SIDLEY

SIDLEY UPDATE

2021 Update for Investment Advisers Important Annual Requirements; 2021 SEC Exam Priorities; Recent SEC Enforcement Initiatives

March 4, 2021

Investment advisers registered with the Securities and Exchange Commission (SEC) (each an RIA) are subject to certain annual requirements under the Investment Advisers Act of 1940 (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 2021 reporting or filing deadlines.

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

This Sidley Update provides important information regarding

- **Annual Form ADV Updating Requirements (page 2)**
- **Compliance Program Review and Testing (page 4)**
- **Other Annual Reminders for RIAs and ERAs (page 6)**
- **SEC Examination Priorities for 2021 (page 8)**
- **Preparing for an SEC Exam (page 12)**
- **Recent Regulatory Developments and Guidance (page 14)**
- **SEC Rule Developments (page 21)**
- **SEC Focus on Digital Assets and ICOs (page 25)**
- **Recent SEC Enforcement Initiatives and Proceedings (page 27)**
- **Form PF Reporting Requirements (page 29)**
- **CFTC and NFA Reporting Requirements for Certain Investment Advisers (page 32)**

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

RIAs, CPOs, and/or CTAs.[1]

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, 2020, fiscal year end must file its annual amendment by March 31, 2021. 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

[1] This Sidley Update generally does not address non-U.S. regulatory developments, a number of which are covered in other Sidley Updates. For example:

- On June 26, 2021, the European Union (EU) Investment Firms Directive (IFD) and Investment Firms Regulation (IFR) will come into effect. See Sidley Austin LLP, Sidley Update, "New EU Investment Firm Prudential (Capital and Remuneration) Regime — Analysis of Final Text" (April 23, 2019), https://www.sidley.com/en/insights/newsupdates/2019/04/new-eu-investment-firm-prudential-regime.
- On March 10, 2021, the EU Sustainable Finance Disclosure Regulation (the SFDR) will introduce certain sustainability related disclosure requirements for (among others) non-EU alternative investment fund managers (AIFMs) that market alternative investment funds (AIFs) in the EU. See Sidley Austin LLP, Sidley Update, "EU ESG Disclosures Required from March 10, 2021 — Action Points for Non-EU Fund Managers" (January 25, 2021), https://www.sidley.com/en/insights/newsupdates/2021/01/eu-esg-disclosures-required-from-march-10-2021-action-points-for-noneu-fund-managers.
- On December 24, 2020, the UK and EU reached an agreement in principle on a Trade and Cooperation Agreement (TCA) to govern the terms of the future relationship between the UK and the EU following the expiration of the Brexit transition period on December 31, 2020. See Sidley Austin LLP, Sidley Update, "UK/EU Investment Management Update (January 2021)" (January 7, 2021), https://www.sidley.com/en/insights/newsupdates/2021/01/ukeu-investment-management-update-january-2021.
- On December 17, 2020, the European Securities and Markets Authority (ESMA) extended its decision to reduce the net short reporting threshold from 0.2% to 0.1% for a period of three months. See Sidley Austin LLP, Sidley Update, "European Union Net Short Position Reporting Threshold Reduced to 0.1%" (Updated December 17, 2020), https://www.sidley.com/en/insights/newsupdates/2020/03/european-union-net-short-position-reporting-threshold-reduced.
- On October 22, 2020, the European Commission (the Commission) launched its public consultation (Consultation) on the EU Alternative Investment Fund Managers Directive (AIFMD). The Consultation marks the next step in the Commission's formal review of the AIFMD. See Sidley Austin LLP, Sidley Update, "AIFMD 2020 — Analysis of the European Commission Consultation on the AIFMD" (November 3, 2020), https://www.sidley.com/en/insights/newsupdates/2020/11/aifmd-2020-analysis-of-the-european-commission-consultation-on-the-aifmd.
- On September 24, 2020, the Commission published a much-anticipated proposal on the establishment of an EU-level regime for cryptoassets; the Markets in Crypto-Assets Regulation (MiCA). See Sidley Austin LLP, Sidley Update, "Analysis of the Proposed EU Markets in Crypto-Assets Regulation" (November 12, 2020), https://www.sidley.com/en/insights/newsupdates/2020/11/analysis-of-the-proposed-eu-markets-in-cryptoassets-regulation.

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
- 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 has acknowledged does not include fund investors. However, many fund advisers voluntarily deliver the brochure to fund investors. An RIA with a December 31, 2020, fiscal year end must deliver its updated brochure to clients by April 30, 2021.[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 (1940 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

[2] Form ADV: General Instructions, http://www.sec.gov/about/forms/formadv-instructions.pdf.
[3] In a two-part netcast on September 12, 2018, 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").
[4] Form ADV: Instructions for Part 1A, https://www.sec.gov/about/forms/formadv-instructions.pdf.
[5] See Form PF: General Instructions, https://www.sec.gov/files/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."

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 fiscal year end, and more frequently if required, as specified in General Instruction 4 to Form ADV. Hence, an ERA with a December 31, 2020, fiscal year end must file its annual updating amendment by March 31, 2021.

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 (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 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 Risk Alert[8] issued by the SEC's Division of Examinations, formerly known as the Office of Compliance Inspections and Examinations (Division), described examples of deficiencies or weaknesses in connection with the Compliance Rule frequently identified in the Division's examinations. Examples include:

- *Compliance manuals are not reasonably tailored to the adviser's business practices*. The SEC 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

[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 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.

practices, valuation procedures, and advisory fees.

- *Annual review was not performed or did not address the adequacy of the adviser's policies and procedures.* The SEC 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 SEC noted that certain compliance manuals contained information or policies that are no longer current.

The SEC has noted[9] specific examples of certain deficiency types, including:

- *Policies and procedures that are incomplete or inaccurate*. The SEC 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 SEC 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 SEC 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,

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

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. The Division recommends that the adviser document the content, timing, and results of the testing, which can expedite the SEC'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

[9] See Note 3 above.
[10] See Note 3 above.

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 should convene a special meeting at least annually 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 at least annually 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 reread) 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.

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 all NFA members must complete 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 the following (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 (Securities Act) registration provided by Rule 506 of Regulation D if the pertinent offering involves certain "bad actors." For continuous or other offerings of long duration, an adviser must update, with reasonable care, its factual inquiries (i.e., by email or questionnaire) to determine whether any covered persons have "disqualifying events," which may also require disclosure in Form ADV.

Annual Eligibility for "New Issues." An adviser should verify annually the eligibility of clients and fund investors to participate in new issues of publicly offered securities (i.e., initial public offerings) 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. The staff of the SEC's New York regional office indicated in 2018 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 (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, 2021, 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, 2021, 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 CPO 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, 2021 — or be deemed to have requested a withdrawal of the applicable exemption or exclusion.

[11] See Note 3 above.

Confirming Affirmation of Investors/Clients Claiming Exemptions Under CFTC Rules. 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, 2021, to file their annual affirmation of the exemption, and, 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 has 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 April 1, 2021, 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. RIAs 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 Division of Examinations - Priorities for 2021

On December 17, 2020, the SEC announced that after 25 years since the creation of the Office of Compliance Inspections and Examinations (OCIE), it would be renaming the office the Division of Examinations. The announcement reinforced the SEC's commitment to the Division's centralized National Examination Program, with staff located across its Washington, DC, headquarters and 11 SEC regional offices. Risk-based examinations of entities registered with the SEC, including investment advisers, mutual funds and exchange-traded funds (ETFs), broker-dealers, transfer agents, and clearing agencies as well as national securities exchanges and municipal advisors will continue to be the Division's priority and focus. The SEC noted that Division program areas will continue to be a primary focus including the Investment Adviser/Investment Company Examination Program; the Broker-Dealer and Exchange Examination Program; the Financial Industry Regulatory Authority (FINRA) and Securities Industry Oversight Examination Program; the Technology Controls Program; and the newly created Event and Emerging Risks Examination Team. In the announcement, the SEC noted that the Division's new name reflects the important role that its expert staff play in support of the SEC's mission to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation."[15]

Exam Priorities 2021

On March 3, 2021, the Division published its examination priorities for 2021 (the "Exam Priorities") for various regulated entities, including investment advisers. The Division has announced its exam priorities annually for the past nine years to provide insights into the areas it believes present potentially heightened

[12] NFA Notice I-21-02, "Member obligations under NFA Bylaw 1101 and Compliance Rule 2-36(d) with respect to CPOs/CTAs exempt from registration" (January 14, 2021), https://www.nfa.futures.org/news/newsNotice.asp?ArticleID=5320.

[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 TIC Form S, TIC Form SLT, TIC Form SHC, and TIC Form SHL.

[15] See SEC Public Statement of the Commissioners, Statement on the Renaming of the Office of Compliance Inspections and Examinations to the Division of Examinations, December 17, 2020, https://www.sec.gov/news/public-statement/joint-statement-division-examinations.

risk to investors or the integrity of the U.S. capital markets. The Division opened this year's Exam Priorities summary with an acknowledgement of the impact the global pandemic has had on everyone, a reminder of firms' obligations under Reg BI and reporting under Form CRS, and the continued importance of firms' compliance programs. The Exam Priorities can serve as a roadmap to assist advisers in assessing their policies, procedures and compliance programs; testing for and remediating any deficiencies related to the Exam Priorities; and preparing for exams by the Division. 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 Division noted that it examined 2,952 advisers, about 15 percent of the RIA population, in (FY) 2020. The number of exams conducted was down only slightly from (FY) 2019, and since March of 2020 conducted under pandemic protocols. Investment company complexes were also prioritized for examinations in 2020 with the Division noting that its staff completed more than 100 examination of investment company complexes. In the Exam Priorities discussion, the Division also highlighted the results of examinations, including over 2,000 deficiency letters and over 130 referrals to the Division of Enforcement. The Division's priorities for 2021 reflect a continued focus on risk areas that have been emphasized in recent years but with attention paid to emerging risks and risks associated with developing products and services. Specific emerging risks the Division identified include, ESG topics, cybersecurity (compromised network management software), supervision of remote employees, LIBOR transition preparedness and "meme stock" issues.

