SIDLEY

SIDLEY UPDATE

2019 Update for Investment Advisers Important Annual Requirements; 2019 SEC Exam Priorities; Recent SEC Enforcement Initiatives

February 15, 2019

Investment advisers registered with the Securities and Exchange Commission (the SEC) (each, an RIA) are subject to certain annual requirements under the Investment Advisers Act of 1940 (the Advisers Act); some of these requirements also either apply to exempt reporting advisers (each, an ERA) or warrant consideration as best practices for ERAs. This Sidley Update alerts investment advisers to certain annual regulatory and compliance obligations, including a number of significant 2019 reporting or filing deadlines.

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

This Sidley Update provides important information regarding

This Sidley 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, the UK is scheduled to withdraw from the European Union (EU) on March 29, 2019, pursuant to the UK's notification under article 50 of the Treaty on European Union. It is still unclear whether the draft withdrawal agreement and the draft political declaration agreed between the UK

Form ADV Annual Updating Amendment for RIAs; Brochure Delivery to Clients

Annual Updating Amendment

Each RIA must file an annual updating amendment to its Form ADV within 90 days of its fiscal year end. Accordingly, an RIA with a December 31, 2018, fiscal year end must file its annual amendment by March 31, 2019 (even though that date falls on a Sunday). 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 required to be 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. IARD cannot accept a filing until the fees are paid and posted to the adviser's account. An adviser should ensure that proper funding is set up electronically prior to filing its annual amendment and allow sufficient time for fee processing and posting.

An RIA must update its Form ADV Part 1A more frequently if required, as specified in General Instruction 4 to Form ADV,[2] by filing an other-than-annual amendment. The RIA also must update (and file) its Part 2A brochure promptly when any information in the brochure becomes materially inaccurate.

Annual Delivery of Brochure to Clients

Within 120 days of its fiscal year end, an RIA 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

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government and the leaders of the European Council in November 2018 will be agreed before this date. If no such agreement is reached, and without an extension to the two-year negotiation period, the UK will withdraw from the EU on March 29, 2019. During, and possibly after, this period there is likely to be considerable uncertainty as to the position of the UK and the arrangements that will apply to its relationships with the EU and other countries following its withdrawal. This uncertainty may affect other countries in the EU, or elsewhere, if they are considered to be affected by these events. See Sidley Austin LLP, Sidley Update, "Brexit Draft Withdrawal Agreement: Key Points for Financial Services Firms" (December 5, 2018), https://www.sidley.com/en/insights/newsupdates/2018/12/brexit-withdrawal-agreement-key-points-for-financial-services-firms.

In January 2018, the second EU Markets in Financial Instruments Directive and the Markets in Financial Instruments Regulation (together, MiFID II) and the EU PRIIPs Regulation (on Packaged Retail and Insurance-based Investment Products) came into effect across the EU. Non-EU investment managers should continue to have regard to the effect of these new regimes on their business, particularly as new regulatory guidance arises and market practice develops.

For investment advisers with an EU licensed subsidiary, the European Commission has adopted legislative proposals for a revised EU prudential framework for investment firms. This will include a new revised capital requirements regime and a new remuneration code. See Sidley Austin LLP, Sidley Update, "Revised EU Capital and Remuneration Framework for Investment Firms – Proposal" (January 30, 2018), https://www.sidley.com/en/insights/newsupdates/2018/01/revised-eu-capital-and-remuneration-framework-for-investment-firms.

In December 2018, the European Commission published a report on the operation of the Alternative Investment Fund Managers Directive (2011/61/EU) (AIFMD). The report concluded that some aspects of AIFMD could be improved. The European Commission is expected to issue further publications during 2019. However, any legislative changes are not expected to take effect for a number of years.

[2] Form ADV: General Instructions, http://www.sec.gov/about/forms/formadv-instructions.pdf.

- 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 RIA with a December 31, 2018, fiscal year end must deliver its updated brochure to clients by April 30, 2019.[3]

Importance of Accurate and Complete Form ADV Disclosure

Inaccurate, misleading or omitted Form ADV disclosure is a frequently cited deficiency in SEC examinations and has been the basis of a number of enforcement proceedings. More technically, Form ADV and Form PF are linked electronically, and inconsistencies in disclosure in the two forms can raise red flags in connection with an SEC examination and prevent an adviser from successfully filing Form PF.

Disclosure points of particular importance include:

- An adviser must accurately calculate its regulatory assets under management (RAUM). RAUM must be calculated on a gross basis, including proceeds of leverage and uncalled capital commitments and 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).[4]

- 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 (the Investment Company Act)) 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 in order to timely file Form PF.[5]

Form ADV Annual Updating Amendment for ERAs

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 an RIA, must amend its Form ADV at least annually, within 90 days of its

[3] In a recent two-part netcast, the SEC staff noted that certain advisers have claimed to deliver their brochures to clients by posting a link on their websites without taking any further steps to ensure delivery. This practice, the staff reminded advisers, is not sufficient for purposes of complying with Rule 204-3 (the "brochure delivery rule"). New York Regional Office Investment Adviser Compliance Outreach Netcast (September 12, 2018), https://www.sec.gov/video/webcast-archive-player.shtml?document_id=nyro-netcast-091218 (the September 2018 Netcast).

[4] Form ADV: Instructions for Part 1A, http://www.sec.gov/about/forms/formadv-instructions.pdf.

[5] See Form PF: General Instructions, 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."

fiscal year end, and more frequently if required, as specified in General Instruction 4 to Form ADV. Hence, an ERA with a December 31, 2018, fiscal year end must file its annual updating amendment by March 31, 2019.

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 US$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.[6] 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 US$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 separately 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 an adviser (whether based in or outside of the United States) must register under the Advisers Act before accepting a client that is not a venture capital fund unless the adviser is eligible for another exemption from registration.

Annual Compliance Program Review

Rule 206(4)-7 under the Advisers Act (the Compliance Rule) requires an RIA 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.[7] Rather, the SEC staff has indicated that it expects an RIA'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.

Common Deficiencies in Compliance Programs

A February 2017 Risk Alert issued by the SEC's Office of Compliance Inspections and Examinations (OCIE) described examples of deficiencies or weaknesses in connection with the Compliance Rule frequently identified in OCIE examinations.[8] Examples include:

- *Compliance manuals are not reasonably tailored to the adviser's business practices*. The staff noted that certain compliance programs did not take into account important individualized business practices, such as the adviser's particular investment strategies, types of clients, trading practices, valuation procedures and advisory fees.

[6] An ERA based outside of the United States will lose the exemption if it (i) manages private fund assets of US$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.

[7] 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.

[8] SEC Office of Compliance Inspections and Examinations, National Exam Program, Risk Alert, "The Five Most Frequent Compliance Topics Identified in OCIE Examinations of Investment Advisers" (February 7, 2017), https://www.sec.gov/ocie/Article/risk-alert-5-most-frequent-ia-compliance-topics.pdf.

- *Annual review was not performed or did not address the adequacy of the adviser's policies and procedures.* The staff also observed that some advisers did not address or correct problems identified in their annual reviews.

- *Adviser does not follow its compliance policies and procedures.*

- *Compliance manuals are not current*. The staff noted that certain compliance manuals contained information or policies that are no longer current.

