopt reasonable compliance policies, procedures and oversight to avoid even the appearance of a violation of the anti-fraud provisions or the ERA's fiduciary duty to clients. Like a registered adviser, an ERA is subject to the "pay-to-play" rule under the Advisers Act, as well as the Advisers Act requirement that an adviser adopt policies and procedures reasonably designed to prevent insider trading. As a best practice, an ERA should review at least annually the adequacy of its policies and procedures and make any needed revisions.

Advisers Registered as CPOs and/or CTAs – NFA Self-Examination and Attestation

NFA believes that all NFA members should regularly review the adequacy of their supervisory procedures. To satisfy their continuing supervisory responsibilities, NFA members must review their operations on a yearly basis using NFA's Self-Examination Questionnaire, which includes a general questionnaire that must be completed by all NFA members and supplemental questionnaires (i.e., CPO and CTA) that must be completed, as applicable.

After reviewing the annual questionnaires, an appropriate supervisory person must sign and date a written attestation stating that he or she has reviewed the NFA member's operations in light of the matters covered by the questionnaire. A separate attestation must be made for each branch office and, if the branch office reviews its own operations, then the main office must receive a copy of the questionnaire's signed attestation. A branch office is an office of the NFA member other than the main office, not a separate entity affiliated with the NFA member. These attestations should be readily available for the most recent two years and retained for the most recent five years.

Other Annual Reminders for Registered Advisers and ERAs

Other annual obligations, as pertinent, include (non-exclusive list):

Review of Disclosure and Offering Documents. An adviser should review all disclosure documents (including fund offering materials) at least annually to ensure that content and disclosure are accurate, up-to-date and consistent across documents (including filings with the SEC and other regulators) and with the adviser's compliance policies and procedures. Advertising materials, pitch books and standard due diligence questionnaire responses should also be reviewed.

Annual Personal Securities Holdings Report. On an annual basis, a registered adviser must collect from each "access person" (by a date specified by the adviser) an annual personal securities holding report containing certain required information regarding securities holdings and securities accounts. The information must be current as of a date no more than 45 days prior to the date the report is submitted.

Annual Delivery of Privacy Notice. An adviser must provide clients and fund investors who are natural persons with a privacy notice disclosing the adviser's practices for maintaining privacy of non-public personal information, both at or before the establishment of the customer relationship and annually thereafter. This privacy notice should provide clients and fund investors with the right to "opt out" from the sharing of non-public personal information with unaffiliated third parties, if applicable. An adviser is not required to make an annual distribution of its privacy notice if the adviser: 1) only provides non-public personal information to unaffiliated third parties for limited, non-marketing-related purposes; and 2) has not changed its policies and practices from those disclosed in the adviser's most recent privacy notice provided to clients and fund investors.

Annual "Bad Actor" Recertification. Private funds and other issuers are not permitted to rely on the exemption from Securities Act of 1933 (Securities Act) registration provided by Rule 506 of Regulation D if the pertinent offering involves certain "bad actors." For continuous or other offerings of long duration, an adviser must update, with reasonable care, its factual inquiries (i.e., by email or questionnaire) to determine whether any covered persons have "disqualifying events," which may also require disclosure in Form ADV.

Annual Eligibility for "New Issues." An adviser should verify annually the eligibility of clients and fund investors to participate in new issues of publicly offered securities (i.e., initial public offerings or IPOs), to make sure "restricted persons" are properly identified and their participation is appropriately restricted.

Form D and "Blue Sky" Filings. Form D filings for private funds with ongoing offerings lasting longer than one year must be amended annually, on or before the first anniversary of the initial Form D filing. On an annual basis, an adviser also should review blue sky filings for each state to ensure any renewal requirements are met.

Annual Affirmation of CFTC Exemptions. Advisers claiming an exemption from registration under CFTC Rules 4.13(a)(1), 4.13(a)(2), 4.13(a)(3) or 4.13(a)(5) or exclusion from the definition of "commodity pool operator" under Regulation 4.5, and CTAs claiming an exemption from CTA registration under Regulation 4.14(a)(8), must affirm the applicable notice of exemption or exclusion within 60 days of each calendar year end – March 1, 2017 – or be deemed to have requested a withdrawal of the applicable exemption or exclusion.

Confirming Affirmation of Investors/Clients Claiming Exemptions. In a January 11, 2017 Notice to Members, NFA noted that persons claiming an exemption from CPO registration under CFTC Rule 4.13(a), an exclusion from CPO registration under CFTC Rule 4.5 or an exemption from CTA registration under CFTC Rule 4.14(a)(8) have until March 1, 2017 to file their annual affirmation of the exemption and that, therefore, it may be difficult for an NFA member to determine if a CPO or CTA that previously claimed an exemption continues to be eligible for the exemption. Accordingly, NFA indicated that a registered CPO or CTA that takes reasonable steps to determine the registration and membership status of investors/clients claiming an exemption or exclusion under these CFTC rules will not be in violation of NFA Bylaw 1101 or Compliance Rule 2-36(d) if, between January 1 and March 31, 2017, it transacts customer business with a previously exempt person that fails to (i) become registered and a member of NFA; (ii) file a notice affirming its exemption from CPO/CTA registration; or (iii) provide a written representation as to why the person is not required to register or file the notice affirming the exemption.[6]

BEA and TIC Reporting Requirements for Cross-Border Investments. Investment advisers and other financial institutions may be required to file reports with the U.S. Bureau of Economic Analysis (BEA) for surveys of cross-border "direct investments" (generally, voting interests of 10 percent or more) by or in U.S. entities, among other things,[7] and with the U.S. Treasury Department, for Treasury International Capital (TIC) surveys of cross-border "portfolio investments" (generally, non-voting interests and voting interests of less than 10 percent).[8]

Firms should review at least annually the reporting requirements and applicable thresholds and exemptions to determine whether and when they must proactively file reports or claims for exemption with the BEA or

[6] NFA Notice I-17-02, "Member obligations under NFA Bylaw 1101 and Compliance Rule 2-36(d) with respect to CPOs/CTAs exempt from registration" (January 11, 2017), available at: https://www.nfa.futures.org/news/newsNotice.asp?ArticleID=4781.