The priorities reviewed under the stated examination priorities for the Division are organized around nine themes: (1) retail investors, including seniors and individuals saving for retirement; (2) information security and operational resiliency; (3) FINTECH and innovations including digital assets; (4) anti-money laundering; (5) LIBOR transition; (6) focus areas for RIAs and investment companies (i.e. compliance programs, registered fund (mutual funds and ETFs), and private fund risks); (7) financial responsibility and trading practices for broker-dealers and fiduciary and disclosure obligations for municipal advisors; (8) market infrastructure issues including clearing agencies, transfer agents and national securities exchanges; and (9) select areas and programs of FINRA and MSRB.

Exams are Risk-Based and Data-Driven

The Division notes in the 2021 Exam Priorities that their priorities provide a preview of key elements of adviser examinations, however, they are not exhaustive and will not be the only topics addressed during and examination. RIAs received a cautionary statement from the Division that "while the priorities drive many of the Division's examinations, we select firms for examination and the areas of focus covered during examinations according to a risk-based analysis, which varies depending on the type of firm and its business activities."

Continued Focus on Retail Investors

For both broker-dealers and investment advisers, the Division continues to emphasize the protection of retail investors. Examinations will have a particular focus on services targeted to retail investors particularly seniors and individuals saving for retirement and the related investments and services for retail investors such as mutual funds and ETFs, municipal securities, other fixed income securities and microcap securities. Among other focus areas, examiners will review a firm's approach and compliance with Regulation Best Interest RIA fiduciary duties and disclosures in firm's Form CRS relationship summary.

Information Security and Operational Resiliency

The Division is focused on reviewing firms' programs to identify and address information security (including cyber-related) risks. Calling attention to the increase in remote operations over the past year in response to the pandemic, the Division is looking to identify and address concerns regarding endpoint security, data loss, remote access, use of third-party communication systems and vendor management. In this context, the Division plans to review steps firms have taken to: (1) safeguard customer accounts and prevent account intrusions, including verifying an investor's identity to prevent unauthorized account access; (2) oversee vendors and service providers; (3) address malicious email activities, such as phishing or account intrusions; (4) respond to incidents, including those related to ransomware attacks; and (5) manage operational risk as a result of dispersed employees in a work-from-home environment. Related electronic records safeguarding and protection practices will also be a focus for the Division. In the Exam Priorities, the Division notes that they intend to review controls surrounding online and mobile application access to investor account information and access to electronically stored books and records with personally identifiable information maintained with third-party cloud service providers. The Division also plans to review business continuity and disaster recovery plans in light of the substantial disruptions to normal business operations many firms experienced during the past year.

While not included in the Exam Priorities summary, the Division will likely continue to focus questions and information gathering during exams on assessing information safeguarding procedures and protection of clients' personal financial information. Examination questions and information requests emanate from the SEC's "cyber-six" and should still be the foundation for advisers' compliance efforts. The six focus areas generally include: (1) governance and risk management, (2) access controls, (3) data loss prevention, (4) vendor management (including oversight practices related to network solutions and cloud-based storage), (5) training, and (6) incident response and resiliency.

FINTECH and Innovation including Digital Assets

The Division notes the rapid pace of innovations in financial technology and capital formation. In turn, the Division highlights its commitment to staying informed about the risks and impact of these developments. RegTech, the use of technology to facilitate compliance, will be a focus of the Division as it assesses how firms have implemented and integrated RegTech into the firm's compliance program.

Aware of registered firms' increased use of new sources of data, "alternative data," to inform investment decision-making, the Division remains focused on assessing the evolving risks of alternative data use. The Division will focus on firms' use of alternative data sets and technologies to interact with and provide services to investors, firms, and other service providers and assess the effectiveness of related compliance and control functions, particularly as they relate to MNPI and insider trading controls. For RIAs that invest in digital assets, examinations will include an assessment of firm policies for: (1) portfolio management, (2) maintenance of books and records, (3) custody, (4) disclosures to clients, (5) pricing and digital asset valuation, and (6) calculation methods of digital assets for purposes of calculating regulatory assets under management.

LIBOR Transition

Echoing the concerns detailed it its 2020 LIBOR Exam Initiative Risk Alert[16], the Division again identified LIBOR transition preparedness as an examination program priority in 2021. The Division has noted it would review, among other things, firms activities to understand any exposure to LIBOR, how registrants have evaluated the effect of the LIBOR transition on business activities, operations, services, and investors and what steps registrants have taken to transition its effected documentation, including amending existing contracts and incorporating appropriate fallback language into new contracts.

Focus Areas Relevant to Investment Advisers and Investment Companies

RIA Compliance Programs. Areas of focus will include whether firms maintain effective compliance programs to address custody and safekeeping of client assets, best execution, fees and expenses, business continuity plans, and valuation of client assets for consistency and appropriateness of methodology. The Division will prioritize examinations of RIAs that have never been examined or have not

[16] OCIE, Examination Initiative: LIBOR Transition Preparedness (June 18, 2020), https://www.sec.gov/files/Risk%20Alert%20-%20OCIE%20LIBOR%20Initiative_1.pdf.

been examined in a number of years. Also a priority for the Division will be advisers offering investment strategies with a focus on sustainability, or labeled socially responsible, impact, or ESG. The stated specific focus of the Division will be to review disclosures, consistency of policies and procedures, marketing materials, and proxy voting practices.

Registered Funds, Including Mutual Funds and ETFs. The focus of the Division for registered funds includes reviews of funds' compliance programs and governance practices, disclosures to investors, valuation practices, filings with the SEC, personal trading activities, and contracts and agreements. The Division also plans to review securities lending practices for funds and advisers. Similar to RIAs, the Division will prioritize examinations of mutual funds or ETFs that have not previously been examined or have not been examined in a number of years.

Private Fund Advisers and Higher Risk Products. The Division will continue with its focus on RIAs that manage private funds with a specific focus on firms that manage what the Division considers higher risk products such as structured products (i.e. collateralized loan obligations and mortgage backed securities) or private funds with portfolio companies that may have experienced material impacts due to recent economic conditions (e.g., real estate related investments). In the Exam Priorities for private fund managers, the Division notes that they will be specifically reviewing for preferential liquidity treatment for funds that experienced liquidity issues in 2020 (including imposing gates or suspending fund withdrawals). The Division will also be reviewing portfolio valuation practices and the impact to management fees, cross trades, principal investments, or distressed sales, as well as for conflicts around liquidity, such as adviser-led fund restructurings.

Additional Focus Areas Relevant to Investment Advisers

Disclosure, Conflicts of Interest, Fiduciary Duty. The focus of examinations through the end of 2020 and the beginning of 2021 suggests that the Division will continue to examine advisers to evaluate whether, as fiduciaries, they have fulfilled their duties of care and loyalty. The focus of Division reviews continues their assessment of whether advisers have provided advice in the best interests of their clients and have eliminated, or at least exposed through full and fair disclosure, all of the identified conflicts of the interest that might incline an adviser, consciously or unconsciously, to render advice that is not disinterested.

Fees/Expenses. Fees and expenses of private fund products continue to be a high priority for the Division's staff. During 2020 the Division reported its findings and observations regarding advisers to private and registered funds that misallocated expenses to the funds. For example, staff observed advisers that 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.[17]

MNPI/Code of Ethics Compliance. Insider trading and the potential misuse of material nonpublic information (MNPI) have long been areas of intense focus of the SEC examination and enforcement programs. Recent SEC investment adviser examinations and enforcement actions against private fund managers reflect a trend toward increased scrutiny of the potential for advisers to receive, and possibly to misuse, MNPI as a result of the adviser's frequent interactions with the issuers in their investment portfolios, even where there is no evidence of misuse. Even in instances where the SEC does not allege that insider trading actually occurred, these actions reflect that investment advisers may face challenging regulatory examinations, enforcement actions, and civil money penalties if the SEC alleges that an investment adviser's policies and procedures were not adequately and effectively designed, implemented, and enforced to address the potential for such misconduct.[18]

[17] See Division of Examinations, Observations from Examinations of Investment Advisers Managing Private Funds, June 23, 2020, https://www.sec.gov/ocie/announcement/risk-alert-private-funds. See also Sidley Investment Fund Update, Observations From Private Fund Adviser Examinations: Practical Tips and Best Practices, July 7, 2020, https://www.sidley.com/en/insights/newsupdates/2020/07/observations-from-private-fund-adviser-examinations.

[18] See https://www.sidley.com/en/insights/newsupdates/2020/06/navigating-interactions-between-investment-advisers-and-their-portfolio-companies.