In the September 2018 Netcast,[9] the staff of the SEC's New York Regional Office (the NYRO staff) referenced the February 2017 Risk Alert and provided specific examples of certain deficiency types, including these:

- *Policies and procedures that are incomplete or inaccurate*. The staff cited as an example valuation policies that did not reflect certain practices followed by an adviser in connection with fair valuation, highlighting the need for the adviser's compliance staff (Compliance) to know what the business and back office staff are doing in practice, not just on paper.

- *Policies and procedures that are not modified in light of new business practices, products or clients*. The staff stated that Compliance should be involved at the beginning of discussions about new business lines or products, as these proposals may require changes not only to policies and procedures but also to staffing levels or expertise, compliance monitoring or testing, Form ADV and other disclosure documents and the annual compliance review.

- *Policies and procedures that are not adequately documented*. The staff offered the example of an adviser using quantitative models for investment decisions but failing to establish written policies and procedures surrounding the review and approval of those models to ensure that the models were operating effectively and as intended.

Periodic and Annual Review

The Compliance Rule also requires an RIA 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. The SEC staff has stated that an RIA's compliance program should continue to evolve 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 (if not already addressed), 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 (e.g., entering a new line of business);

- recent enforcement actions; and

- changes to applicable laws, rules, regulations and/or SEC staff guidance.

[9] See Note 3 above.

The review process should incorporate reasonable trend analysis and "macro" analysis as well as "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. OCIE recommends that the adviser document the content, timing and results of the testing, which can expedite the staff's review of the adviser's compliance program when the adviser is examined.[10] 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 documentation evidencing the required annual review. Failure by an RIA 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 RIA'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 during the year. 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 emphasizes 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 an employee joins the firm or when the testing of policies and procedures demonstrates a lack of understanding of the policies and procedures.

An RIA's compliance policies and procedures should be documented in a compliance manual 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 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 use an annual certification to remind supervised persons of their specific disclosure obligations, such as the obligation to disclose outside business activities.

ERAs

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 Advisers Act's antifraud provisions. An ERA, therefore, should adopt reasonable compliance policies, procedures and oversight to avoid even the appearance of a violation of the antifraud provisions or the ERA's fiduciary duty to clients. Like an RIA, an ERA is subject to Advisers Act Rule 206(4)-5 (the Pay-to-Play Rule) 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.

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[10] See Note 3 above.

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 yearly 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, 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 RIAs and ERAs

Other annual obligations, as pertinent, include (nonexclusive 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, standard due diligence questionnaire responses and the adviser's website should also be reviewed.

Annual Personal Securities Holdings Report. On an annual basis, an RIA 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 all 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 nonpublic 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 nonpublic 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 (a) only provides nonpublic personal information to unaffiliated third parties for limited, non-marketing-related purposes and (b) 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 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) 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 that any renewal requirements are met. In the September 2018 Netcast, the NYRO staff indicated that examiners had noticed an increase in the number of Form D deficiencies, such as missing or late filings, forms not completed according to the instructions and inconsistencies between Form D and Form ADV.[11]

Distribution of Audited Financials to Private Fund Investors. An adviser relying on the "audit provision" of Advisers Act Rule 206(4)-2 (the Custody Rule) with respect to its private fund clients must deliver audited financial statements of each pertinent private fund to fund investors within 120 days of the fund's fiscal year end (by April 30, 2019, if the fiscal year ends on December 31) or within 180 days of the private fund's fiscal year end, if the private fund is a fund of funds (by June 29, 2019, if the fiscal year ends on December 31).

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, 2019 — or be deemed to have requested a withdrawal of the applicable exemption or exclusion.

Confirming Affirmation of Investors/Clients Claiming Exemptions Under CFTC Rules. In a January 15, 2019, 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, 2019 to file their annual affirmation of the exemption and that, therefore, it may be difficult for an NFA member to determine whether 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, 2019 it transacts customer business with a previously exempt person that fails to (a) become registered and a member of NFA, (b) file a notice affirming its exemption from CPO/CTA registration or (c) provide a written representation as to why the person is not required to register or file the notice affirming the exemption.[12]

BEA and TIC Reporting Requirements for Cross-Border Investments. Investment advisers and other financial institutions may be required to file reports with the 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,[13] and with the Treasury Department, for Treasury International Capital (TIC) surveys of cross-border "portfolio investments" (generally, nonvoting interests and voting interests of less than 10 percent).[14]

Firms should routinely review 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 the Treasury Department. In addition, firms may be required to submit reports for certain surveys, even if filing thresholds have not been met or exceeded, if contacted by the BEA or the Treasury Department.

SEC Examination Priorities for 2019

On December 20, 2018, OCIE released its report (the 2019 Exam Priorities Report) setting forth its list of examination priorities for 2019 (the Exam Priorities) for various regulated entities, including investment

[11] See Note 3 above.

[12] NFA Notice I-19-02, "Member obligations under NFA Bylaw 1101 and Compliance Rule 2-36(d) with respect to CPOs/CTAs exempt from registration" (January 15, 2019), https://www.nfa.futures.org/news/newsNotice.asp?ArticleID=5086.

[13] 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.

[14] These TIC surveys include the TIC Form S, TIC Form SLT, and for 2019, the TIC Form SHL.

advisers.[15] OCIE announces its exam priorities annually to provide insights into the areas it believes present potentially heightened risk to investors or the integrity of the U.S. capital markets.[16] The Exam Priorities can serve as a roadmap to assist advisers in assessing their policies, procedures and compliance programs; testing for and remediating any suspected deficiencies related to the Exam Priorities; and preparing for OCIE exams. Advisers are encouraged to review their current policies, procedures and client disclosures with these priorities in mind. ERAs, as well as RIAs, are subject to SEC examination, although the SEC has indicated that it does not expect to examine ERAs on a routine basis.

The number of investment advisers examined by OCIE has increased significantly in recent years. In fiscal year (FY) 2018, the OCIE National Exam Program examined approximately 17 percent of RIAs, up from 15 percent during FY 2017 and 11 percent during FY 2016. Just five years ago, nine percent of RIAs were examined. Examinations of registered investment companies (RICs) were also up during FY 2018, increasing by approximately 45 percent.[17]

OCIE's current examination priorities, as outlined in the 2019 Exam Priorities Report, reflect both perennial risk areas that have been emphasized in recent years and risks associated with developing products and services. The priorities are organized around six themes: (a) **retail investors**, including seniors and those saving for retirement; (b) compliance issues and risks associated with entities responsible for **critical market infrastructure**, including clearing agencies, national securities exchanges, the Financial Industry Regulatory Authority (FINRA), the Municipal Securities Rulemaking Board (MSRB), transfer agents and other Regulation Systems Compliance and Integrity (Regulation SCI) entities (i.e., entities required to comply with Regulation SCI); (c) select areas and programs of **FINRA** and **MSRB**; (d) **digital assets**, including cryptocurrencies, coins and tokens; (e) **cybersecurity**; and (f) **anti-money-laundering** programs of financial institutions that are required by regulations adopted under the Bank Secrecy Act to establish such programs.

Exams are Risk-Based and Data-Driven

OCIE notes in the 2019 Exam Priorities Report that while the Exam Priorities provide a preview of key areas where OCIE intends to focus its limited resources and will drive many of OCIE's examinations, they do not encompass all of the areas that will be covered in exams. As explained in the 2019 Exam Priorities Report, the scope of any examination is determined through a risk-based approach that includes analysis of the registrant's operations, products offered and other factors. The 2019 Exam Priorities Report emphasizes that this risk-based approach, both in selecting registered entities to examine and determining the scope of risk areas to examine, "remains flexible in order to cover emerging and exigent risks to investors and the marketplace as they arise." To this end, "OCIE is increasingly leveraging technology and data analytics as well as human capital to fulfill its mission."