[7] These include both surveys of foreign direct investment in the United States such as BE-13, BE-605, BE-12 and BE-15, and surveys of U.S. direct investment abroad, such as BE-577, BE-10 and BE-11.

[8] These TIC surveys include the TIC Form S, TIC Form SLT, and for 2017, the TIC Form SHC.

the Treasury Department. In addition, firms may be required to submit reports for certain surveys if contacted by the BEA or the Treasury Department.

Recent developments include the Treasury Department's release of TIC Form SHC for the latest five-year benchmark Survey of U.S. Ownership of Foreign Securities. TIC Form SHC, which is used to report ownership of foreign securities by U.S. end-investors and U.S. custodians as of December 31, 2016, will be due March 3, 2017 and may apply to some advisers.[9] Also, the BEA recently made changes, in cooperation with the Treasury Department, to its direct investment surveys that are applicable for investment surveys conducted beginning in 2017. Under these changes, cross-border voting investments of 10 percent or more in, or by, private funds will only be subject to BEA reporting if such investments involve, directly or indirectly, a direct investment in an "operating company," which the BEA defines as "companies that are not other private funds or holding companies." The BEA expects that some hedge fund firms that were subject to BEA direct investment reporting as a result of cross-border voting interests will instead be subject to TIC reporting, to the extent that their total cross-border investments exceed the much higher TIC reporting thresholds. Many private equity funds, however, will remain subject to BEA direct investment reporting.[10]

Recent Regulatory Developments and Guidance That May Affect an Adviser's Compliance Program

The following selected regulatory developments may affect the compliance programs of certain advisers. Advisers should review these and other changes in applicable laws, rules, regulations and/or SEC staff guidance to determine whether compliance policies and procedures need to be added or revised.

Department of Labor Fiduciary Duty Rule

In April 2016, the U.S. Department of Labor issued a final rule to, among other things, expand the circumstances under which consultants, brokers and other advisers, including registered investment advisers, become "fiduciaries" for purposes of ERISA and the prohibited transaction provisions of the Internal Revenue Code. Although certain investment advisers and other persons may already be fiduciaries for purposes of ERISA if advising client investment vehicles such as ERISA plans or individual retirement accounts (IRAs), under the final rule, a person becomes a fiduciary if the person provides certain investment recommendations to a plan or IRA owner for a fee and meets certain other conditions. The new rule may affect the marketing practices of persons, including investment advisers, offering investment products to plans and IRAs, as well as discourage private fund advisers from offering services to IRAs or other relevant clients, unless they comply with certain exemptions. The final rule is scheduled to become applicable April 10, 2017, with the conditions of the Best Interest Contract Exemption, intended to ensure that retirement investors receive advice that is in their best interest while also allowing advisers and their financial institutions to continue receiving compensation that

[9] *See* http://ticdata.treasury.gov/Publish/shc2016in.pdf for forms and instructions.
[10] Further information on these changes is available on the BEA's website. *See also* Sidley Austin LLP, Sidley Update, "BEA Implements Changes to Direct Investment Survey Reporting Requirements for Certain Private Funds" (January 10, 2017), available at: http://www.sidley.com/en/news/2017-01-10-investment-funds-update.

would otherwise be prohibited, such as commissions, 12b-1 fees, and revenue sharing, subject to a phased implementation. However, the implementation of the final rule is now subject to considerable uncertainty due to the review mandated by the Trump administration on February 3, 2017.

Form ADV Amendments and Clarification of "Umbrella" Registration

In August 2016, the SEC adopted amendments to Form ADV that, among other things:

- Require advisers to provide specific information, on an aggregate basis, about the separately managed accounts (SMAs) they manage, including the approximate percentage of SMA RAUM invested in 12 broad asset categories. Advisers with at least $500 million in SMA RAUM are required to provide additional information on the use of borrowings and derivatives in SMA accounts.
- Require advisers to provide information regarding their use of social media and outsourced chief compliance officers and report the RAUM of parallel managed accounts related to a registered investment company that is advised by the adviser and which follow substantially the same investment strategy.
- Streamline and standardize the process of "umbrella" registration of related private fund advisers on one Form ADV, provided that the advisers conduct a single advisory business. The amendments, which codify prior SEC guidance, reference conditions that must be met in order to use such "umbrella registration," including that each relying adviser be controlled by, or under common control with, the filing adviser, and that the filing adviser's principal office and place of business must be in the United States. The advisers must advise only private funds and SMA clients that are qualified clients and are otherwise eligible to invest in the private funds advised by the filing adviser or a relying adviser and whose accounts pursue investment objectives and strategies that are substantially similar or otherwise related to those private funds. The SEC did not expand the scope of umbrella registration to include "umbrella reporting" by ERAs.

The compliance date for the Form ADV amendments is October 1, 2017; therefore, many advisers will likely first address the revised Form ADV conditions when filing their annual updating amendments in 2018.[11]

Recordkeeping Rule Amendments

The SEC also adopted amendments related to the maintenance of books and records related to performance calculations and performance-related communications under Rule 204-2. The amendments remove the "10 person" condition, requiring advisers to retain records supporting performance claims in any communication that is circulated or distributed, directly or indirectly, to *any* person. The amendments also add a new category of communications that must be retained, namely all communications relating to the performance or rate of return of all managed accounts or securities recommendations.[12]

[11] *See* Sidley Austin LLP, Sidley Update, "SEC Adopts Form ADV Amendments to Require Reporting on Separately Managed Accounts and Clarify 'Umbrella' Registration" (September 9, 2016), available at: http://www.sidley.com/en/news/2016-09-09-investment-funds-update.

[12] *Id.*

Guidance Regarding Reliance on Predecessor Registrations

In November 2016, the SEC's Division of Investment Management released guidance reminding advisers of circumstances under which, and the methods by which, an adviser may rely on a predecessor's registration with the SEC.

- *Succession by application*. If an unregistered successor is acquiring or assuming all of the assets and liabilities of the advisory business of a registered adviser, and the acquired adviser is no longer conducting advisory activities, the successor must file a new application for registration on Form ADV within thirty days after the succession. The successor may rely on the predecessor's registration until the successor's registration becomes effective.
- *Succession by amendment.* Alternatively, if the successor is a new investment adviser formed solely as a result of a change in form of organization or a reorganization and there has been no practical change in control or management, the successor may amend the registration of the registered adviser by filing an amended Form ADV within thirty days after the change or reorganization to reflect such changes rather than file a new application.[13]

The guidance addressed a number of common questions that the SEC staff has received regarding instances in which an adviser may be able to rely on the successor registration provisions, such as whether a change in business organization raises succession concerns and whether an adviser can rely on succession by amendment for internal reorganizations.