Allocation of Investment Opportunities. Private fund advisers have had allocation of investment opportunities toward the top of the compliance priority list for a number of years. Through its recent examination activity, the Division continues to review advisers' policies and actions to confirm that advisers are not giving preferential treatment to some clients or systematically excluding eligible clients from participating in specific opportunities without providing the clients with appropriate disclosure regarding the firm's allocation policies. Specific scenarios private fund managers should review for potential deficiencies include inadequately disclosing the allocation process, failing to execute the allocation process disclosed to investors (causing investors to bear undisclosed unintended fees), or not receiving equitable investment allocations.

Focused Examination Activity. Based on recent examinations and comments by members of the Division, focused examinations may develop in 2021 for managers of ESG strategies and Qualified Opportunity Zone Funds. Focused examination activity typically scrutinizes an adviser's risk identification, mitigation controls, policies, and procedures; marketing practices; adherence to fiduciary duty, including adequacy of disclosures; and overall effectiveness of compliance programs in areas of specific risks related to the focus topic.

Preparing for an SEC Examination

It is critically important that advisers be prepared for the possibility of an exam, including possibly on short notice.

The Division's Pre-Examination Evaluation

While the Division 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 the Division'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.[19]

According to a December 2019 SEC staff report,[20] 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 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.

The Division is Leveraging Technology to Enhance Exam Capabilities

The Division uses quantitative and predictive analytics to facilitate its risk process, enabling the Division to direct its resources more efficiently and effectively.[21] For example, the Division'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

[19] SEC OCIE, "Examination Information for Entities Subject to Examination or Inspection by the Commission," https://www.sec.gov/about/offices/ocie/ocie_exambrochure.pdf.
[20] SEC, Annual Staff Report Relating to the Use of Form PF Data (December 30, 2019), https://www.sec.gov/files/2019-pf-report-to-congress.pdf.
[21] See Note 3 above.

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.[22]

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
- as recommended by the Division, 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[23]

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 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. 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. During the COVID-19 pandemic, the Division has moved to conducting examinations off-site through correspondence, unless it the staff deems it absolutely necessary to be on-site. The Division recognizes that registrants have taken similar steps regarding in-office and remote working arrangements and are devoting substantial time and attention to maintaining normal operations under current conditions. 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.

---

22 *Ibid.*

23 *Ibid.*

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 in timely 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.

Observations on the Division's Risk Alert on Investment Adviser Compliance Programs

A Risk Alert issued by the Division on November 19, 2020, provides an overview of the Division's observations of RIA examinations, with a focus on compliance issues related to the Compliance Rule under the Advisers Act.[24] The Risk Alert, together with remarks from the Division's director, Peter Driscoll, provides a reminder of how the Division evaluates written policies and procedures while emphasizing the importance of appointing a knowledgeable CCO.

The Compliance Rule — one of the most common sources of deficiencies cited by the Division[25] — requires RIAs to (i) adopt written policies and procedures tailored to the nature of their firm's operations, (ii) review those policies and procedures on at least an annual basis, and (iii) appoint a competent and knowledgeable CCO with requisite power, responsibility, and authority to develop, administer, and enforce those policies and procedures. The Risk Alert enumerates the following six categories of notable deficiencies:

1. *Inadequate compliance resources.* The staff observed deficiencies originating from inadequately resourced compliance departments, including CCOs who were stretched too thin over multiple roles

[24] SEC OCIE Risk Alert, "OCIE Observations: Investment Adviser Compliance Programs" (November 19, 2020), https://www.sec.gov/files/Risk%20Alert%20IA%20Compliance%20Programs_0.pdf; see Sidley Austin LLP, Sidley Update, "Observations on OCIE's Risk Alert on Investment Adviser Compliance Programs" (December 1, 2020), https://www.sidley.com/en/insights/newsupdates/2020/12/observations-on-ocies-risk-alert-on-investment-adviser-compliance-programs.

[25] OCIE, "The Five Most Frequent Compliance Topics Identified in OCIE Examinations of Investment Advisers" (February 7, 2017) (The Five Most Frequent Compliance Topics Identified in OCIE Examinations of Investment Advisers), https://www.sec.gov/ocie/Article/risk-alert-5-most-frequent-ia-compliance-topics.pdf. See also "SEC and FINRA Issue 2020 Examination Priorities for Broker-Dealers and Investment Advisers" (January 17, 2020), https://www.sidley.com/en/insights/newsupdates/2020/01/sec-and-finra-issue-2020-examination-priorities-for-broker-dealers-and-investment-advisers.

and responsibilities to develop or maintain the requisite compliance with the Advisers Act; inadequately or insufficiently trained staff, which resulted in deficiencies related to conducting annual reviews, timely filings, and timely responses to the Division requests; and outdated compliance infrastructures.

2. *Insufficient authority of CCOs.* The staff cited a number of cases in which a CCO had insufficient authority (and in some cases, insufficient knowledge of strategy, transactions, or business operations) to develop and enforce compliance policies and procedures effectively.

3. *Annual review deficiencies.* The staff observed a number of RIAs who were not able to either demonstrate their performance of annual reviews or identify significant compliance issues in conducting their annual reviews. Other RIAs failed to perform comprehensive reviews that reflected key areas of risk (e.g., cybersecurity, fee calculation) for their advisory businesses.

4. *Failure to implement written policies and procedures.* The staff observed RIAs' failure to implement their written policies and procedures relating to personnel training, the review of advertising materials, back-testing fee calculations, testing business continuity plans, and more.

5. *Failures to maintain complete and accurate written policies and procedures*. In a recurring observation, the staff noted that some firms adopt compliance policies and procedures that are outdated, inaccurate, and incomplete and/or in some cases contain irrelevant information.

6. *Failure to establish or maintain reasonably designed written policies and procedures.* The SEC observed that some RIAs had adopted written policies and procedures that were not appropriately tailored to their advisory businesses, were not implemented, or failed to address essential categories of compliance such as portfolio management, marketing, trading practices, and disclosures. In other cases, the staff observed RIAs who had no written policies or procedures in place.

Provided the overview above, the Division encourages RIAs to review their written policies and procedures (including implementation thereof) to ensure that they are tailored to each RIA's business and adequately reviewed and administered.

Observations on the Division's Risk Alert on Examinations of Investment Advisers: Supervision, Compliance, and Multiple Branch Offices

The Division issued a Risk Alert on November 9, 2020, providing an overview of its observations during RIA examinations with a focus on RIAs that operate multiple branch offices that are geographically dispersed from the RIAs' principal offices (Multibranch Advisers).[26]

Among other things, the Risk Alert focused on the assessment of the compliance and supervisory practices of Multibranch Advisers relating to advisory personnel working at such branch offices. The Division emphasizes two broad areas of focus: (i) the adequacy of compliance programs under the Compliance Rule, the Custody Rule, Rule 204A-1 (Code of Ethics Rule), Rule 206(4)-1 (Advertising Rule), and fiduciary obligations with respect to fees and expenses billing practices, and (ii) the supervision of investment advisory activities across all of a Multibranch Adviser's offices.

1. Common Deficiencies in Compliance Programs

The Compliance Rule. The staff observed that more than half of the Multibranch Advisers examined

[26] SEC OCIE Risk Alert, "Observations from OCIE's Examinations of Investment Advisers: Supervision, Compliance and Multiple Branch Offices'" (November 9, 2020), https://www.sec.gov/files/Risk%20Alert%20-%20Multi-Branch%20Risk%20Alert.pdf; see Sidley Austin LLP, Sidley Update, "Observations on OCIE's Risk Alert on Examinations of Investment Advisers: Supervision, Compliance, and Multiple Branch Offices" (November 17, 2020), https://www.sidley.com/en/insights/newsupdates/2020/11/observations-on-ocies-risk-alert-on-examinations.

had compliance policies and procedures that were inaccurate because they contained outdated information, inconsistently applied across branch offices, inadequately implemented or simply not enforced.

Custody Rule. The staff observed noncompliance with the Custody Rule by certain Multibranch Advisers because of policies and procedures that failed to adequately limit the ability of advisory personnel to process withdrawals and deposits in client accounts and/or to alter clients' addresses of record.

Code of Ethics Rule. The staff cited a number of Multibranch Advisers for Code of Ethics Rule deficiencies, including failure to comply with reporting requirements, review transactions, and holdings reports, properly identify access persons, or include all required provisions in their codes of ethics (e.g., provisions requiring a review and approval process prior to supervised persons investing in limited or private offerings, initial and annual holdings report submissions, and/or quarterly transaction report submissions).

Advertising Rule. The staff observed a number of problem areas in advertising materials, including performance presentations that omitted material disclosures, superlatives, or unsupported claims, falsely stated experience or credentials of supervised persons or the advisory firm, and third-party rankings or awards that omitted material facts regarding the accolades.

Fees and expenses The SEC found that some RIAs either did not have policies and procedures that addressed identifying and remediating instances in which undisclosed fees were charged to clients or did not enforce such policies. The staff explains that most fee billing issues were related to a lack of oversight over billing processes.

2. Supervision of Investment Advisory Activities

The SEC noted deficiencies in the oversight of investment recommendations and the failure to disclose related conflicts of interests. Additionally, the SEC cited Multibranch Advisers for failures to adequately disclose conflicts of interest and material information regarding the disciplinary history of certain branch office advisory personnel. The SEC also observed deficiencies pertaining to the trading and investment practices of certain Multibranch Advisers, including a lack of documentation demonstrating analyses regarding obtaining best execution for clients, effectuation of principal transactions involving inventory securities without obtaining prior client consent, and inadequate monitoring of trading by advisory personnel.