Continued Focus on Retail Investors

The Exam Priorities continue OCIE's trend in recent years to prioritize the protection of retail investors, particularly seniors and those saving for retirement. According to the 2019 Exam Priorities Report, in examinations of investment advisers, OCIE will continue to review the services and products offered to these investors, focusing on, among other things, adviser compliance programs, the appropriateness of certain investment recommendations to seniors and the supervision by firms of their investment professionals and other employees.

[15] SEC Office of Compliance Inspections and Examinations, "2019 Examination Priorities" (December 20, 2018), https://www.sec.gov/files/OCIE%202019%20Priorities.pdf.

[16] SEC Press Release 2018-299, "SEC Office of Compliance Inspections and Examinations Announces 2019 Examination Priorities" (December 20, 2018), https://www.sec.gov/news/press-release/2018-299.

[17] The 2019 Exam Priorities Report; SEC, Agency Financial Report, Fiscal Year 2018 (November 13, 2018), https://www.sec.gov/files/sec-2018-agency-financial-report.pdf.

In furtherance of its commitment to retail investors, OCIE will continue to prioritize the examination of mutual funds and exchange traded funds (ETFs), the activities of their advisers and the oversight practices of their boards of directors. In the 2019 Exam Priorities Report, OCIE references previous examinations that identified advisers that selected more expensive mutual fund share classes for clients, when lower-cost share classes were available, without adequate disclosure to investors, and notes that in future exams, examiners will continue to evaluate financial incentives for financial professionals that may influence their selection of particular share classes.

With respect to mutual funds and ETFs, examiners also will focus on risks associated with (a) index funds that track custom-built or bespoke indexes, (b) ETFs with little secondary market trading volume and smaller assets under management, (c) funds with higher allocations to certain securitized assets, (d) funds with aberrational underperformance, (e) funds managed by advisers relatively new to managing RICs and (f) advisers that provide advice to both RICs and private funds with similar investment strategies. OCIE also will continue to focus on investment advisers participating in wrap fee programs, with a continued interest in brokerage practices and the adequacy of disclosures.

Other Relevant Focus Areas

Many of the topics covered in the Exam Priorities, including those discussed primarily in the section on retail investors, are relevant not only to advisers with retail clients but also to advisers that advise other types of clients, including institutional clients and private funds. Focus areas include these:

Disclosure of the Costs of Investing. OCIE stresses in the Exam Priorities that the proper disclosure and calculation of fees, expenses and other charges investors pay is critically important. Examiners will review, among other things, whether fees and expenses are calculated and charged in accordance with the disclosures provided to clients and investors and pertinent client agreements.

Conflicts of Interest. Examiners will focus on ensuring that investment advisers are acting in a manner consistent with their fiduciary duty and meeting their contractual obligations to their clients. The Exam Priorities include the following points, among others:

- A financial professional must inform investors of any conflicts of interest that might provide incentives for the professional to recommend certain types of products or services.
- OCIE will examine arrangements in which an investment adviser uses services or products provided by affiliated entities. These arrangements may present conflicts of interest related to, for example, portfolio management practices and compensation arrangements.
- Borrowing funds from clients presents a number of conflicts of interest for an investment adviser. Examiners observing this practice will evaluate whether adequate disclosures, including the potentially poor or failing financial condition of the adviser, are made to the client and the adviser has acted consistently with these disclosures.

Portfolio Management and Trading. OCIE notes in the 2019 Exam Priorities Report that an integral component of investment adviser exams is reviewing portfolio management processes. Examiners will review a firm’s practices for executing investment transactions, fairly allocating investment opportunities among clients, ensuring consistency of investments with client objectives, disclosing critical information to clients and complying with other legal restrictions.

OCIE also will examine portfolio recommendations to assess, among other things, whether an adviser’s investment or trading strategies are (a) in the best interests of investors based on their investment objectives and risk tolerance; (b) contrary to, or have drifted from, disclosures to investors; (c) venturing into new, risky investments or products without adequate risk disclosure; and/or (d) appropriately monitored for attendant risks.

Digital Assets. The digital asset market, which includes cryptocurrencies, coins and tokens, has grown rapidly, and the number of investment advisers engaged in this space continues to expand as well. In the 2019 Exam Priorities Report, OCIE references investment adviser examinations that have identified emerging risks related to selling or recommending digital assets, such as concerns related to custody and safekeeping of investor assets, valuation, omitted or misleading disclosures regarding the complexities of the products and technology, and the risks of dramatic price volatility.

According to the Exam Priorities, OCIE will continue to monitor the sale, trading and management of digital assets and, where the products are securities, examine for regulatory compliance. In particular, OCIE will take steps to identify market participants involved with these products, or considering such involvement, and then assess the extent of their activities. For firms actively engaged in the digital asset market, OCIE will conduct examinations focused on, among other things, portfolio management and trading of digital assets, safety of client assets, pricing of client portfolios and compliance and internal controls.

Never-Before-Examined Investment Advisers. OCIE will continue to conduct risk-based examinations of certain investment advisers that have never been examined, including newly registered advisers as well as advisers registered for several years that have not yet been examined. OCIE also will prioritize examinations of certain investment advisers that have not been examined for a number of years and may have substantially grown or changed business models.

Cybersecurity. Cybersecurity remains a top SEC priority, and OCIE will continue to work with firms in all sectors to identify and manage cybersecurity risks. Examinations will focus on, among other things, proper configuration of network storage devices, information security governance generally and policies and procedures related to retail trading information security. Specific to investment advisers, OCIE will emphasize cybersecurity practices at firms with multiple branch offices, including those that have recently merged with other advisers, and continue to focus on, among other areas, governance and risk assessment, access rights and controls, data loss prevention, vendor management, training and incident response.

Preparing for an SEC Examination

OCIE is examining more advisers than in recent years and using augmented technological resources, so it is critically important that advisers be prepared for the possibility of an exam, including possibly on short notice.

OCIE's Pre-Examination Evaluation

While OCIE generally follows a risk-based examination strategy, an adviser may be selected for examination for any number of reasons including, but not limited to, the adviser's risk profile; a tip, complaint or referral; or OCIE's review of a particular compliance risk area. Certain advisers also are selected randomly. Examiners typically will not share with the adviser the reason that the entity has been selected for examination.[18]

According to a December 2018 SEC staff report,[19] before a private fund adviser examination begins, the staff generally reviews the adviser's Form ADV and Form PF filings as part of a routine pre-examination evaluation. This review, in combination with other data sources, provides SEC staff with an understanding of the adviser's current business, operations and investment strategy as well as an analysis of how this strategy has evolved or changed over different reporting periods. The staff has developed automated

[18] SEC Office of Compliance Inspections and Examinations, "Examination Information for Entities Subject to Examination or Inspection by the Commission," https://www.sec.gov/about/offices/ocie/ocie_exambrochure.pdf (the "OCIE Exam Brochure").