The guidance also noted that an adviser that fails to file a substantially complete Form ADV that indicates that the adviser is submitting a filing as a succession by application or succession by amendment within the required timeframe would have to file a new application to register on Form ADV. Such an adviser, the staff indicated, would be conducting an investment advisory business without being registered.

Expiration of Rule 206(3)-3T

On August 19, 2016, the Division of Investment Management released a letter alerting advisers that had relied on Rule 206(3)-3T of the Rule's expiration on December 31, 2016. Prior to expiration, the Rule had provided advisers that were also registered broker-dealers with alternate means to comply with Section 206(3) of the Advisers Act when engaging in principal transactions with client accounts. The letter noted that some advisers may wish to apply for an exemptive order that, if granted, could provide similar means to comply with Section 206(3).[14]

New California Law Requiring Public Pension and Retirement Systems Disclosures

Starting on January 1, 2017, each California public pension and retirement system must require vehicles in which it has made "alternative investments" (e.g., investments in private equity, venture, hedge or absolute return funds) to provide information related to those alternative investments, including information

[13] *See* SEC Division of Investment Management, IM Guidance Update, "Staff Guidance Concerning Investment Adviser Reliance on Predecessor Registrations" (November 2016), available at: https://www.sec.gov/investment/im-guidance-2016-05.pdf.

[14] *See* SEC Division of Investment Management, Letter to Ira D. Hammerman, "Rule 206(3)-3T under the Investment Advisers Act of 1940" (August 19, 2016), available at: https://www.sec.gov/divisions/investment/guidance/staff-letter-sifma-081916.pdf.

regarding fees and expenses borne directly or indirectly by the system, and investment performance. For "grandfathered" investments (i.e., existing investments for which the public pension or retirement system has not made a new capital commitment on or after January 1, 2017), each public pension or retirement system must undertake reasonable efforts to obtain the same information that it is required to obtain from non-grandfathered investment vehicles. Each California public pension and retirement system must also disclose the information it receives, at least once annually, at a public meeting.[15]

Business Continuity and Transition Plan Rule Proposal

The SEC has proposed new rules and amendments to the existing rules to require registered advisers to adopt and implement written business continuity and transition plans. Such plans would be required as part of the Advisers Act anti-fraud rules to address internal and external risks associated with significant disruptions of an adviser's operations. Although many advisers already have business continuity plans, many such plans may not include documented transition plans to address succession planning, financial or control changes affecting the adviser. The proposed rule includes prescriptive components that would be required for advisers' plans, including alternative physical office locations, risk assessments, procedures related to the custody and transfer of assets and assessment of legal and contractual issues. The proposed amendments to Rule 204-2 would require advisers to maintain such written continuity and transition plans currently in effect or which were in effect during the previous five years.[16]

Anti-Money Laundering Rule for Registered Investment Advisers

In September 2015, the U.S. Treasury's Financial Crimes Enforcement Network (FinCEN) published a notice of proposed rulemaking regarding anti-money laundering (AML) requirements for registered investment advisers. The proposal would require registered investment advisers to establish an AML program and report suspicious activities. The SEC would be granted authority to examine registered investment advisers for compliance with the new requirements. Many registered investment advisers would be forced to significantly enhance their compliance programs with respect to monitoring and reporting, training, testing and risk assessment related to AML. Registered investment advisers who have traditionally delegated AML responsibilities to service providers may be forced to take a more active role.[17] No further updates have been made to the proposed rules.

Preparing for an SEC Examination

The books and records of all SEC-registered advisers, including the records of any private funds to which the adviser provides investment advice, are subject to exam by the SEC staff. ERAs also are subject to SEC examination, although the SEC has indicated that it does not expect to examine ERAs on a routine basis.

[15] California Assembly Bill No. 2833 (September 14, 2016), available at: https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201520160AB2833.

[16] *See* Sidley Austin LLP, Sidley Update, "SEC Proposes New Rule for Investment Advisers That Would Require Business Continuity and Transition Plans" (July 7, 2016), available at: http://www.sidley.com/news/2016-07-07-investment-advisers-update.

[17] *See* Sidley Austin LLP, Sidley Update, "FinCEN Proposes Anti-Money Laundering Rule for Registered Investment Advisers" (September 3, 2015), available at: http://www.sidley.com/news/09-03-15-banking-and-financial-services-update.

Generally, an adviser being examined is required to provide the SEC with access to all books and records related to its advisory business, whether or not they are required to be kept.

The SEC staff generally conducts a risk-based examination strategy. The SEC staff has indicated that in most cases, the staff considers the quality of the adviser's compliance systems and its internal control environment when determining the scope of the examination and the areas to be reviewed. Depending on the nature of the examination, the staff often will contact an adviser in advance and provide a detailed document request list before commencing the examination. Lists will vary depending on the nature and focus of the examination.

Certain proactive steps should be taken to prepare for the contingency of an examination. For example, an adviser should:

- obtain and review sample SEC document request lists to anticipate likely SEC staff requests;
- ensure that its disclosure documents (including filings with the SEC and other regulators), compliance policies and procedures and actual business and compliance practices are all consistent;
- review results from periodic and annual compliance reviews in order to make sure that findings have been addressed;
- review previous SEC examination findings (if any) to make sure that past deficiencies have been remedied; and
- consider conducting a mock examination or gap analysis.

Most advisers that are examined receive an "exam findings" letter, outlining technical and/or more serious compliance weaknesses or violations. It is critically important that the adviser address all deficiencies, including revisions (as needed) to its compliance program and/or disclosure documents. Even minor deficiencies, if not corrected, may be considered serious by the SEC staff when the next exam occurs and the staff may take administrative or other enforcement action against such "recidivist" behavior.