Observations on the Division's Risk Alert for COVID-19 Compliance Risks and Considerations

On August 12, 2020, the Division released a risk alert related to COVID-19-related issues and risks relevant to SEC-registered investment RIAs and broker-dealers.[27] The alert focuses on (1) protection of investors' assets; (2) supervision of personnel; (3) practices relating to fees, expenses, and financial transactions; (4) investment fraud; (5) business continuity; and (6) the protection of investor and other sensitive information. The SEC's concerns focus on the issues related to market volatility and the risks associated to policies, disclosures, and security related to working remotely.

(1) Protection of Investors' Assets

Investors' assets may be compromised when investor requests by mail cannot be retrieved on a daily basis. Firms should review and adjust their procedures related to collecting and processing investor checks and transfer requests and consider implementing additional steps to validate investor identity and disbursement

[27] SEC OCIE Risk Alert: Select COVID-19 Compliance Risks and Considerations for Broker-Dealers and Investment Advisers (August 12, 2020), https://www.sec.gov/files/Risk%20Alert%20-%20COVID-19%20Compliance.pdf.

instructions. Firms should recommend that their investors, especially senior and other vulnerable investors, identify a trusted contact person.

Establishing an internal plan to retrieve mail on a periodic basis could alleviate many of these risks. Firms should further notify investors that mailed-in assets may experience delays and remind them of alternative methods to deposit assets.

(2) Supervision of Personnel

Working remotely provides additional risks when coupled with market volatility. The Division encourages firms to closely review and modify their supervisory and compliance policies with specific regard to (i) supervisors not having the same level of oversight when working from home; (ii) supervised persons making securities recommendations in market sectors with heightened risks for fraud or greater volatility; (iii) restraints associated with due diligence and reviewing third-party managers, investments, and portfolio companies while working remotely; (iv) any communications or transactions occurring outside the firm's systems due to personnel using personal devices; (v) remote oversight of trading and reviewing affiliated, cross, aberrational, and high-volume trading; (vi) difficulties in performing diligence on background checks when performing onboarding and having the personnel take necessary exams.

Firms may alleviate risk by (i) educating employees on the appropriate methods of business communication and use of firm software; (ii) considering whether communications, specifically those not used prior to COVID-19, are being appropriately monitored and running additional testing to confirm adherence to trade policies; (iii) adjusting due diligence practices to address practical limits of remote reviews (such as adjusting the type or frequency of reporting); and (iv) having broker-dealers continue to monitor FINRA guidance regarding requirements to update Form BRs and Form U4s used to conduct inspections of office locations.

(3) Practices Relating to Fees, Expenses, and Financial Transactions

The Division expressed concern that recent market volatility could increase the risk of conflicts of interest and improper fee generation due to increased pressure to generate revenue.

Firms may alleviate risks associated with improper fee generation and conflicts of interest by (i) assessing conflicts of interest continually; (ii) reviewing valuation practices for consistency and confirm that valuation issues have not resulted in overbilling, higher asset-based advisory fees, or inflated portfolio performance returns; (iii) validating the accuracy of disclosures and fee and expense calculations; (iv) considering adjustments to policies or procedures related to the suitability of investments; (v) identifying and monitoring transactions that resulted in high fees and expenses to investors to evaluate whether such transactions were in the best interest of clients; (vi) determining whether investment RIAs or broker-dealers borrowed or took loans from investors or clients and evaluating the risks and potential conflicts associated with such financial help and how those risks can be ameliorated or disclosed; and (vii) ensuring that when an RIA received financial assistance, from the government or otherwise, the adviser may be required to update its Form ADV Part 2A and/or Part 1, Item 18.[28]

(4) Investment Fraud

The Division noted that times of financial uncertainty can lead to a higher risk of fraud and/or fraudulent offerings. The Division reminded RIAs and broker-dealers that they should be mindful of these risks, especially when conducting due diligence on investments.

(5) Business Continuity

---

[28] Division of Investment Management Coronavirus (COVID-19) Response FAQs https://www.sec.gov/investment/covid-19-response-faq.

Advisers and broker-dealers are required to have business continuity plans for periods of disruption.[29] The Division encourages firms to review and update such plans to address compliance and technological issues that could affect protracted remote operations, including (i) risk operations with supervised persons taking new or expanded roles to maintain business operations and (ii) technological and infrastructure issues such as securing servers and systems, relocating infrastructure and support for remote personnel, and protecting data stored or created remotely.

(6) Protection of Investor and Other Sensitive Information

The Division highlighted the risks associated with cybersecurity and data protection when working remotely. The Division encourages firms to review and modify any compliance policies and procedures designed to protect personally identifiable information.

Firms should consider (i) whether current policies or procedures should be modified due to personnel working in shared or less secured environments and (ii) providing personnel with additional cybersecurity training and tools such as: enhanced system access security, such as by using multifactor authentication and validated encryption technologies to protect communications and data stored on all devices, especially personally owned devices.

Observations From Private Fund Adviser Examinations: Practical Tips and Best Practices

On June 23, 2020, the Division released a risk alert intended to assist RIAs to private funds in reviewing and enhancing their compliance programs and to provide investors with information regarding private fund adviser deficiencies. The three general areas covered include (1) conflicts of interest, (2) fees and expenses, and (3) MNPI and related code of ethics procedures and controls.[30]

(1) Conflicts of Interest

The alert identifies several situations where disclosure is insufficient. Full and fair disclosure should "be sufficiently specific so that a client is able to understand the material fact or conflict of interest and make an informed decision whether to provide consent."[31] Issues concerning conflicts of interest may need to be addressed on a case by case basis. RIAs should assess the adequacy of disclosures and ensure that disclosures contain details sufficient for the RIA's unique situation, such as avoiding overusing "may" language to describe actual practices or present conflicts. RIAs should also review procedures relating to identifying, interpreting, and disclosing conflicts and governance procedures for addressing identified conflicts, as well as verify and document the execution of existing procedures.

Allocation of Investments. Conflict-of-interest issues were often found when RIAs inadequately disclosed the allocation process or failed to execute the process disclosed to investors. Advisers should provide appropriate disclosures to clients when providing preferential treatment or excluding eligible clients from participating in specific opportunities. This is particularly important in regard to new clients, higher-fee-paying clients, and proprietary accounts or proprietary-controlled clients.

Specific Portfolio Transactions. Conflicts also arise when investments by multiple clients are made in the same portfolio company (such as one client owning debt and another owning equity in a single portfolio company) and during purchases and sales between clients (such as disclosures of transaction details like

---

[29] John Sakhleh and Chris Mills, Sidley Austin LLP, "Business Continuity Planning: Preparing for Pandemics and Other Significant Business Disruptions (June 22, 2020), https://www.sidley.com/-/media/publications/westlaw_business-continuity-planning.pdf?la=en.
[30] *See* Division of Examinations, Observations from Examinations of Investment Advisers Managing Private Funds, June 23, 2020, https://www.sec.gov/ocie/announcement/risk-alert-private-funds.
[31] SEC, Commission Interpretation Regarding Standard of Conduct for Investment Advisers (June 5, 2019), https://www.sec.gov/rules/interp/2019/ia-5248.pdf.

pricing methods and anticipated limitations among clients participating in such cross-transactions).[32] The SEC's active engagement on these issues and their concerns are outlined in a number of enforcement proceedings.[33]

Fund Structures and Investment Rights. Conflicts are also found with regards to fund structure and access to investment opportunities and investor rights. The Division focused on particular instances where private fund RIAs failed to completely or adequately disclose preferential liquidity rights for funds or side-by-side vehicles, adequately disclose investment allocation practices, follow disclosed processes, or provide sufficiently detailed disclosure of pricing terms, valuation practices, or investor options for restructurings. These same issues were found in prior enforcement proceedings.[34]

Advisers' Economic Interests. The Division noted deficiencies when RIAs (i) failed to disclose preexisting ownership interests or other financial interests held by principals or employees; (ii) inadequately disclosed economic relationships between the adviser or fund and select investors or clients; (iii) failed to disclose financial incentives for the adviser or conflicts where portfolio companies controlled by private funds entered into service agreements with the RIA, its affiliates, or other portfolio companies; and (iv) failed to follow disclosed practices regarding these types of conflicts or adopting procedures reasonably designed to address conflicts arising from interest in client investments.

To avoid issues with conflicts regarding an adviser's economic interests, RIAs should (i) review financial relationships with private funds and portfolio companies as well as policies to identify new relationships or arrangements that require new or amended disclosure; (ii) assess ownership and economic interests in fund portfolio companies to ensure that those interests are consistent with the adviser's fiduciary duties to the fund; (iii) review and memorialize any analysis with respect to the use of affiliated service providers to ensure that the nature and quality of the services are at least as good as, and costs are comparable to or less than, services available from third parties; and (iv) raise awareness among employees of the need for timely reporting and identification of financial conflicts through reminders and retraining.

(2) Fees and Expenses

The Division identified four types of deficiencies related to fees and expenses, such as (i) failing to sufficiently disclose practices for different types of fees and expenses; (ii) failing to adhere to disclosed practices; (iii) lacking appropriately tailored policies based on the types of fees and expenses or the adviser's specific combination of clients; and (iv) failing to follow and/or document existing policies.