[19] SEC, Annual Staff Report Relating to the Use of Form PF Data (December 14, 2018), https://www.sec.gov/2018-form-pf-report-to-congress.pdf.

analyses and risk metrics that summarize and combine Form ADV data with key Form PF data about an adviser's private funds and advisory business. These reports are designed to assist staff in identifying potential reporting errors, compliance issues or other issues of interest for the examination team to consider.

OCIE is Leveraging Technology to Enhance Exam Capabilities

As described in the September 2018 Netcast, OCIE uses quantitative and predictive analytics to facilitate its risk process, enabling OCIE to direct its resources more efficiently and effectively. For example, OCIE's National Exam Analytics Tool (NEAT) enables examiners to access and systematically analyze years of trading data much more efficiently than in the past and has been expanded to support blotter data validations and options. Examiners can use NEAT to identify indicia of possible insider trading, front running, improper cross and principal trades, window dressing, improper allocations of investment opportunities and other kinds of misconduct. In most exams, the adviser will be asked to promptly provide a trade blotter, initial position report, employee trade blotter and a restricted list. The adviser will be provided with a template requesting that fields such as dates and times be formatted in a particular way. Trade blotters that cannot be quickly produced, are incomplete or contain errors may raise questions about the reliability of the registrant's data and the adequacy of the compliance program and portfolio management controls.[20]

An Exam Can Occur at Any Time — Be Prepared!

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 staff requests;
- make sure that its compliance program has been updated to reflect any new products, business lines or clients;
- 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 with one another;
- make sure that all of its books and records are up to date and readily accessible;
- review results from periodic and annual compliance reviews to make sure that findings have been addressed;
- review previous SEC examination findings (if any) to make sure that past deficiencies have been remedied;
- consider conducting a mock examination or gap analysis; and
- as recommended by OCIE, consider how best to present the adviser's business, key personnel and key risks to the examination staff and have a "first day" presentation ready to go.[21]

Exam Process

The books and records of all RIAs, including the records of any private funds to which the adviser provides investment advice, are subject to examination. Generally, an adviser being examined is required

[20] See Note 3 above.

[21] See Note 3 above.

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. As noted above, while ERAs are subject to SEC examination, the SEC has noted that it does not expect to examine ERAs on a routine basis.

While exams may be conducted on an announced or unannounced basis, exams usually are announced.[22] In the case of an announced exam, the staff typically calls the CCO to inform the entity that it will be examined. At that point, the staff may either send the initial request list identifying certain information and documents that will be reviewed or schedule a call with the adviser to learn more about the business before sending the initial request list. In many cases, the staff will visit the firm; however, certain exams are conducted primarily by document submission and review and telephone interviews, sometimes followed by an on-site visit. When the exam is unannounced, the staff may provide the adviser with a document request list upon arrival and may conduct an initial interview. Initial document request lists vary depending on the nature and focus of the examination and may be followed by one or more subsequent request lists. The scope of recent exams has varied greatly. In some cases, the scope is relatively narrow, with an emphasis on several higher-risk areas.

The staff will review the information and documents provided and may request interviews with relevant personnel. The staff also may request relevant information and documents held by third-party service providers and may contact the firm's clients to gather additional information or to verify information provided. The length of the exam depends on a number of variables, including the scope of the exam, the complexity of the business, whether information is complete and provided timely in response to the exam team's requests and the accessibility of firm personnel for requested meetings and interviews. Following the on-site portion of an exam, the staff, in many cases, will perform additional analyses of the information obtained and may contact the adviser to ask clarifying questions or request additional information or documents. Typically, the staff will conduct an "exit interview" at the end of the exam to discuss, among other things, issues identified and give the adviser an opportunity to ask questions and provide additional information.

Most advisers that are examined receive an "exam findings" or "deficiency" letter, outlining technical and/or more serious compliance weaknesses or violations. The examined entity will be asked to respond in writing to any issues identified in the deficiency letter, including any steps that it has taken or will take to address the issues and to prevent their reoccurrence. The entity's response will generally be due within 30 days of the date of the letter. It is critically important that the adviser address all deficiencies, including revisions (as needed) to its compliance program and/or disclosure documents. SEC staff may consider even minor deficiencies, if not corrected, as serious when the next exam occurs, and the staff may take administrative or other enforcement action against such "recidivist" behavior.

If the exam staff identifies serious issues during an examination, in addition to sending the entity a deficiency letter, the staff may refer the issues to the SEC's Division of Enforcement for possible action.

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

The following 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.

[22] Additional information regarding the OCIE exam process is contained in the September 2018 Netcast and the OCIE Exam Brochure. See Note 3 and Note 18 above.

Guidance Regarding Electronic Communications and Social Media

In a recent Risk Alert,[23] OCIE noted that it had conducted a limited-scope examination initiative of RIAs designed to obtain an understanding of the various forms of electronic messaging used by advisers and their personnel, the risks presented by evolving forms of electronic communications and the associated complications in complying with certain provisions of the Advisers Act.[24] Specifically, OCIE noted that a number of changes in the way mobile and personally owned devices are used — including the increasing use of social media, texting and other types of electronic messaging apps and the pervasive use of mobile and personally owned devices for business purposes — pose challenges for advisers in meeting their obligations under Advisers Act Rule 204-2 (the Books and Records Rule) and the Compliance Rule.

During the initiative, the staff observed a range of practices with respect to electronic communications, including advisers' not conducting any testing or monitoring to ensure compliance with firm policies and procedures. The Risk Alert lists a number of suggested practices observed and identified by the staff that OCIE believes may assist advisers in meeting their record retention and compliance obligations. Examples include:

- permitting only those forms of electronic communications that the adviser determines can be used in compliance with the requirements of the Books and Records Rule;
- prohibiting business use of apps and other technologies that can be readily misused by allowing an employee to communicate anonymously, allowing for automatic destruction of messages or preventing third-party viewing or backup;
- if an adviser permits its personnel to use social media, personal email accounts or personal websites for business purposes, adopting and implementing policies and procedures for the monitoring, review and retention of such electronic communications;
- requiring employee training on the adviser's policies and procedures regarding prohibitions and limitations placed on the use of electronic messaging and electronic apps; and
- soliciting feedback from employees regarding what forms of messaging are requested by clients and service providers so that the adviser can assess the risks involved and how those forms of communication might be incorporated into the adviser's policies.

OCIE also suggested that an adviser that permits use of social media, personal email or personal websites for business purposes consider contracting with software vendors to (i) monitor the social media posts, emails or websites; (ii) archive such business communications to ensure compliance with record retention rules; and (iii) ensure that the adviser has the capability to identify any changes to content and compare postings to a lexicon of key words and phrases.

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[23] SEC Office of Compliance Inspections and Examinations, National Exam Program, Risk Alert, "Observations from Investment Adviser Examinations Related to Electronic Messaging" (December 14, 2018), https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20Electronic%20Messaging.pdf.

[24] For purposes of this initiative, "electronic messaging" or "electronic communication" included written business communications conveyed using, for example, text/SMS messaging, instant messaging, personal email and personal or private messaging. OCIE included communications when conducted on the adviser's systems or third-party applications (apps) or platforms or sent using the adviser's computers, mobile devices issued by advisory firms, or personally owned computers or mobile devices used by the adviser's personnel for the adviser's business. The staff indicated in the Risk Alert that email use on advisers' systems was excluded from the review because firms have had decades of experience complying with regulatory requirements with respect to firm email, and it often does not pose similar challenges as other electronic communication methods because it occurs on firm systems rather than on third-party apps or platforms.