SEC Exam Initiatives and Priorities for 2017

Examinations of Whistleblower Compliance. In October 2016, OCIE issued a Risk Alert indicating that it is examining advisers' compliance with key whistleblower provisions arising out of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), as implemented by the SEC's adoption of Rule 21F-17 under the Securities Exchange Act of 1934. Rule 21F-17 provides that "no person may take any action to impede an individual from communicating directly with [SEC] staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement … with respect to such communications."

OCIE staff is reviewing, among other things, compliance manuals, codes of ethics, employment agreements and severance agreements to determine whether provisions in those documents pertaining to confidentiality of information and reporting of possible securities law violations may raise concerns under Rule 21F-17. OCIE indicated that in the exams, the staff evaluates whether these documents contain provisions similar to those in agreements the SEC has found to violate Rule 21F-17, including provisions that (a) purport to limit the types of information that an employee may convey to the SEC or other regulators; or (b) require

departing employees to waive their rights to any individual monetary recovery in connection with reporting information to the government. As noted below, the SEC has brought several recent enforcement actions charging violations of Rule 21F-17 stemming from agreements using language that the SEC perceived to have a "chilling effect" on employees' abilities to communicate potential securities law violations to the SEC.[18]

Multi-Branch Adviser Initiative. In December 2016, OCIE released a Risk Alert notifying advisers of a new initiative to examine advisers operating out of multiple offices to determine whether they are in compliance with the federal securities laws in light of the additional risks associated with operating in this manner. OCIE staff will assess the design and effectiveness of an adviser's compliance program with respect to its oversight of advisory services provided at its branch offices. Specific areas of focus for such examinations may include controls with respect to fees and expenses, controls over advertisements created or disseminated from branch offices, implementation of the adviser's code of ethics and compliance with Rule 206(4)-2, the Advisers Act custody rule. OCIE noted it also will focus on the way in which investment advice is provided to advisory clients from supervised persons located in branch offices, including with respect to allocation of investment opportunities.[19]

Share Class Initiative. In July 2016, OCIE released a Risk Alert notifying advisers of a new initiative to examine advisers with regard to certain conflicted investment recommendations, including conflicts related to advisers' financial incentives to recommend certain share classes that result in increased fees for the adviser or its affiliates.[20] Specifically, OCIE is seeking to identify conflicts of interest tied to advisers' compensation or financial incentives for recommending mutual fund and 529 Plan share classes that have substantial loads or distribution fees. Examples of conflicts of interest include situations in which the adviser is also a broker-dealer or affiliated with a broker-dealer that receives fees from sales of certain share classes and situations in which the adviser recommends that clients purchase more expensive share classes of funds for which an affiliate of the adviser receives additional fees.

Supervision Practices Initiative. In September 2016, OCIE issued a Risk Alert notifying advisers of an initiative to examine supervision and compliance controls of advisers that employ or have employed individuals with a history of disciplinary events in the financial services sector. OCIE noted that it is using its analytical capabilities to evaluate information from a variety of sources to identify registered advisers for exams under this initiative. OCIE will assess the adviser's compliance practices regarding the hiring and supervision of such individuals, disclosures in Form ADV, conflicts of interest related to financial arrangements initiated by such individuals and the identification of conflicts or risks associated with such individuals in marketing materials.[21]

[18] *See* SEC Office of Compliance Inspections and Examinations, National Exam Program, "Examining Whistleblower Rule Compliance" (October 24, 2016), available at: https://www.sec.gov/ocie/announcement/ocie-2016-risk-alert-examining-whistleblower-rule-compliance.pdf.

[19] *See* SEC Office of Compliance Inspections and Examinations, National Exam Program, "Multi-Branch Adviser Initiative" (December 12, 2016), available at: https://www.sec.gov/ocie/announcement/risk-alert-multi-branch-adviser-initiative.pdf.

[20] *See* SEC Office of Compliance Inspections and Examinations, National Exam Program, "OCIE's 2016 Share Class Initiative" (July 13, 2016), available at: https://www.sec.gov/ocie/announcement/ocie-risk-alert-2016-share-class-initiative.pdf.

[21] *See* SEC Office of Compliance Inspections and Examinations, National Exam Program, "Examinations of Supervision Practices At Registered Investment Advisers" (September 12, 2016), available at: https://www.sec.gov/ocie/announcement/ocie-2016-risk-alert-supervision-registered-investment-advisers.pdf.

On January 12, 2017, the SEC's National Exam Program (NEP) released its list of examination priorities for 2017 (Release).[22] The Release highlights areas that the SEC staff perceives to have heightened compliance risk. Compliance officers should take note of these areas of concern and assess areas for improvement.

OCIE's current examination priorities, as outlined in the Release, are organized around three themes:

Retail Investors. The staff is planning and/or conducting examinations regarding issues that retail investors may encounter as the financial services industry continues to provide new alternatives in advice and products and services, including electronic investment advice.

Senior Investors and Retirement Investments. The staff intends to continue its focus on its Retirement-Targeted Industry Reviews and Examinations (ReTIRE) initiative, senior investors and public pension advisers as the U.S. population becomes more dependent on their retirement investments. Among other things, the staff will examine investment advisers to public pension plans with regard to conflicts of interest management.

Market-Wide Risks. The staff will continue to focus on ensuring fair, orderly and efficient markets. In this regard, OCIE will remain attentive to cybersecurity, anti-money laundering, money market funds and clearing agencies, among others. More specifically, OCIE will be examining advisers with an eye toward, among other things:

- *Never-Before-Examined Firms.* OCIE is expanding its Never-Before-Examined Adviser initiative to include focused, risk-based examinations of newly registered advisers as well as of selected advisers that have been registered for a longer period but have not yet been examined by OCIE.
- *Private Fund Advisers.* The staff indicated that it will continue to examine private fund advisers, focusing on conflicts of interest and disclosure of those conflicts as well as actions that appear to benefit the adviser at the expense of investors.
- *Cybersecurity.* OCIE will continue its initiative to examine cybersecurity compliance procedures and controls, including testing the implementation of those procedures and controls.
- *Public Pension Advisers.* The staff will focus on how advisers to public pension plans are managing conflicts of interest and fulfilling their fiduciary duties, including attention to pay-to-play issues and undisclosed gifts and entertainment practices.
- *ReTIRE.* Continuing its multi-year initiative, OCIE will focus on, among other things, recommendations and sales of variable insurance products, sales and management of target date funds and controls surrounding cross-transactions, with particular focus on fixed-income securities.
- *Wrap Fee Programs.* The staff is expanding its focus on registered advisers and broker-dealers associated with wrap fee programs, which charge a bundled fee for advisory and brokerage services. OCIE will focus on whether the adviser is acting consistent with its fiduciary duty and meeting its contractual obligations to clients. Areas of interest may include account suitability, effectiveness of disclosures, conflicts of interest and brokerage practices, including best execution and trading away.