Allocation for Fees and Expenses. Deficiencies regarding RIAs' handling of fee and expense allocations may occur when RIAs fail to (i) sufficiently disclose specific allocations; (ii) properly review specific allocations to confirm appropriate allocations and policy compliance; (iii) review allocation methodologies used to allocate fees and expenses among private fund clients; (iv) properly allocate expenses that were permitted by the relevant fund operating agreements (such as salaries of adviser personnel, compliance expenses, regulatory filing fees, and office expenses); (v) follow contractual limits on expenses that could be charged to investors; and (vi) follow their own travel and entertainment expense policies. Advisers should be aware that the Division over the past several years continues to conduct a particular focus on allocations of fees and expenses.[35]

---

[32] SEC OCIE, Investment Adviser Principal and Agency Cross-Trading Compliance Issues, https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20Principal%20and%20Agency%20Cross%20Trading.pdf.

[33] Inv. Adv. Act Rel. No. 5448 (February 24, 2020), https://www.sec.gov/litigation/admin/2020/ia-5448.pdf; Inv. Adv. Act Rel. No. 4983 (August 10, 2018), https://www.sec.gov/litigation/admin/2018/ia-4983.pdf; Inv. Adv. Act Rel. No. 5050 (September 27, 2018), https://www.sec.gov/litigation/admin/2018/ia-4983.pdf.

[34] Inv. Adv. Act Rel. No. 5001 (Sept. 7, 2018), https://www.sec.gov/litigation/admin/2018/ia-5001.pdf.

[35] See, e.g., OCIE Priorities 2020, https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2020.pdf; OCIE Priorities 2017, https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2017.pdf; OCIE Priorities 2016, https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2016.pdf.

Advisers may alleviate deficiencies by (i) reviewing expense practices, including adviser expenses shared with clients and for what basis; (ii) confirming authorization for all shared expenses under organizational documents and the specific disclosure of both the expenses and the allocation practices; (iii) confirming the details and execution of procedures used to identify and monitor contractual obligations for expenses limitations or policy-based exclusions; and (iv) confirming the details and execution of controls to identify new types or categories of expenses and procedures for identifying the proper allocation.

Operating Partners. Division staff noted that many private fund RIAs used "operating partners," often an employee or affiliate of the adviser, for services used by the private funds or their portfolio companies. In such arrangements, RIAs often failed to use sufficiently specific disclosure with regard to their relationship with the operating partner, the operating partner's role, or the operating partner's compensation.[36] To avoid such conflicts, RIAs are recommended to review arrangements and related disclosures regarding support services to portfolio companies or funds and sufficiently disclose the services provided and compensation or other benefits received by the adviser and expenses borne by the client.

Valuation. Division staff frequently included valuation among examination priorities for private fund managers, and the SEC has brought multiple enforcement actions addressing these issues.[37] Advisers can address such deficiencies by (i) reviewing disclosures regarding valuation procedures and the use of fair value practices; (ii) confirming the accuracy and sufficiency of prior disclosures regarding valuation and fair value practices; (iii) confirming that policies and procedures address valuation issues in sufficient detail; (iv) confirming consistent execution and documentation of disclosed valuation procedures and standards; and (v) monitoring and tracking changes to valuation practices and reviewing and updating policies, procedures, and disclosures accordingly.

Monitoring/Board/Deal Fees and Fee Offsets. Staff noticed that some private fund RIAs (1) failed to apply or calculate management fee offsets; (2) allocated portfolio company fees across clients incorrectly; (3) made payments to affiliates without applying the adviser's policy to offset such fees against management fees; (4) did not have adequate policies and procedures to detect payments that required disclosure, allocation, or offsets; and (5) failed to adequately disclose long-term monitoring agreements with portfolio companies and related fees received by the adviser that were accelerated upon the sale of the portfolio company. Some of the SEC's suggestions include that RIAs review disclosures regarding additional revenues received by the adviser through arrangements between the adviser or its affiliates and portfolio companies as well as to confirm the adequacy of the firm's disclosures and policies addressing such arrangements.

(3) MNPI

The Division observed that some private fund RIAs lacked policies reasonably designed to deal with risks or to prevent misuse of potential MNPI exposure from interactions with (i) insiders of publicly traded companies; (ii) outside consultants arranged by "expert network firms"; or (iii) value-added investors. Advisers were also found to lack controls to address risks posed by employees obtaining MNPI through access to office space or systems or though transaction-based access to information about public issuers (such as through pursuing private investments in public equity).

[36] See, e.g., Inv. Adv. Act Rel. No. 5485 (April 22, 2020), https://www.sec.gov/litigation/admin/2020/ia-5485.pdf; Inv. Adv. Act Rel. No. 5074 (December 13, 2018), https://www.sec.gov/litigation/admin/2018/ia-5074.pdf.

[37] OCIE Priorities 2020, https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2020.pdf; Inv. Adv. Act Rel. No. 5373 (September 27, 2019), https://www.sec.gov/litigation/admin/2020/ia-5485.pdf; Inv. Adv. Act Rel. No. 5070 (December 3, 2018), https://www.sec.gov/litigation/admin/2018/ia-5074.pdf.

The Division suggests that an RIA should (i) confirm that the implementation and enforcement of policies are tailored to address MNPI risks specific to its business; (ii) ensure substantive and consistent documentation of steps taken to confirm that it is not in possession of MNPI; (iii) review the sufficiency of information barriers in light of the nature and structure of the adviser's business; and (iv) independently review the status of information received and not relying exclusively on assurances from an issuer that the adviser has not received MNPI.

The Division also noted deficiencies in RIAs implementing their own code of ethics, such as the failure to (i) establish, maintain, or enforce provisions of their code of ethics intended to prevent the misuse of MNPI; (ii) enforce trading restrictions on securities placed on their restricted lists; (iii) address procedural weaknesses for adding to or removing securities from their restricted lists; (iv) enforce requirements in their code of ethics relating to employees' receipt of gifts and entertainment; and (v) administer timely transactions and holdings reporting requirements or preclearance requirements under their policies or the code of ethics rule.

The Division Announces Plans to Assess Compliance with Reg BI and Form CRS as Scheduled

As of June 30, 2020, the Division began evaluating whether firms have made reasonable progress in implementing Regulation Best Interest (Reg BI) policies and procedures and have made a "good-faith effort" to establish policies reasonably designed to comply with Reg BI and the rules related to Form CRS. Reg BI exclusively applies to broker-dealers, while Form CRS applies to both broker-dealers and RIAs.

Reg BI establishes "best interest" standards of conduct for broker-dealers when making recommendations to retail investors involving securities transactions, investment strategies, and types of accounts. The risk alert provides a summary of how the Division may assess a firm's compliance with their obligations, including what a list of documents and information the Division may request.[38]

The Division may further focus on the following key areas of compliance for Reg BI:

- *The Disclosure Obligation:* requiring broker-dealers, prior to or at the time of the recommendation, to provide full and fair disclosure of all material facts relating to the scope and terms of the relationship with the retail customer and all material facts relating to conflicts of interest associated with the recommendation.
- *The Care Obligation:* requiring broker-dealers to exercise reasonable diligence, care, and skill when making recommendations to retail customers.
- *The Conflict of Interest Obligation:* requiring broker-dealers to establish, maintain, and enforce written policies and procedures reasonably designed to address conflicts of interest associated with its recommendations to retail customers.
- *The Compliance Obligation:* requiring broker-dealers to establish, maintain, and enforce written policies and procedures designed to achieve compliance with Reg BI.

Additionally, Form CRS requires broker-dealers and RIAs to deliver, to new and existing retail customers, a summary of the relationship between the customer and the firm. Firms were required to deliver Form CRS to existing customers by July 30, 2020. Detailed information regarding examinations related to Form CRS may be found the accompanying risk alert.[39]

SEC Rule Developments

SEC Adopts New Investment Adviser Marketing Rule

[38] SEC OCIE, Examinations that Focus on Compliance with Regulation Best Interest (April 7, 2020), https://www.sec.gov/files/Risk%20Alert-%20Regulation%20Best%20Interest%20Exams.pdf.
[39] SEC OCIE, Examinations that Focus on Compliance with Form CRS (April 7, 2020), https://www.sec.gov/files/Risk%20Alert%20-%20Form%20CRS%20Exams.pdf.

On December 22, 2020, the SEC unanimously adopted certain amendments to the Advisers Act relating to RIA advertisements and compensation to solicitors (the Marketing Rule).[40] According to the SEC, the amendments aim to modernize the rules of the Advisers Act and reflect changes in technology, investor expectations, and the evolution of industry practices. The Marketing Rule applies to all RIAs but does not apply to the marketing of registered investment companies or business development companies, which is and continues to be regulated separately.

The amendments create a single rule, Rule 206(4), which supersedes an array of SEC staff guidance and applies to both direct and indirect communications. Among other things, the Marketing Rule expands the definition of an "advertisement" to encompass advertisement to investors in a private fund advised by the RIA. The Marketing Rule formally excludes from the definition of an advertisement certain activities, for example, information contained in a statutory or regulatory notice or filing and any communication that includes hypothetical performance provided in response either to an unsolicited request or to a prospective or current investor in a private fund in a one-on-one communication. The adopting release also establishes de facto exclusions, such as account statements, statements about an advisory firm's culture or community activity, and certain information included in a fund's private placement memorandum.

The Marketing Rule sets forth prohibited statements, such as untrue material statements and omissions, unsubstantiated material statements of fact, untrue or misleading implications or inferences, advertisements that are otherwise materially misleading, and "cherry-picking" in connection with (i) references to specific investment advice where such investment advice is not presented in a fair and balanced manner or (ii) the inclusion or exclusion of performance results, or presentation of performance time periods, in a manner that is not fair and balanced. Unlike the existing rule, the Marketing Rule permits the use of testimonials, endorsements, and third-party ratings under certain conditions.