Advisory Fee and Expense Compliance Issues

A Risk Alert issued in April 2018[25] addresses deficiencies relating to fees and expenses charged by RIAs that were most frequently identified in OCIE exams. The most frequent deficiencies identified include, among others:

- *Disclosure Issues Involving Advisory Fees.* Staff observed, for example, advisers that did not disclose certain additional fees or markups in addition to advisory fees, such as fee sharing arrangements with affiliates.

- *Adviser Expense Misallocations*. Staff observed advisers to private and registered funds that misallocated expenses to the funds. For example, certain advisers allocated distribution and marketing expenses, regulatory filing fees and travel expenses to clients instead of the adviser, in contravention of the applicable advisory agreements, operating agreements or other disclosures.

- *Fee-Billing Based on Incorrect Account Valuations*.

- *Omitting Rebates and Applying Discounts Incorrectly*.

Best Execution Guidance

In a July 2018 Risk Alert,[26] OCIE described many of the most common deficiencies in connection with the best execution obligations of advisers identified by staff in recent adviser examinations. Examples include:

- *Not performing best execution reviews*. The staff observed advisers that could not demonstrate that they periodically and systematically evaluated the execution performance of broker-dealers used to execute client transactions.

- *Not considering materially relevant factors during best execution reviews*. The staff observed advisers that did not consider the full range and quality of a broker-dealer's services in directing brokerage and failed to solicit and review input from the firm's traders and portfolio managers.

- *Not seeking comparisons with other broker-dealers*. The staff observed advisers that used certain broker-dealers without seeking out or considering the quality and costs of services available from other broker-dealers. The staff noted that certain advisers used a single broker-dealer for all clients without seeking comparisons from competing broker-dealers initially and/or on an ongoing basis to assess their chosen broker-dealer's execution performance.

- *Failing to adequately disclose the use of soft dollar arrangements*. For example, some advisers did not provide adequate disclosure regarding products and services acquired with soft dollars that did not qualify as eligible brokerage and research services under the Securities Exchange Act of 1934 (the Exchange Act) Section 28(e) safe harbor.

Further Guidance Regarding "Inadvertent Custody"

In February 2017, the SEC's Division of Investment Management released a Guidance Update regarding

[25] SEC Office of Compliance Inspections and Examinations, National Exam Program, Risk Alert, "Overview of the Most Frequent Advisory Fee and Expense Compliance Issues Identified in Examinations of Investment Advisers" (April 12, 2018), https://www.sec.gov/files/ocie-risk-alert-advisory-fee-expense-compliance.pdf.

[26] SEC Office of Compliance Inspections and Examinations, National Exam Program, Risk Alert, "Compliance Issues Related to Best Execution by Investment Advisers" (July 11, 2018), https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20IA%20Best%20Execution.pdf.

"inadvertent custody" — that is, where an RIA has authority to transfer client assets from a client's custodial account based on broad authority indicated in the client's agreement with its custodian to which the RIA is not a party (the February 2017 Guidance).[27] The February 2017 Guidance warned that a custodial agreement between a client and its custodian that permits the custodian to accept instructions from an RIA to transfer assets from the custodial account for any purpose other than authorized trading establishes the RIA's custody of such assets.

On June 5, 2018, the SEC staff added two new frequently asked questions (FAQs) to the SEC's FAQs about the Custody Rule that substantially modified the position taken by the staff in the February 2017 Guidance:[28]

- New FAQ II.11 states that an RIA that does not have a copy of a client's custodial agreement — and does not know, or have reason to know, whether the agreement would give the adviser inadvertent custody — need not comply with the Custody Rule with respect to that client's account if inadvertent custody would be the sole basis for custody. The relief is not available, however, where the adviser recommended, requested or required a client to engage the particular custodian. FAQ II.11 does not address the requirements for RIAs that, but for performing due diligence in response to the February 2017 Guidance, would not have known or have had reason to know whether a client's custodial agreement would give the RIA inadvertent custody.

- New FAQ II.12 clarifies SEC treatment of an RIA that has the authority to deduct fees from a client account and/or check-writing authority under the same circumstances presented in FAQ II.11. If pertinent, the RIA may (i) rely on the fee deduction exception (i.e., not obtain a surprise examination for the account) and (ii) complete its Form ADV accordingly (i.e., not report the account as one for which the RIA has custody). The RIA must comply with all other aspects of the Custody Rule. FAQ II.12 also reiterates that an RIA must comply fully with the Custody Rule (including obtaining a surprise examination) with respect to any accounts for which it has check-writing authority.

Some industry participants have noted that language in an endnote to the February 2017 Guidance could be read as raising possible questions regarding whether all transactions must settle on a delivery-versus-payment (DVP) basis in order for an adviser to rely on the staff's position that "authorized trading" does not itself constitute custody. Such an interpretation would be problematic for many advisers, as certain types of securities commonly traded in client accounts do not settle on a DVP basis. The new FAQs do not address the issue, and the intent of the language in the February 2017 Guidance remains unclear. Adviser industry groups continue to engage the SEC staff in discussions regarding this issue.

Cash Solicitation Rule Guidance

A Risk Alert issued in October 2018[29] highlights the topics related to Advisers Act Rule 206(4)-3 (the Cash Solicitation Rule) most frequently associated with deficiencies identified in OCIE exams of RIAs. The compliance deficiencies include, among others,

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[27] SEC Division of Investment Management, IM Guidance Update: "Inadvertent Custody: Advisory Contract Versus Custodial Contract Authority," No. 2017-01 (February 2017), https://www.sec.gov/investment/im-guidance-2017-01.pdf.

[28] SEC Division of Investment Management, "Staff Reponses to Questions About the Custody Rule," FAQ II.11 (posted June 5, 2018) and FAQ II.12 (posted June 5, 2018), https://www.sec.gov/divisions/investment/custody_faq_030510.htm.

[29] SEC Office of Compliance Inspections and Examinations, National Exam Program, Risk Alert, "Investment Adviser Compliance Issues Related to the Cash Solicitation Rule" (October 31, 2018), https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20Cash%20Solicitation.pdf.

- *Solicitor disclosure documents.* Some advisers used third-party solicitors that did not provide solicitor disclosure documents to prospective clients or provided solicitor disclosure documents that did not contain all required information.

- *Client acknowledgements*. Some advisers did not timely receive a signed and dated client acknowledgement of receipt of the adviser brochure and solicitor disclosure document.

- *Solicitation agreements*. Certain advisers paid cash fees to a solicitor without a solicitation agreement in effect or pursuant to an agreement that did not contain certain specific provisions required by the Cash Solicitation Rule.

- *Bona fide efforts to ascertain solicitor compliance*. Staff observed advisers that did not make a bona fide effort to ascertain whether third-party solicitors complied with solicitation agreements and appeared to not have a reasonable basis for believing that the third-party solicitors so complied.

Similar conflicts that technically are not subject to the Cash Solicitation Rule may implicate other provisions of the Advisers Act, such as the anti-fraud provisions of Sections 206(1) and 206(2). For example, OCIE observed advisers that recommended service providers to clients in exchange for client referrals without full and fair disclosure of the conflicts of interest.