[22] *See* SEC Office of Compliance Inspections and Examinations, National Exam Program, "Examination Priorities for 2017" (January 12, 2017), available at: https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2017.pdf.

- *Electronic Investment Advice.* The staff will examine registered advisers and broker-dealers that offer investment advice through automated or digital platforms, including "robo-advisers" that primarily interact with clients online. These examinations will focus on compliance programs, marketing, formulation of investment recommendations, data protection and disclosures of conflicts of interest. The staff also will review compliance practices for overseeing algorithms that generate recommendations.

Recent Enforcement Proceedings and Related Cases

The SEC announced in October 2016 that it brought a record number of enforcement cases involving advisers or investment companies in fiscal year 2016.[23] The SEC's announcement indicated that the agency has utilized its new data analytics to uncover fraud, which has allowed it to litigate "novel and significant actions to better protect investors and our markets." In addition, the U.S. Supreme Court issued a decision regarding the insider trading personal benefit standard. The following is a summary of a number of recent enforcement actions of relevance to investment advisers, as well as the Supreme Court decision:

- *Fees and Expenses.*
  - *Fee Allocation.* The SEC entered into a settlement with a private equity fund adviser for failing to disclose to various funds it advised its allocation practice with respect to transaction fees received from portfolio companies. The SEC alleged that the adviser retained a significant amount of transaction fees without disclosing its allocation practice or offsetting the management fees accordingly.[24]
  - *Fees for Dual Servicing.* The SEC entered into a settlement with three affiliated advisers for placing clients in higher-fee mutual fund share classes when lower-fee share classes were available. The SEC found that, due to the advisers' dual registration as investment advisers and broker-dealers, the advisers received the benefit of the fees associated with such higher-fee share class investments. The SEC further found that the advisers failed to disclose the conflict of interest associated with the advisers' financial incentive to recommend investments in the higher-fee share classes.[25]
  - *Wrap Fee Programs.* The SEC entered into a settlement with two advisers that allegedly failed to establish policies and procedures regarding commission amounts charged to advisory clients when sub-advisers "traded away" with a broker-dealer outside a wrap fee program. The SEC found that lacking such policies and procedures, the advisers were unable to determine whether such sub-advisers or wrap fee programs were suitable and that such additional costs were not disclosed to affected clients.[26]
  - *Accelerated Fees.* The SEC entered into a settlement with a group of investment advisers to private equity funds for alleged failure to disclose the potential for the advisers to receive accelerated monitoring fees upon the termination of portfolio company monitoring agreements. The SEC also

[23] *See* SEC Press Release 2016-212 (October 11, 2016), available at: https://www.sec.gov/news/pressrelease/2016-212.html.

[24] *See* SEC Administrative Proceeding File No. 3-17491 (August 24, 2016), available at: https://www.sec.gov/litigation/admin/2016/ia-4494-s.pdf.

[25] *See* SEC Press Release No. 2016-52 (March 14, 2016), available at: https://www.sec.gov/news/pressrelease/2016-52.html.

[26] *See* SEC Press Release No. 2016-181 (September 8, 2016), available at: https://www.sec.gov/news/pressrelease/2016-181.html.

found a lack of disclosure in fund financial statements concerning the fact that accrued interest related to a general partner's loan agreement with five of its associated funds would be allocated solely to the general partner. The SEC further found that the advisers failed to supervise a senior partner's personal expense reimbursement practices.[27]

- *Fee and Expenses Disclosure.* The SEC entered into a settlement with a private equity fund adviser for various violations, including operating as an unregistered broker-dealer. The SEC found that, although the funds' governing documents disclosed that the adviser would provide brokerage services in exchange for a fee, the adviser was not registered as a broker-dealer. The adviser also was found to have charged operating partner oversight fees to two portfolio companies when the governing documents did not authorize these fees to be charged, nor were such fees disclosed to limited partners. In addition, the SEC found that the adviser used fund assets to make political and charitable contributions and charged entertainment expenses not expressly authorized by the funds' governing documents, and the adviser neither sought nor obtained appropriate consent. The adviser and its principal owners also were found to have directly purchased shares in a portfolio company from an employee and fund interests from defaulting limited partners in contravention of the funds' governing documents and without complying with future capital contribution requirements.[28]
- *Expense Allocation.* The SEC entered into a settlement with an investment adviser to private equity funds for failing to provide adequate disclosures of certain financial conflicts of interest. The SEC found that the adviser structured certain fund investments in a manner that caused the funds to incur additional administrative and advisory expenses but allowed the adviser to avoid certain expenses, giving rise to an undisclosed financial conflict of interest, and allocated insurance premiums to the funds that did not relate to the management of the funds. The SEC found that the adviser also negotiated a legal fee discount on work performed for the funds but did not share the discount with the funds.[29]

- *Data Breach.* The SEC entered into a settlement with an adviser that was charged with failure to establish adequate policies and procedures reasonably designed to protect confidential customer information. The SEC found that, while the adviser had policies and procedures in place, they were not designed to adequately protect personal information as required by Regulation S-P. As a result of this failure, the SEC alleged, an employee downloaded confidential customer information to his personal server. The personal server was subsequently hacked and confidential customer information was then posted for sale online. Among other things, the SEC found that the adviser did not adequately restrict employee access to customer data to those who had a business need and did not sufficiently test the effectiveness of such authorizations or related use of data portals.[30]

[27] *See* SEC Press Release No. 2016-165 (August 23, 2016), available at: https://www.sec.gov/news/pressrelease/2016-165.html.

[28] *See* SEC Press Release No. 2016-100 (June 1, 2016), available at: https://www.sec.gov/news/pressrelease/2016-100.html.

[29] *See* SEC Administrative Proceeding File No. 3-17538 (September 14, 2016), available at: https://www.sec.gov/litigation/admin/2016/ia-4529-s.pdf.