Replacing the current cash solicitation rule, the new rule covers solicitation activity under the definitions of testimonials and endorsements and expands its application to cover private fund investors and noncash compensation as well. The Marketing Rule also enumerates certain disclosure requirements as relating to and prohibits an adviser from compensating disqualified persons for testimonials or endorsements (subject to specified partial exemptions, including for de minimis payments, for example).

Other provisions of the Marketing Rule provide for amendments to the Form ADV and the books and records rule (Rule 204-2) and rescission of certain SEC staff no-action letters.

The Marketing Rule will be effective 60 days after it is published in the Federal Register and the compliance date for RIAs is 18 months after the effective date.

SEC Broadens "Accredited Investor" and "Qualified Institutional Buyer" Definitions

On August 26, 2020, the SEC) adopted amendments (that took effect on December 8, 2020) expanding the definitions of "accredited investor" and "qualified institutional buyer."[41,42,43]

"Qualified Institutional Buyer" Amendments. The amendments to the definition of "qualified institutional

---

[40] See "Investment Adviser Marketing," Investment Advisers Act Release No. 5653 (Dec. 22, 2020), available at https://www.sec.gov/rules/final/2020/ia-5653.pdf (adopting release); see also Sidley Austin LLP, Sidley Update, "SEC Adopts New Investment Advisor Marketing Rule" (January 4, 2021), https://www.sidley.com/-/media/update-pdfs/2021/202114ifupdate.pdf?la=en.

[41] Sidley Austin LLP, Sidley Update: "SEC Broadens Accredited Investor and Qualified Buyer Definitions" (August 28, 2020), https://www.sidley.com/en/insights/newsupdates/2020/08/sec-broadens-accredited-investor-and-qualified-institutional-buyer-definitions.

[42] SEC, Final Rule: "Accredited Investor Definition," Securities Act Release No. 33-10824 (August 26, 2020), https://www.sec.gov/rules/final/2020/33-10824.pdf.

[43] SEC, Press Release 2020-191: "SEC Modernizes the Accredited Investor Definition" (August 26, 2020), https://www.sec.gov/news/press-release/2020-191.

buyer" broaden the definition (as defined in Rule 144A under the Securities Act) to include (i) limited liability companies and Rural Business Investment Companies (RBICs) if they meet the "$100 million in securities owned and invested" threshold in the definition and (ii) any institutional investors included in the "accredited investor" definition that are not otherwise covered under the definition of "qualified institutional buyer," provided they meet the $100 million threshold.

"Accredited Investor" Amendments. The amendments allow investors to qualify as "accredited investors" based on "defined measures of professional knowledge, experience or certifications in addition to the existing tests for income or net worth" as well as setting forth an investments test for entities.[44]

In particular, the amendments to the "accredited investor" definition in Rule 501(a) under the Securities Act add the following categories of persons or entities:

- natural persons with certain professional certifications, designations, or credentials or other credentials issued by an accredited educational institution, which the SEC may designate from time to time by order (including holders in good standing of the Series 7, Series 65, and Series 82 licenses)
- natural persons who are "knowledgeable employees" of private funds (i.e., hedge funds, venture capital funds, and private equity funds excluded from the definition of "investment company" in Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act)
- limited liability companies with $5 million in assets
- SEC- and state-registered investment advisers, ERAs, and RBICs
- any entity, including American Indian tribes, governmental bodies, funds, and entities organized under the laws of foreign countries, that owns "investments," as defined in Rule 2a51-1(b) under the Investment Company Act, in excess of $5 million and was not formed for the specific purpose of investing in the securities offered
- "family offices" with at least $5 million in assets under management and their "family clients," as each term is defined under the Advisers Act, as long as such family office's investments are directed by someone with "such knowledge and experience in financial and business matters that such family office is capable of evaluating the merits and risks of the prospective investment," and such family office was not formed for the specific purpose of acquiring the securities offered
- for the purposes of calculating joint income or determining net worth under Rules 501(a)(5) and (6) under the Securities Act, "spousal equivalents" — cohabitants occupying a relationship generally equivalent to that of a spouse

SEC Amends Exemptions From Investment Adviser Registration for Advisers to Rural Business Investment Companies

On March 2, 2020, the SEC adopted amendments (that took effect on March 10, 2020) to two rules to implement congressionally mandated exemptions from registration for RIAs who advise RBICs.[45] These exemptions were enacted as part of the RBIC Advisers Relief Act of 2018, which amended the Advisers Act.[46]

The Commission adopted amendments to rules 203(l)-1 and 203(m)-1. These rules implement exemptions from SEC registration for RIAs to venture capital funds and private funds.[47]

Under rule 203(l), RIAs who solely advise venture capital funds are exempted from investment adviser

[44] *Supra* note 3.
[45] Sidley Austin LLP, Sidley Press Release: "SEC Amends Exemptions from Investment Adviser Registration for Advisers to Rural Business Investment Companies" (March 2, 2020), https://www.sec.gov/news/press-release/2020-51.
[46] *Id.*
[47] *Id.*

registration. The amendment adds RBICs to the definition of the term “venture capital fund.”[48]

Under Rule 203(m), RIAs who solely advise private funds and have assets under management in the United States totaling less than $150 million are exempt from investment adviser registration. The amendment excludes the assets of RBICs from the definition of the term “assets under management” for purposes of the private fund adviser exemption, such that assets of RBICs do not count toward the $150 million threshold.[49]

Advisers to RBICs relying on either amendment are required to submit Form ADV reports as ERAs and must include on their reports certain information about the private funds they advise, consistent with current Form ADV filing requirements for ERAs.[50]

The amendments do not exempt advisers from state regulatory requirements. Advisers must evaluate the need for state registration, and those still required to register with a state regulatory authority must also complete all of Form ADV.[51]

SEC Adopts Rule Amendments to Provide Investors Using Proxy Voting Advice More Transparent, Accurate, and Complete Information

On July 22, 2020, the SEC adopted amendments to a number of its rules governing proxy solicitations, with the aim of ensuring that clients of proxy voting advice businesses receive more transparent, accurate, and complete information on which to make voting decisions, without imposing undue costs or delays that could adversely affect the timely provision of proxy voting advice:[52]

- **Rule 14a-1(1)(1)(iii)**, as amended, contains a new paragraph stipulating that under certain conditions, the terms “solicit” and “solicitation” include solicited proxy voting advice to a shareholder regarding that shareholder’s vote, consent, or authorization on matters requiring or requesting a shareholder’s vote, consent, or authorization. The rule excludes from the revised definitions proxy voting advice provided in response to unprompted client requests.[53,54]
- **Rule 14a-2(b)(9)(i)** will require proxy advisers to include the following disclosures prominently in their proxy voting advice (or electronic medium used to deliver the advice):
    - any information regarding an interest, transaction, or relationship of the proxy adviser (or its affiliate) that is material to assessing the objectivity of the proxy voting advice in light of the circumstances of the particular interest, transaction, or relationship
    - any policies and procedures used to identify, as well as the steps taken to address, any such material conflicts of interest arising from such interest, transaction, or relationship[55]
- **Rule 14a-2(b)(9)(ii)(A)** will require a proxy adviser to adopt and publicly disclose written policies and procedures reasonably designed to ensure that companies that are the subject of proxy voting advice have access to such advice at or before the time the advice is disseminated to the proxy

---

48 SEC, Final Rule: “Exemptions From Investment Adviser Registration for Advisers to Certain Rural Business Investment Companies,” Securities Act Release No. IA-5454 (March 10, 2020), https://www.sec.gov/rules/final/2020/ia-5454.pdf.
49 *Id.*
50 *Id.*
51 *Id.*
52 Sidley Austin LLP, Corporate Governance Update, “SEC Amends Proxy Solicitation Rules and Supplements Guidance on Investment Advisers’ Proxy Voting Responsibilities (July 27, 2020), https://www.sidley.com/en/insights/newsupdates/2020/07/sec-amends-proxy-solicitation-rules-and-supplements.
53 SEC, Press Release: “SEC Adopts Rule Amendments to Provide Investors Using Proxy Voting Advice More Transparent, Accurate and Complete Information” (July 22, 2020), https://www.sec.gov/news/press-release/2020-161.
54 SEC, Final Rule: “Exemptions From the Proxy Rules for Proxy Voting Advice,” Securities Act Release No. 34-89372 (November 2, 2020), https://www.sec.gov/rules/final/2020/34-89372.pdf.
54 *Id.*
55 *Supra* notes 12 and 13.

advisers' clients.[56]

- **Rule 14a-2(b)(9)(ii)(B)** requires a proxy adviser to adopt and publicly disclose written policies and procedures reasonably designed to ensure that the proxy adviser provides its clients with a mechanism by which they can reasonably be expected to become aware of any written statements regarding proxy voting advice by companies that are the subject of such advice, in a timely manner before the shareholder meeting (or, if no meeting, before the votes, consents, or authorizations may be used to effect the proposed action). The "timely manner" requirement will be met if the proxy adviser's client has sufficient time to consider the company's response in connection with a vote. The new rules do not condition the availability of the proxy rule exemptions on proxy advisers disabling or suspending prepopulated and automatic submission of votes in instances where a company indicates it intends to file or has filed a response to the voting advice as additional soliciting materials.[57]