SEC Focus on Digital Assets and Initial Coin Offerings

Over the past year, the SEC has paid increasing attention to issues involving the rapidly growing digital asset market, which includes cryptocurrencies, coins and tokens. As noted above, OCIE indicated in its 2019 Exam Priorities that it will continue to monitor the sale, trading and management of digital assets and, where the products are securities, examine for regulatory compliance. During FY 2018, the SEC Division of Enforcement's Cyber Unit became fully operational and led the Division in addressing a range of misconduct relating to digital assets and initial coin offerings (ICOs). As noted in the Division of Enforcement's 2018 Annual Report,[30] digital asset offerings, including ICOs, are often high-risk investments. For example, the issuers may lack established track records, viable products, business models or the capacity for safeguarding digital assets from theft by hackers, and some of the offerings are designed to conceal outright fraud.

The Division of Enforcement has recommended a number of enforcement actions to the SEC in this area in recent months. As of the close of FY 2018, the SEC had brought over a dozen standalone enforcement actions involving digital assets and ICOs, and dozens of investigations are still open.[31] While many of these cases involve allegations of fraud, the Division of Enforcement also has pursued enforcement actions to ensure compliance with the registration requirements of the federal securities laws.

For example, the SEC issued an order against a digital asset hedge fund manager for failing to register its fund as an investment company and offering and selling the fund's securities in an unregistered offering.[32] This constitutes the SEC's first-ever enforcement action finding an investment company registration violation by a hedge fund manager based on its investments in digital assets and is also the first instance in which the SEC has found that certain digital assets are investment securities for purposes of the Investment Company Act.[33] According to the order, the manager offered a fund that operated as an

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[30] SEC Division of Enforcement, 2018 Annual Report (November 2, 2018), https://www.sec.gov/files/enforcement-annual-report-2018.pdf.

[31] *Ibid.*

[32] Administrative Proceeding File No. 3-18740 (September 11, 2018), https://www.sec.gov/litigation/admin/2018/33-10544.pdf.

[33] See Sidley Update, "One-Two-Three Punch: SEC and FINRA Announce Actions Against Unregistered Broker, Digital Asset Manager and FINRA Registered Person" (September 18, 2018), https://www.sidley.com/en/insights/newsupdates/2018/09/sec-and-finra-announce-actions, for additional information regarding enforcement proceedings involving participants in the digital asset markets.

unregistered investment company while marketing it as the "first regulated crypto asset fund in the United States," falsely claiming that the fund was regulated by the SEC and had filed a registration statement with the SEC. The SEC found that by engaging in an unregistered nonexempt public offering and investing more than 40 percent of the fund's assets in digital asset securities, the manager caused the fund to operate an unregistered investment company. After being contacted by the SEC staff, the manager ceased its public offering and offered buybacks to affected investors.

Recent Enforcement Initiatives and Proceedings

The following is a summary of several recent enforcement actions of relevance to investment advisers.

Deficient Cybersecurity Procedures and Violations of the Identity Theft "Red Flags" Rule

A dually registered broker-dealer and investment adviser recently settled SEC charges related to failures in its cybersecurity policies and procedures in connection with a cyberintrusion that compromised the personal information of thousands of customers.[34] Specifically, the SEC charged the firm with violating Rule 30(a) of Regulation S-P (the Safeguards Rule) and failure to develop and implement a written Identity Theft Prevention Program as required by Rule 201 of Regulation S-ID (the Red Flags Rule), which are designed to protect confidential customer information and protect customers from the risk of identity theft. This was the first SEC enforcement action charging violations of the Red Flags Rule.

According to the SEC's order, cyberintruders impersonated firm contractors over a six-day period in 2016 by calling the firm's support line and requesting that the contractors' passwords be reset. The intruders used the new passwords to gain access to the personal information of 5,600 of the firm's customers. The intruders then used the customer information to create new online customer profiles and obtain unauthorized access to account documents for three customers. As of the date of the order, there had been no known unauthorized transfers of funds or securities from customer accounts as a result of the attack.

The Safeguards Rule requires SEC-registered broker-dealers and RIAs to adopt written policies and procedures that address administrative, technical and physical safeguards for the protection of customer records and information. According to the order, the firm violated the Safeguards Rule because its policies and procedures to protect customer information and to prevent and respond to cybersecurity incidents were not reasonably designed to meet these objectives. Among other things, the firm's policies and procedures with respect to resetting contractor representatives' passwords, terminating web sessions for contractor representatives and identifying higher-risk representatives and customer accounts for additional security measures were not reasonably designed.

The Red Flags Rule requires SEC-registered broker-dealers and RIAs to develop and implement a written Identity Theft Prevention Program that is designed to detect, prevent and mitigate identity theft in connection with the opening of a covered account or any existing covered account. The SEC found that although the firm adopted a written Identity Theft Prevention Program in 2009, the firm violated the Red Flags Rule because it did not review and update the program in response to changes in risks to its customers or provide adequate training to its employees. In addition, the program did not include reasonable policies and procedures to respond to identity theft red flags, such as those detected by the firm during the 2016 intrusion.

[34] Administrative Proceeding File No. 3-18840 (September 26, 2018), https://www.sec.gov/litigation/admin/2018/34-84288.pdf.

Faulty and Untested Investment Models

The SEC announced settled administrative charges against an RIA and three of its affiliates (the Respondents) for, among other matters, misconduct involving faulty investment models.[35] According to the SEC's order, during the pertinent period the Respondents managed and sold 15 quantitative-model-based mutual funds, variable life insurance investment portfolios and variable annuity investment portfolios (the RIC Products) and separately managed account strategies (the SMA Strategies).

The SEC found that the RIA tasked a junior analyst, who had no experience in portfolio management or any formal training in financial modeling, with developing quantitative models for use in managing investment strategies. The RIA ultimately used these models to manage each of the RIC Products and SMA Strategies. The analyst did not follow any formal process to confirm the accuracy of his work, and the RIA failed to provide him meaningful guidance, training or oversight as he developed the models. The SEC found that the RIA launched the RIC Products and the SMA Strategies without first confirming that the models worked as intended and/or without disclosing any risks associated with using the models.

According to the SEC's order, after using the models for several years the RIA determined that certain of the models contained material errors. Ultimately, more than 50 errors were discovered, including incorrect calculations, inconsistent formulas and the use of numerical amounts where percentages were intended (such as 1.77 instead of 1.77 percent). The errors affected the models' allocation outputs. As a result, the RIA stopped using, running or relying on the models.

The SEC found that the Respondents failed to disclose to investors in the RIC Products or the SMA Strategies that the models contained errors and were no longer being used. The Respondents also failed to disclose these facts to the boards of the RIC Products as a general matter and despite the boards' request for such information during the information-gathering process required by Section 15(c) of the Investment Company Act. Certain of the pertinent investment advisory agreements were subsequently terminated, again without disclosure of the discovery of the errors.

Misleading Marketing Materials

An RIA settled SEC charges arising from alleged material misstatements and omissions by the adviser to certain of its advisory clients concerning hypothetical stock returns associated with the firm's blended research stock ratings.[36] The blended research strategies combine research ratings from the adviser's fundamental analysts and quantitative models to manage portfolios of stocks for client investment.

During the relevant period the adviser advertised that blending fundamental and quantitative stock ratings over time could yield better returns than either type of ratings alone. To illustrate the validity of this claim, the firm advertised the results of a hypothetical portfolio of stocks rated "buy" by both the firm's fundamental analysts and quantitative models, showing that the hypothetical portfolio had annualized returns from 1995 forward that exceeded the annualized returns of either a hypothetical portfolio of fundamental "buy" rated stocks or a hypothetical portfolio of quantitative "buy" rated stocks.