[30] *See* SEC Press Release No. 2016-112 (June 8, 2016), available at: https://www.sec.gov/news/pressrelease/2016-112.html.

- *Insider Trading.*
  - The SEC entered into a settlement with a hedge fund adviser for failing to have adequate policies and procedures reasonably designed to prevent the misuse of material non-public information (MNPI) consistent with the nature of its business. The adviser hired an analyst who had experience in a target industry. The SEC found that while the adviser had policies and procedures that prohibited the receipt and use of MNPI, the adviser failed to adopt policies or procedures to address the particular risk presented by the analyst's frequent interaction with contacts at public companies in whose securities the adviser traded. The SEC found that the adviser and the analyst's supervisor failed to respond appropriately to red flags that should have alerted them to the risk of potential insider trading at the firm. Among other alleged red flags, the analyst did not maintain documentation to support his recommendations. The SEC found that the analyst provided information to the firm that should have reasonably put the supervisor and the adviser on notice of potential misuse of MNPI, noting that the supervisor did not bring such information to the attention of the adviser's Chief Compliance Officer, as required by the adviser's policies and procedures.[31]
  - In December 2016, the U.S. Supreme Court unanimously clarified the *Dirks v. SEC*, 463 U.S. 646 (1983) (*Dirks*) insider trading "personal benefit" standard in its *Salman v. United States*, No. 15-628 (U.S. Dec. 6, 2016) decision. The Court found that a gift of confidential information given to a relative could amount to a personal benefit to which tipper and tippee liability could attach. The Court rejected the *United States v. Newman*, 73 F. 3d 438 (2d Cir. 2014), *cert. denied*, 136 S. Ct. 242 (2015) requirement that there must be a tangible pecuniary or other financial benefit, finding that such requirement would be inconsistent with *Dirks*.[32]
- *Use of Third Party Performance.* The SEC imposed penalties in settlements with 13 investment advisory firms charged with securities law violations relating to use of a third party's performance information. The SEC found that the advisers negligently relied on the third party's performance claims, using them in the advisers' own advertising, in some cases without substantiation. In an accompanying press release, the SEC noted that advisers cannot rely on the claims of another firm when making investment advisory decisions without verifying the information themselves.[33]
- *Bribes to Foreign Officials.* The SEC settled civil charges of violations of the Foreign Corrupt Practices Act with a registered investment adviser in connection with dealings with sovereign wealth funds and other transactions involving foreign government officials. The SEC also found that executives ignored risks and suspicious transactions and the adviser lacked adequate internal controls, including accounting controls, to prevent the violations.[34]
- *Whistleblowers.* The SEC has settled several enforcement actions recently involving charges of violations of Rule 21F-17 of the SEC's whistleblower regulations. As noted in the OCIE Risk Alert regarding OCIE's

[31] *See* SEC Press Release No. 2016-214 (October 13, 2016), available at: https://www.sec.gov/news/pressrelease/2016-214.html.

[32] *See* Sidley Austin LLP, Securities Enforcement Update, "Supreme Court Affirms Insider Trading Ruling in *Salman v. United States*" (December 7, 2016), available at: http://www.sidley.com/news/2016-12-07-securities-enforcement-update.

[33] *See* SEC Press Release No. 2016-167 (August 25, 2016), available at: https://www.sec.gov/news/pressrelease/2016-167.html.

[34] *See* SEC Press Release No. 2016-203 (September 29, 2016), available at: https://www.sec.gov/news/pressrelease/2016-203.html.

initiative to examine registrants' compliance with key whistleblower provisions, enforcement actions have identified certain provisions of confidentiality or other agreements required by employers as contributing to violations because they contained language that, by itself or under the circumstances in which the agreements were used, impeded employees and former employees from communicating with the SEC concerning possible securities laws violations. OCIE noted that this potential chilling effect can be especially pronounced when such documents (e.g., severance agreements) provide that an employee may forfeit all benefits if he or she violates any terms of the agreement. Remedial actions taken in connection with the settlements include requiring advisers to revise their documentation going forward to remove provisions inconsistent with whistleblower regulations and to provide specific disclosures to employees and former employees regarding their whistleblower rights.[35]

Form PF Reporting Requirements

Most registered advisers to private funds are required to file Form PF on either a quarterly or annual basis; advisers that are exempt from SEC registration, including ERAs, are not required to file Form PF. The information contained in Form PF is designed, among other things, to assist the Financial Stability Oversight Council (FSOC) in its assessment of systemic risk in the U.S. financial system. Form PF, which is a joint form between the SEC and the CFTC with respect to Sections 1 and 2 of the form, is filed with the SEC via the Private Fund Reporting Depository (PFRD) electronic filing system and is not publicly available.

Given the volume and complexity of the work involved, many private fund advisers face a number of challenges in preparing Form PF, including making decisions regarding (and documenting) assumptions and methodologies, due to the ambiguous or subjective nature of a number of Form PF's instructions, definitions and questions. The SEC staff has provided assistance with respect to these issues and other Form PF questions, both directly in response to private inquiries and in FAQs posted (and periodically updated) on the SEC's website.[36]

Who Must File

An SEC-registered investment adviser is required to file Form PF if it (a) advises one or more private funds and (b) collectively, with related persons (other than related persons that are separately operated), had RAUM of $150 million or more attributable to private funds as of the end of its most recently completed fiscal year.

CFTC-registered CPOs that are dually registered with the SEC and are required to file Form PF must submit information with respect to each advised commodity pool that also is a private fund. Because commodity pools are considered hedge funds for purposes of Form PF, the filing adviser must complete the sections of the form applicable to hedge funds for each commodity pool reported on Form PF. For a dual registrant,

[35] *See* SEC Office of Compliance Inspections and Examinations, National Exam Program, "Examining Whistleblower Rule Compliance" (October 24, 2016), available at: https://www.sec.gov/ocie/announcement/ocie-2016-risk-alert-examining-whistleblower-rule-compliance.pdf.