A proxy adviser will be deemed to satisfy this requirement if it has written policies and procedures reasonably designed to inform clients when a company that is the subject of proxy voting advice notifies the proxy adviser that it intends to file or has filed with the SEC additional soliciting materials setting forth the company's statement regarding the advice, by notifying clients

- on its electronic platform that the company intends to file or has filed such additional soliciting materials and including an active hyperlink to those materials on the EDGAR database when available or
- through email or other electronic means that the company intends to file or has filed such additional soliciting materials and including an active hyperlink to those materials on the EDGAR database when available.[58]

The SEC has provided supplemental guidance to aid RIAs in complying with the above amendments when exercising their proxy voting responsibilities. The guidance takes the form of frequently asked questions about the amendments and the SEC's responses to them.[59] Included in the supplemental guidance are disclosures proxy advisory firms can make and steps to take to ensure that they are making voting determinations in a client's best interest, particularly when using electronic vote management systems.[60]

These amendments took effect on September 3, 2020, but the final rules provide for a one-year transition period after the publication of the final rules to give proxy advisers sufficient time to develop processes and systems to comply with certain aspects of the new rules.[61] Proxy advisers will not be required to comply with the amendments to Exchange Act Rule 14a-2(b)(9) until December 1, 2021.[62]

SEC Focus on Digital Assets and Related Activities

The SEC continues to focus on issues involving digital assets and blockchain technology. As noted above, the Division indicated in its 2020 Exam Priorities that it will continue to identify SEC-registered market participants engaged in this space and monitor the sale, trading, and management of digital assets, and that focus is expected to continue through 2021.

Industry participants and regulators, including the SEC, have continued to engage with digital assets as an emerging asset class. 2020 brought regulatory guidance from the SEC and other regulators that helped the continued improvement of the market infrastructure supporting digital asset securities. That said, the SEC remains focused on investor protection issues, which inform both its rulemaking and enforcement positions,

---

[56] *Id.*
[57] *Id.*
[58] *Id.*
[59] SEC, "Supplement to Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers," Securities Act Release No. IA-5547 (September 3, 2020), https://www.sec.gov/rules/policy/2020/ia-5547.pdf.
[60] *Id.*
[61] *Supra* note 12.
[62] *Id.*

especially under the new administration. The question of whether a particular digital asset is a security remains a critical threshold question for regulators and market participants.

Custody of Digital Assets

Pursuant to the Advisers Act Custody Rule**,** RIAs are required to custody funds and securities with a "qualified custodian," subject to certain exceptions.[63] Qualified custodians under the Advisers Act Custody Rule includes certain banks and savings associations and registered broker-dealers, among other certain types of financial institutions.[64] SEC staff has previously requested input on the application of the Advisers Act Custody Rule to digital assets[65] but has not yet provided any specific guidance on compliance with the Advisers Act Custody Rule with respect to digital assets. However, several regulators released guidance in 2020 germane to the question of how a qualified custodian may provide custody for digital assets.

- *Registered Broker-Dealers.* On December 23, 2020, the SEC issued a statement setting forth conditions under which certain limited-scope, or special-purpose, broker-dealers would be permitted to self-custody digital asset securities in compliance with Rule 15c3-3 under the Securities Exchange Act of 1934 (Broker-Dealer Custody Statement).[66] Although not explicitly addressed in the Broker-Dealer Custody Statement, a broker-dealer complying with the Broker-Dealer Custody Statement would meet the definition of a qualified custodian under the Advisers Act Custody Rule.
- *National Banks and Savings Associations.* On July 22, 2020, the Office of the Comptroller of the Currency (OCC) issued an interpretative letter confirming the authority of national banks and federal savings associations to provide custody services for digital assets on behalf of their customers.[67] On January 13, 2021, the OCC also granted the first national bank charter to a digital-asset-focused bank.[68]
- *State Banks and Trust Companies.* On October 23, 2020, the Wyoming Division of Banking issued a no-action letter to a Wyoming-chartered trust company stating, among other things, that the Wyoming Division of Banking would not pursue enforcement action if the trust company held itself out as a "qualified custodian" under the Advisers Act Custody Rule.[69] In response, the SEC Division of Investment Management, in consultation with FinHub, released a statement noting that determining who qualifies as a qualified custodian is "a complicated, and facts and circumstances based, analysis" and that the SEC and the staff are not bound by statements or views expressed by state regulators in considering the requirements of the Advisers Act Custody Rule and any enforcement actions thereunder.[70] The SEC Division of Investment Management also reiterated its request for feedback on specific issues involving the application of the Advisers Act Custody Rule to digital assets.

When Digital Assets Are Securities

Since the SEC issued its Report of Investigation finding that sales of digital assets may be securities

[63] 17 C.F.R. § 275.206(4)-2(a)
[64] 17 C.F.R. § 275.206(4)-2(d)(6)
[65] Letter from Paul G. Cellupica, Deputy Dir. and Chief Counsel, Div. of Inv. Mgmt., SEC, SEC Staff Letter, to Karen Barr, Pres. and CEO, Inv. Adviser Ass'n, Engaging on Non-DVP Custodial Practices and Digital Assets (March 12, 2019), https://www.sec.gov/investment/non-dvp-and-custody-digital-assets-031219-206.
[66] See Sidley Austin LLP, Sidley Update, "Digital Asset Securities Custody: U.S. SEC Issues Broker-Dealers Enforcement Relief and Requests Industry Comment" (December 28, 2020), https://www.sidley.com/en/insights/newsupdates/2020/12/digital-asset-securities-custody-us-sec-issues-broker-dealers-enforcement.
[67] See Sidley Austin LLP, Sidley Update, "OCC Confirms the Authority of National Banks to Provide Cryptocurrency Custody Services" (July 27, 2020), https://www.sidley.com/en/insights/newsupdates/2020/07/occ-confirms-the-authority-of-national-banks-to-provide-cryptocurrency-custody-services.
[68] https://www.occ.gov/news-issuances/news-releases/2020/nr-occ-2020-98.html.
[69] http://wyomingbankingdivision.wyo.gov/home/pressreleases/twooceanno-actionletterdigitalassetcustodyqualifiedcustodianstatus.
[70] https://www.sec.gov/news/public-statement/statement-im-finhub-wyoming-nal-custody-digital-assets.

offerings in 2017,[71] the Commission has brought numerous enforcement actions against issuers of digital asset securities for engaging in fraud and violating the registration provisions of the federal securities laws. With certain exceptions, such actions have generally been brought in relatively smaller offerings or to prevent the distribution of digital assets from actually occurring.[72] On December 22, 2020, however, the SEC filed a complaint against a digital asset issuer and two of its executives, alleging that they had raised $1.3 billion through a continuous unregistered securities offering from 2013 to the present, in violation of Sections 5(a) and 5(c) of the Securities Act of 1933, as amended.[73] This is a case with significant implications because as of the day before the SEC's complaint was filed, the digital asset at issue was one of the most widely traded digital assets and was ranked third in market capitalization, behind only Bitcoin and Ethereum.[74] The SEC's complaint underscores the continued market uncertainty and heightened risks of transacting in digital assets that may be securities. Market participants should continue to monitor these developments and implement appropriate portfolio management and trading practices with robust pricing and valuation mechanism for digital assets.

Enforcement Against Digital Asset Fund Managers

The SEC's enforcement actions related to digital assets against fund managers in 2020 have been limited to cases involving fraud.[75] In each case, however, the SEC filed emergency actions and obtained orders imposing asset freezes against the fund managers, illustrating the SEC's willingness to take decisive action where investor protection concerns are raised.

Recent Enforcement Initiatives and Proceedings

The following is a summary of several recent enforcement actions and trends of relevance to RIAs.

Failure to Promptly Amend Schedule 13D

The SEC settled charges with an RIA for alleged failure to promptly amend its Schedule 13D with respect to its beneficial ownership of common stock shares in a prosthetics care company.[76] The SEC cited the RIA's failure to timely disclose that it (i) changed its intent with respect to its interest in potentially acquiring the company and (ii) subsequently liquidated its position in the company.

The RIA managed five private funds that purchased more than 5% of the company's stock and reported the transactions on a Schedule 13D. The funds disclosed that the transactions were for "investment purposes" and that "based on [the funds'] review and/or discussions with management, the [funds] may explore a possible acquisition or restructuring of the Issuer."[77] When the RIA sold over 4% of the company's shares, it did not file an amendment to its Schedule 13D reporting the sales. One of the RIA's compliance employees discovered the error, and outside counsel eventually reported the sales more than two months late. According to the SEC, the RIA failed to promptly file two Schedule 13D amendments: the first to report the "material change" with respect to its acquisition intent, and the second to report the actual sales.[78] As a result of the RIA's failure to timely amend, it was ordered to pay $100,000.