According to the SEC's order, the advertisements demonstrating the superior returns of the hypothetical portfolio were misleading because the materials failed to disclose that some of the quantitative ratings used to create the hypothetical portfolio were determined using a retroactive, back-tested application of the firm's quantitative model. In some advertisements, the adviser also falsely claimed that the hypothetical portfolio was based on the firm's own quantitative stock ratings dating back to the mid-1990s, even though before 2000 the adviser did not generate its own quantitative stock ratings.

The SEC found that the misleading advertisements were due in part to the adviser's failure to adopt and implement policies and procedures reasonably designed to prevent false and misleading advertisements.

[35] Administrative Proceeding File No. 3-18681 (August 27, 2018), https://www.sec.gov/litigation/admin/2018/33-10539.pdf.

[36] Administrative Proceeding File No. 3-18704 (August 31, 2018), https://www.sec.gov/litigation/admin/2018/ia-4999.pdf.

Personnel in the group responsible for managing blended research strategies generally knew that the research proof analysis calculated returns dating back to 1995, before the adviser began generating its own quantitative ratings, and also understood that some of the quantitative ratings were back-tested. However, this information was not clearly and consistently communicated to personnel responsible for preparing and reviewing the pertinent advertisements. The adviser's compliance personnel were unaware that some of the quantitative ratings were back-tested and thus lacked pertinent facts when determining whether the firm's advertisements complied with the federal securities laws.

Misappropriation of Client Assets

In a settled administrative proceeding,[37] the SEC found that a dually-registered investment adviser and broker-dealer violated the Compliance Rule by failing to have reasonably designed policies and procedures in place to prevent its personnel from misappropriating client funds. According to the SEC's order, during the pertinent period the firm permitted its investment adviser representatives and registered representatives ("financial advisors") to initiate third-party disbursements from client accounts of up to a specified dollar limit per day based on the financial advisor's attestation on an internal electronic form that he or she had received a verbal request from the client by phone or in person and providing certain details about the request. The SEC found that while the firm's policies provided for certain reviews prior to issuing the disbursements, such reviews were not reasonably designed to prevent a financial advisor from making false attestations about having received a client request to transfer funds to a third party or to detect such false attestations.

According to the SEC, over a period of nearly a year a particular financial advisor initiated multiple unauthorized transactions out of accounts of his advisory clients by making false attestations on approximately 90 internal electronic forms to initiate third-party transfers, resulting in his misappropriation of over $5 million. The firm did not detect that any of these transactions were unauthorized for nearly a year, until the defrauded clients contacted the firm with questions about their accounts. The SEC also found that the firm had failed reasonably to supervise the financial advisor.

The SEC noted in the order that the firm has since developed significant enhancements to its policies, procedures, systems and controls relating to preventing or detecting conversion of client advisory and customer brokerage funds by its personnel. The enhanced policies and controls include increased client contact, independent client callbacks on a risk-based and randomly sampled basis and new or revised internal surveillance procedures.

Due Diligence and Monitoring Failures

A former RIA settled SEC charges that it negligently failed to perform adequate due diligence and monitoring of certain investments, which ultimately contributed to substantial client losses.[38] According to the SEC's order, the firm advised clients to purchase interests in facilities and other investments containing repurchase agreements ("repos") that eventually proved to be fraudulent, even though the adviser's initial due diligence in connection with the investments had identified concerning information. The adviser continued to offer the repos to clients despite growing concerns about the legitimacy of the investments.

The SEC focused on allegations that the firm's compliance program lacked sufficient resources, finding that the firm failed to reasonably design and implement certain compliance policies and procedures. According to the order, the adviser repeatedly refused to provide the CCO with the compliance resources that he requested despite specific risk concerns cited by the CCO. The SEC found that the denial of resources "undermined the effectiveness of [the firm's] compliance program resulting in compliance failures." Of key importance, the adviser did not have written policies and procedures regarding initial and ongoing due diligence with respect to its repo program, even after the CCO stated in two consecutive

[37] Administrative Proceeding File No. 3-18566 (June 29, 2018), https://www.sec.gov/litigation/admin/2018/34-83571.pdf.

[38] Administrative Proceeding File No. 3-18884 (November 6, 2018), https://www.sec.gov/litigation/admin/2018/ia-5061.pdf.

annual risk assessments (which he escalated to the firm's CEO and board of directors) that counterparty risk was a significant risk to the firm.

Separately, the firm's former CEO also agreed to settle charges that he was aware of, but failed to address, resource deficiencies in the firm's compliance program, which contributed substantially to the adviser's compliance failures.[39]

False and Misleading Disclosures by Two Robo-Advisers

The SEC instituted settled proceedings against two robo-advisers for making false statements about investment products and publishing misleading advertising. The proceedings are the SEC's first enforcement actions against robo-advisers, which provide automated, software-based portfolio management services. In the related press release, C. Dabney O'Riordan, Chief of the Enforcement Division's Asset Management Unit, stated: "Technology is rapidly changing the way investment advisers are able to advertise and deliver their services to clients. Regardless of their format, however, all advisers must take seriously their obligations to comply with the securities laws."[40]

In the first proceeding,[41] the SEC found that a robo-adviser made false statements about a tax-loss harvesting strategy that it offered to clients. According to the SEC's order, the robo-adviser also retweeted posts that constituted prohibited client testimonials while omitting required disclosures, paid bloggers for client referrals without the required disclosure and documentation and failed to maintain a compliance program reasonably designed to prevent violations of the securities laws.

In the second proceeding,[42] the SEC found that a robo-adviser disseminated false and misleading marketing materials and performance data. The robo-adviser posted on its website and social media a purported comparison of the investment performance of its clients with those of two robo-adviser competitors. The comparisons were misleading because (i) the robo-adviser included only a small subset of its client accounts and (ii) compared the performance of this subset with rates of return that were not based on the competitors' actual trading models but instead were an approximation of the competitors' performance based on information available from their websites. The SEC also found that the robo-adviser failed to maintain required performance documentation. In stating that the violations were caused in part by the robo-adviser's ineffective compliance program, the SEC noted that the firm's compliance policies and procedures did not require any officer of the firm to review or approve marketing materials or performance data posted on its digital media platforms.

Share Class Selection Disclosure Initiative

The SEC continues to focus on disclosure failures relating to marketing and distribution fees, often referred to as "12b-1 fees," paid by investors in certain share classes of mutual funds. OCIE exams have revealed numerous instances of advisers that selected a more expensive share class for investors when a lower-cost share class for the same fund was available without making adequate disclosure to investors, and the SEC has brought more than 15 enforcement matters involving share class disclosures in the last five years.[43]

In an attempt to address this continuing problem, the Division of Enforcement launched the Share Class Selection Disclosure Initiative (the Initiative) in February 2018. The Initiative is a voluntary program for investment advisers to (i) self-report to the SEC their failures to disclose financial conflicts of interest relating to compensation they received in the form of 12b-1 fees and (ii) pay disgorgement to harmed

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[39] Administrative Proceeding File No. 3-18885 (November 6, 2018), https://www.sec.gov/litigation/admin/2018/ia-5062.pdf.

[40] SEC Press Release 2018-300, "SEC Charges Two Robo-Advisers With False Disclosures" (December 21, 2018), https://www.sec.gov/news/press-release/2018-300.