[36] *See* Form PF Frequently Asked Questions, available at: http://www.sec.gov/divisions/investment/pfrd/pfrdfaq.shtml (most recently updated on January 18, 2017). FINRA, as administrator for the PFRD filing system, also posts information to assist Form PF filers, including PFRD System Frequently Asked Questions, available at: http://www.iard.com/pfrd/pdf/PFRD_System_FAQs.pdf (most recently updated on April 16, 2016).

filing Form PF can serve to satisfy certain CFTC Form CPO-PQR reporting requirements. Dual registrants also have the option of using Form PF to satisfy certain CFTC reporting requirements with respect to commodity pools that are not private funds in lieu of completing certain sections of Form CPO-PQR.[37]

To avoid duplicative reporting, Form PF information regarding sub-advised funds should be reported by only one adviser. The adviser that completes information in Form ADV Schedule D Section 7.B.1 with respect to any private fund is also required to report that fund on Form PF. If, however, the adviser reporting the private fund on Form ADV is not required to file Form PF (i.e., because it is an ERA), then another adviser, if any, to the fund, if required to file Form PF, must report the fund on Form PF.

Determining an Adviser's Filing Category

The scope of required Form PF disclosure, the frequency of reporting and filing deadlines differ based on the RAUM of the adviser attributable to different types of private funds (in particular, hedge funds, liquidity funds and private equity funds). Accurately determining an adviser's filing category is a critical first step. Specific definitions of fund types are provided in the Form ADV Part 1A Instructions and the Form PF: Glossary of Terms.

The RAUM thresholds applicable to different categories of Form PF filers are summarized in the chart below. An adviser meeting only the minimum $150 million private fund RAUM reporting threshold, as well as a large private equity fund adviser, must file Form PF annually within 120 days of its fiscal year end. A large liquidity fund adviser or large hedge fund adviser must file quarterly, within 15 days (for large liquidity fund advisers) and 60 days (for large hedge fund advisers) of its fiscal quarter end.

Advisers are required to follow certain aggregation instructions for purposes of determining whether or not they meet the *de minimis* $150 million private fund asset threshold for reporting on Form PF, as well as the pertinent large private fund adviser thresholds. Aggregation also is required for large hedge fund advisers to determine whether any hedge fund is a "qualifying hedge fund" subject to additional reporting requirements. The aggregation instructions (and, conversely, certain netting instructions for fund of funds advisers and others whose funds invest in other private funds) may raise challenging interpretive issues for many advisers.

Frequency of Reporting and Filing Deadlines

The reporting frequency and upcoming filing deadlines for different categories of Form PF reporting advisers are summarized below. The filing deadlines set forth in the following table are for advisers with a December 31 fiscal year end.

[37] Regardless of any reporting on Form PF, however, all registered CPOs and CTAs are required to file at least Schedule A of CFTC Form PQR and Form CTA-PR, as applicable, and comply with the requirements of NFA Form PQR.

	Large Hedge Fund Adviser	**Large Liquidity Fund Adviser**	**Large Private Equity Fund Adviser**	**Smaller Private Fund Adviser**
RAUM Threshold	$1.5 billion or more attributable to hedge funds as of the end of any month during the preceding fiscal quarter	$1.0 billion or more in combined liquidity fund and registered money market fund assets as of the end of any month during the preceding fiscal quarter	$2.0 billion or more attributable to private equity fund assets as of the end of the most recent fiscal year	$150 million or more (but less than the applicable "large" adviser threshold) attributable to private funds as of the end of the most recent fiscal year
Reporting Frequency	Quarterly	Quarterly	Annually	Annually
Reporting Deadline*	60 days from end of fiscal quarter	15 days from end of fiscal quarter	120 days from fiscal year end	120 days from fiscal year end
Applicable Form PF Sections	Sections 1 and 2	Sections 1 and 3	Sections 1 and 4	Section 1
Upcoming Filing Deadline	**March 1, 2017** (for fourth quarter 2016)	**April 17, 2017*** (for first quarter 2017)	**May 1, 2017*** (for 2016)	**May 1, 2017*** (for 2016)

* If the filing due date falls on a holiday, a weekend or a day when the PFRD system is closed, the Form PF filing will be considered timely filed with the SEC if filed no later than the following business day.

How the SEC Staff Uses Form PF Data

While the primary aim of Form PF was to create a source of data for FSOC's assessment of systemic risk, the SEC also is using the data to support its own regulatory programs, including examinations, investigations and investor protection efforts.[38] OCIE staff generally reviews an adviser's Form PF filing as a part of its pre-exam evaluation and reviews information contained in the filing for inconsistencies with other information obtained during an exam, such as due diligence reports, pitch books, offering documents, operating agreements and books and records. In addition, OCIE staff typically looks for discrepancies

[38] *See* SEC, "Annual Staff Report Relating to the Use of Data Collected from Private Fund Systemic Risk Reports" (August 23, 2016), available at: https://www.sec.gov/investment/reportspubs/special-studies/im-private-fund-annual-report-082316.pdf.

between an adviser's Form PF filing and any publicly available documents related to the adviser, including the adviser's Form ADV and brochure. Enforcement staff also obtains and reviews Form PF filings in connection with ongoing adviser investigations.

Reporting Requirements for Certain Investment Advisers on CFTC and NFA Form CPO-PQR and/or Form CTA-PR

Many advisers to privately offered funds and registered investment companies are required to register as CPOs and/or CTAs with the CFTC with respect to certain commodity pools that they advise, and to become members of the NFA. CFTC-registered CPOs and CTAs must report certain information on CFTC and NFA Form CPO-PQR (also referred to herein as CFTC Form PQR and NFA Form PQR, as applicable) and Form CTA-PR and NFA PR, respectively. The forms must be filed electronically using the NFA's EasyFile System.