Failure to Disclose Expenses

[71] SEC, Release No. 81,207, Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 (July 25, 2017) (the DAO Report).
[72] See *SEC v. Telegram Group Inc. et al*, 19-cv-09439-PKC (S.D.N.Y. Oct 11, 2019),.and *SEC v. Kik Interactive Inc.*, 19-cv-05244-AKH (S.D.N.Y. June 4, 2019).
[73] *SEC v. Ripple Labs, Inc. et al.*, No. 1:20-cv-10832, Dkt. 4 (S.D.N.Y. Dec. 22, 2020).
[74] SEC staff, speaking in an individual capacity, have expressed views that transactions in Bitcoin and Ethereum do not constitute securities transactions. See https://www.sec.gov/news/speech/speech-hinman-061418.
[75] https://www.sec.gov/news/press-release/2020-341; https://www.sec.gov/news/press-release/2020-137.
[76] SEC Administration Proceeding File No. 3-20020 (September 17, 2020), https://www.sec.gov/litigation/admin/2020/34-89914.pdf.
[77] *Id.*
[78] *Id.*

The SEC settled charges with an RIA relating to alleged misrepresentations regarding expenses.[79] According to the SEC, the RIA neglected to disclose all annual operating expenses in the prospectuses of four money market funds that it managed. Instead, it required the funds to reimburse certain expenses that it had previously waived, causing them to incur roughly $5.2 million in additional expenses. The SEC found that these expense omissions were materially misleading under Section 34(b) of the Investment Company Act.

As a result of the RIA self-reporting the conduct, taking prompt steps to remediate the violations, and reimbursing the expenses with interest, the SEC did not impose a civil penalty.

Misrepresenting Payment for Order Flow Arrangements

The SEC settled charges against two affiliated RIAs relating to alleged material misrepresentations made to institutional clients about compensation arrangements with several broker-dealers.[80] The RIAs served as RIAs to a series of mutual funds and a series of ETFs. According to the SEC, one RIA would route the other RIA's client orders for execution to certain broker-dealers who agreed to pay specific amounts per share to that RIA as "payments for order flow." In addition, the RIAs agreed that the broker-dealers would execute the client orders on a "net basis," (e.g., buying a security in the market for one price and then selling it to the RIA at a higher price). The difference between the two prices was retained by the broker-dealer as compensation for carrying out the trade. These adjusted execution prices allowed the broker-dealers to recoup their payments for order flow and generate profits.

The SEC found that the RIAs, on several occasions, provided false assurances to the boards of the mutual funds and the ETFs that these compensation arrangements with the broker-dealers did not adversely affect the prices at which the funds' orders were executed. The SEC also found that these assurances were materially misleading because the arrangements involved adjusting execution prices to account for the payment for order flow.

Misleading Investors

A publicly traded financial services corporation settled charges brought by the SEC that it misled investors regarding its business success.[81] The allegations cover the period 2012 to 2016, during which the corporation opened fake accounts for customers without their knowledge and sold unnecessary, unused products. During the time in question, the corporation publicly highlighted its successful community bank "cross-sell" strategy. It claimed the strategy, selling additional products to current customers, was key to its success. The SEC found that the corporation intended investors to rely on the success of the cross-sell strategy even though the data was inflated by unused, unneeded, unauthorized accounts and products. Beginning in 2002, the corporation created millions of unauthorized or fraudulent financial product accounts. These practices did not align with the corporation's investor disclosures.

The SEC concluded that the corporation " 'misled investors, including through a misleading performance metric, about what it claimed to be the cornerstone of its Community Bank business model and its ability to grow revenue and earnings.' "[82] To settle the charges, the corporation agreed to pay $500 million to be returned to investors. It reached a $3 billion settlement with the SEC and the Department of Justice, of which the $500 million is a component.

---

[79] SEC Administration Proceeding File No. 3-20105 (September 30, 2020), https://www.sec.gov/litigation/admin/2020/ia-5599.pdf.
[80] SEC Administration Proceeding File No. 3-19904 (August 5, 2020), https://www.sec.gov/litigation/admin/2020/34-89481.pdf.
[81] SEC Administrative Proceeding File No. 3-19704 (February 21, 2020), https://www.sec.gov/litigation/admin/2020/34-88257.pdf.
[82] SEC Press Release 2020-38, "Wells Fargo to Pay $500 Million for Misleading Investors About the Success of Its Largest Business Unit" (February 21, 2020), https://www.sec.gov/news/press-release/2020-38.

Failure to Supervise Investment Advisers; Absence of Compliance Procedures

The SEC settled charges with an RIA and its affiliate RIA for inadequate supervision of RIAs and registered representatives.[83] The settlement also involved charges that the RIAs did not have sufficient compliance policies.

According to the SEC, the RIAs did not supervise financial professionals in a manner that prevented them from providing unsuitable recommendations of single-inverse ETF investments to retail investors. Single-inverse ETFs held for more than one day may lead to large losses and involve substantial risk. The SEC found that the RIAs did not sufficiently supervise employees' recommendations or train them about these ETF products. According to the SEC, employees did not comprehend the risk of loss presented by these products and therefore, provided inappropriate guidance to clients to buy or hold single-inverse ETFs for long periods of time. Many of these clients were senior citizens and retirees with limited means and risk tolerances inconsistent with the risk inherent in these products.

The SEC found that the RIAs did not have adequate compliance policies regarding these product recommendations. Between April 2012 and September 2019, the policies were not sufficiently designed to prevent or detect inappropriate single-inverse ETF guidance. The SEC also found that the RIAs did not adopt policies and procedures, or implement existing policies and procedures, to prevent this guidance. The RIAs settled with the SEC for a $35 million penalty that is to be distributed to clients who suffered losses from long single-inverse ETF holding periods. The SEC also censured the RIAs and ordered them to cease and desist from additional violations.

Enforcement Action Trends

Last year, the Division saw fewer enforcement actions than in 2019, an increase in monetary relief ordered, a shift in the subject matter most common to enforcement actions, and payments of more money in whistleblower awards. Additionally, the Division adjusted to operating remotely in the wake of COVID-19.

The SEC brought 715 enforcement actions during the fiscal year ending September 30, 2020, a 17% decrease from 2019.[84] The SEC ordered a record $4.680 billion in monetary remedies including $3.589 billion in disgorgement. More than 80% of these remedies were derived from only 5% of the largest SEC actions. The SEC paid a record amount in whistleblower awards as part of the SEC Whistleblower Program: $175 million. Like many offices, the SEC was forced to adopt a remote work environment as a result of COVID-19 but still brought 492 enforcement actions after the transition to remote work. Securities offering frauds were the biggest category of enforcement activities, followed by investment advisory and investment company issues. RIAs and investment companies, issuer reporting/auditing and accounting cases, and Foreign Corrupt Practices Act enforcements all decreased from 2019 to 2020. The Division continued efforts to shorten the time it takes to complete enforcement investigations and recommend enforcement action, with a median timeline of 21.6 months.

Division enforcement priorities may shift in 2021. A new administration, SEC Chair, and enforcement staff may seek more aggressive enforcement.

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.

[83] SEC Administrative Proceeding File No. 3-19714 (February 27, 2020), https://www.sec.gov/litigation/admin/2020/34-88295.pdf.
[84] SEC Division of Enforcement, 2020 Annual Report (November 2, 2020), https://www.sec.gov/files/enforcement-annual-report-2020.pdf.

Given the volume and complexity of the work involved, many private fund RIAs 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[85] and in FAQs posted (and periodically updated) on the SEC's website.[86] According to a December 2019 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.[87]

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 PF.[88] Each adviser was charged a $75,000 penalty. During the course of the SEC investigation, the RIAs 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. Dual registrants may no longer file Form PF to satisfy CFTC Form CPO-PQR reporting requirements.

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

---

[85] 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.
[86] 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 January 18, 2017).
[87] See Note 19 above.
[88] 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.

large liquidity fund adviser or large hedge fund adviser must file quarterly, within 15 days (for large liquidity fund advisers) or 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.

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	Section 1
Filing Deadline	March 1, 2021 (for fourth quarter 2020)	April 15, 2021 (for first quarter 2021)	April 30, 2021 (for 2020)	April 30, 2021 (for 2020)

*Form PF filings are due on the required due date for each filing regardless of whether the due date falls on a weekend or holiday as long as the PFRD system is open on the day the filing is due. The PRFD system schedule can be accessed at https://www.iard.com/availability.

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, the Division 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 Division 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.[89] 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
- 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 regulated investment companies (RICs) 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

CFTC-registered CPOs must report quarterly on either CFTC Form CPO-PQR or NFA Form PQR. CPOs may satisfy the CFTC filing requirement by filing NFA Form PQR in lieu of CFTC Form CPO-PQR. Quarterly reports are due within 60 days of the end of the quarters ending March, June, and September, and an annual report is due within 90 days of the end of December. The reporting forms have been substantially simplified beginning with the 2020 year-end filing.

The CFTC's Division of Swap Dealer and Intermediary Oversight, which was recently renamed the Market Participants Division, has posted FAQs regarding Form CPO-PQR, while the NFA has posted FAQs

[89] See Note 19 above.

regarding Form PQR.[90]

Advisers that are dually registered with the SEC and the CFTC can no longer satisfy certain CFTC Form PQR filing requirements by filing Form PF.[91]

If a pool is operated by co-CPOs and one of the CPOs is also an SEC-registered investment adviser that files Form PF, the non-investment-adviser CPO must nevertheless file the applicable sections of CFTC Form PQR.

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.[92] 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.[93]

---

[90] 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.

[91] 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).

[92] See CTA Form PR Manual (on the NFA website), https://www.nfa.futures.org/electronic-filing-systems/CTA-PR-System-Help.pdf.

[93] 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.

CONTACTS

Laurin Blumenthal Kleiman, Partner +1 212 839 5525, lkleiman@sidley.com

Nathan A. Howell, Partner +1 312 853 2655, nhowell@sidley.com

Chuck Daly, Counsel +1 212 839 6727, charles.daly@sidley.com

Victoria A. Anglin, Associate +1 312 853 0574, vanglin@sidley.com

---