[41] Administrative Proceeding File No. 3-18949 (December 21, 2018), https://www.sec.gov/litigation/admin/2018/ia-5086.pdf.

[42] Administrative Proceeding File No. 3-18950 (December 21, 2018), https://www.sec.gov/litigation/admin/2018/ia-5087.pdf.

[43] See Note 30 above.

investors. The Division agreed not to recommend financial penalties against advisers participating in the Initiative but warned that it would "recommend stronger sanctions in any future actions" against advisers that engaged in the misconduct but failed to take advantage of the Initiative. The deadline for self-reporting under the Initiative was June 12, 2018.

Violations of the Foreign Corrupt Practices Act

The SEC settled an enforcement action involving alleged violations by an investment adviser of the Foreign Corrupt Practices Act arising from bribes paid to Libyan government officials in connection with soliciting business from Libyan stated-owned financial institutions.[44] According to the SEC's order, a former asset management subsidiary of the investment adviser (the Subsidiary) partnered with a French financial services company to solicit investment business from Libyan state-owned financial institutions. During the pertinent period, the French firm paid a Libyan middleman for supposed "introductory" services. Although employees of the Subsidiary were aware that the intermediary was paying bribes to Libyan government officials in order to secure investments, the employees nevertheless agreed to continue to use the Libyan intermediary. As a result of this scheme, the investment adviser (through the Subsidiary) was awarded business tied to $1 billion of investments from the Libyan financial institutions.

The SEC found that the investment adviser lacked appropriate internal accounting controls with respect to the use of introducing brokers and other intermediaries in emerging markets and accordingly violated the internal accounting controls provision of the Exchange Act. According to the order, the advisory firm did not timely institute appropriate risk-based due diligence and compliance requirements pertaining to the retention and oversight of intermediaries.

Form PF Reporting Requirements

Most RIAs that advise private funds are required to file Form PF either quarterly or annually; advisers exempt from SEC registration, including ERAs, are not required to file Form PF. 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[45] and in FAQs posted (and periodically updated) on the SEC's website.[46] According to a December 2018 SEC staff report, the staff regularly contacts individual filers when staff members identify anomalous and possibly erroneous data as well as possibly delinquent or missing filings and works with these individual filers to determine steps for improving timeliness and accuracy of filings.[47]

When delinquencies persist, the staff has taken further steps to ensure that information is appropriately filed. In June 2018, the SEC announced settlement orders with 13 RIAs that repeatedly failed to file Form

[44] Administrative Proceeding File No. 3-18684 (August 27, 2018), https://www.sec.gov/litigation/admin/2018/34-83948.pdf.

[45] The public Form PF inquiry email address and a phone number to reach staff with questions relating to Form PF are available at https://www.sec.gov/divisions/investment/iard/iardhelp.shtml.

[46] See Form PF Frequently Asked Questions, 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, http://www.iard.com/pfrd/pdf/PFRD_System_FAQs.pdf (most recently updated on March 18, 2017).

[47] See Note 19 above.

PF.[48] Each adviser was charged a $75,000 penalty. During the course of the SEC investigation, the advisers remediated their failures by making the necessary filings.

Who Must File

An RIA is required to file Form PF if it (i) advises one or more private funds and (ii) collectively, with related persons (other than related persons that are separately operated), had RAUM of $150 million or more (calculated in accordance with Form PF aggregation requirements) 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, 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.[49]

To avoid duplicative reporting, Form PF information regarding subadvised 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 in Section 7.B.1 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 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.

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[48] SEC Press Release 2018-100, “SEC Charges 13 Private Fund Advisers for Repeated Filing Failures” (June 1, 2018), https://www.sec.gov/news/press-release/2018-100.

[49] 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.

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.

	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	Sections 1
Upcoming Filing Deadline	March 1, 2019 (for fourth quarter 2018)	April 15, 2019 (for first quarter 2019)	April 30, 2019 (for 2018)	April 30, 2019 (for 2018)

*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 the Financial Stability Oversight Council's assessment of systemic risk, the SEC is also using the data to support its own regulatory programs, including examinations, investigations and investor protection efforts. As noted above, the 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, the OCIE staff typically looks for discrepancies between an adviser's Form PF filing and any publicly available documents related to the adviser, including the adviser's Form ADV Part 1A and its Part 2A brochure.

The most recent SEC annual Form PF staff report describes a number of ways the staff is using Form PF data to identify and monitor private fund industry trends, identify emerging compliance risk areas, inform policymaking and prioritize the use of exam and enforcement resources.[50] As described in the report, the SEC staff has developed various analytical tools to enhance the staff's ability to assess large volumes of data, streamline analysis of the data by automating certain analytic processes and evaluate Form PF data in conjunction with other relevant datasets. For example, these tools have enhanced the staff's ability to

- identify "outliers" among private funds and private fund advisers using factors such as performance, investment exposures and liquidity;
- identify private funds based on one or more areas of policy interest, such as type of strategy, types of investments, use of derivatives and extent of leverage; and
- empirically test claims made in the financial press or other public sources regarding private funds and the private fund industry.

The SEC staff also obtains and reviews Form PF information to focus its enforcement investigations, including investigations of private fund advisers. For example, the staff used Form PF data together with other information to identify hedge fund advisers whose reported data — such as returns, exposures, liquidity — appear inconsistent with the funds' investment strategies or other benchmarks. These reviews have, in certain cases, led to examinations and enforcement 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 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

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[50] See Note 19 above.

Division of Swap Dealer and Intermediary Oversight has posted FAQs regarding Form CPO-PQR, while the NFA has posted FAQs regarding Form PQR.[51]

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.[52]

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.[53] 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 filings is due within 60 days of quarter end. Similarly, a midsize 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 annually; however, a dual registrant will still be subject to quarterly NFA reporting requirements pursuant to NFA Form PQR. Note, however, that whereas a midsize 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 midsize 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).

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 quarterly 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 quarterly satisfy their NFA Form PQR filing requirements through filing CFTC Form PQR.[54]

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 quarterly within 60 days of the quarter end, except for the December 31 quarter, when the filing will be due within 90 days.[55]

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

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[51] See CFTC, "CFTC Division of Swap Dealer and Intermediary Oversight Responds to Frequently Asked Questions Regarding Commission Form CPO-PQR" (November 5, 2015), http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/faq_cpocta110515.pdf. See also NFA, "CPO Form PQR," https://www.nfa.futures.org/faqs/members/CPOFormPQR.html.

[52] See Form CPO-PQR Filing System Overview (on the NFA website), http://www.nfa.futures.org/electronic-filing-systems/PQR-Help.pdf.

[53] 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.

[54] 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.

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

Gross AUM Threshold				
Filing Requirements	**Large CPO***	**Mid-Size 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 (*within 60 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 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 applies only 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.[56] 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.[57]

[56] See Form CTA-PR Filing System Help (on the NFA website) http://www.nfa.futures.org/electronic-filing-systems/CTA-PR-System-Help.pdf.

[57] See CFTC, "CFTC Division of Swap Dealer and Intermediary Oversight Responds to Frequently asked Questions Regarding Commission Form CTA-PR" (in the same release as the CFTC's FAQs regarding Form CPO-PQR cited in Note 51 above). See also NFA, "CTA Form PR FAQs," https://www.nfa.futures.org/NFA-electronic-filings/CTAFAQsFormPR.pdf.

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