CFTC and NFA Reporting Requirements on Form CPO-PQR

The scope of required disclosure, the frequency of reporting and whether or not a given Form CPO-PQR filing is required by the CFTC and/or NFA is determined generally by the CPO's aggregated gross pool assets under management (Gross AUM). As in the case of Form PF, Form CPO-PQR filers are required to follow certain aggregation instructions for purposes of determining the applicable filing category. The CFTC's Division of Swap Dealer and Intermediary Oversight has posted FAQs regarding Form CPO-PQR, while the NFA has posted FAQs regarding Form PQR.[39]

Based on the information that the CPO enters on the Cover Page of Form CPO-PQR, all subsequent screens of the Form will be dynamically generated to present only required schedules.[40]

As noted above, advisers that are dually registered with the SEC and the CFTC can satisfy certain CFTC Form PQR filing requirements by filing Form PF.[41] For example, a large CPO that is a quarterly Form PF filer can file Form PF Sections 1 and/or 2 in lieu of CFTC Form PQR Schedules B and C. Each of these requirements is due within 60 days of quarter end. Similarly, a mid-sized CPO that is an annual Form PF filer can file Form PF Sections 1.b and 1.c in lieu of CFTC Form PQR Schedule B. A dual registrant is required only to submit Schedule A of CFTC Form PQR on an annual basis; however, a dual registrant will still be subject to quarterly NFA reporting requirements pursuant to NFA Form PQR. Note, however, that whereas a mid-sized CPO must meet its CFTC Form PQR reporting obligation within 90 days of calendar year end, the filing deadline for an annual Form PF filer is 120 days from fiscal year end. Hence, a mid-sized CPO that wishes to meet a portion of its CFTC reporting requirements through Form PF may need to file its Form PF within 90 days (rather than 120 days) of its year end (assuming a calendar year fiscal year).

[39] *See* CFTC, "CFTC Division of Swap Dealer and Intermediary Oversight Responds to Frequently Asked Questions Regarding Commission Form CPO-PQR" (November 5, 2015), available at: http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/faq_cpocta110515.pdf; *see also* NFA, "CPO FAQs: Form PQR," available at: https://www.nfa.futures.org/NFA-electronic-filings/CPOFAQsFormPQR.pdf.

[40] *See* Form CPO-PQR Filing System Overview (on the NFA website), available at: https://www.nfa.futures.org/NFA-electronic-filings/PQR-Help.pdf.

[41] Form PF filing deadlines are based on the adviser's fiscal year (or quarter), while Form CPO-PQR/Form CTA-PR filing deadlines are based on the calendar year (or quarter). Note that dual registrants with a fiscal year that differs from the calendar year may have difficulty using Form PF to satisfy their CFTC Form PQR filing obligations.

With respect to co-CPOs, the CPO with the greater Gross AUM is required to report for the pool. If a pool is operated by co-CPOs and one of the CPOs is also a dual registrant that files Form PF Sections 1 and/or 2 (and thus is only required to file CFTC Form PQR Schedule A), the non-investment adviser CPO must nevertheless file the applicable sections of CFTC Form PQR.

Each CPO that is an NFA member must file NFA Form PQR on a quarterly basis within 60 days of the quarters ending in March, June and September and a year-end report within 60 or 90 days (depending on the size of the CPO) of the calendar year end. Large CPOs that file the required CFTC Form PQR schedules on a quarterly basis satisfy their NFA Form PQR filing requirements through filing CFTC Form PQR.[42]

CPOs that file Form PF with the SEC in lieu of certain portions of CFTC Form PQR are required to file NFA Form PQR with the NFA on a quarterly basis within 60 days of the quarter end, except for the December 31 quarter, when the filing will be due within 90 days.[43]

CFTC Form PQR and NFA Form PQR filing requirements are summarized in the following chart.

Gross AUM Threshold				
Filing Requirements	**Large CPO***	**Mid-Sized CPO****	**Small CPO*****	**CPO That Files Form PF in Lieu of CFTC Form PQR Schedules B and C**
First Quarter	CFTC Form PQR Schedules A, B, C# *(within 60 days of quarter end)*##	NFA Form PQR *(within 60 days of quarter end)*	NFA Form PQR *(within 60 days of quarter end)*	NFA Form PQR *(within 60 days of quarter end)*
Second Quarter	CFTC Form PQR Schedules A, B, C# *(within 60 days of quarter end)*##	NFA Form PQR *(within 60 days of quarter end)*	NFA Form PQR *(within 60 days of quarter end)*	NFA Form PQR *(within 60 days of quarter end)*
Third Quarter	CFTC Form PQR Schedules A, B, C# *(within 60 days of quarter end)*##	NFA Form PQR *(within 60 days of quarter end)*	NFA Form PQR *(within 60 days of quarter end)*	NFA Form PQR *(within 60 days of quarter end)*
Fourth Quarter	CFTC Form PQR Schedules A, B, C# *(within 60 days of quarter end)*##	CFTC Form PQR Schedules A, B *(within 90 days of calendar year end)*##	CFTC Form PQR Schedule A + NFA Form PQR *(within 90 days of calendar year end)*	CFTC Form PQR Schedule A + NFA Form PQR *(within60 or 90 days, depending on the size of the CPO)*

* $1.5 billion or more attributable to aggregated pools as of the close of business on any day during the most recent calendar quarter.

** $150 million or more (but less than the applicable "large" CPO threshold) attributable to

[42] As noted above, all registered CPOs must file CFTC Form PQR Schedule A. Quarterly CFTC Form PQR filers also file Schedule B, which contains a Schedule of Investments.

[43] While Form PF may fulfill certain CFTC filing requirements, it does not fulfill the NFA quarterly filing requirements.

aggregated pools as of the close of business on any day during the most recent calendar year.

*** Less than $150 million attributable to aggregated pools as of the close of business on each day during the most recent calendar year.

Schedule C Part 2 is only applicable to any pool that has a net asset value individually, or in combination with any parallel pool structure, of at least $500 million.

Satisfies the NFA filing requirement.

Form CTA-PR

Each registered CTA is required to file an annual Form CTA-PR with the CFTC within 45 days of the calendar year end and a quarterly NFA Form CTA-PR within 45 days of the calendar quarter end.[44] The same form is used for both the CFTC and the NFA filings. All Form CTA-PR filings are made through the NFA's EasyFile System. The CFTC and the NFA have posted FAQs regarding Form CTA-PR.[45]

If you have any questions regarding this Sidley Update, please contact the Sidley lawyer with whom you usually work, or

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[44] *See* Form CTA-PR Filing System Help (on the NFA website), available at: http://www.nfa.futures.org/NFA-electronic-filings/CTA-PR-System-Help.pdf.

[45] *See* NFA, "CTA FAQs: Form PR" available at: https://www.nfa.futures.org/NFA-electronic-filings/CTAFAQsFormPR.pdf. CFTC's FAQs on Form CTA-PR are in the same release as the FAQs regarding Form CPO-PQR.

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