Lowenstein Sandler

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INVESTMENT MANAGEMENT

YEAR-END DEVELOPMENTS AND COMPLIANCE CHECKLISTS

By: Scott H. Moss, Esq., Ethan L. Silver, Esq., Andrew E. Graw, Esq., Brian A. Silikovitz, Esq., George Danenhauer, Esq., and Lesley P. Adamo, Esq.

Lowenstein Sandler's Investment Management Group is pleased to provide you with (i) a summary of recent legislative and regulatory developments that impact the investment management community and (ii) checklists of annual considerations for private investment funds, investment advisers, commodity trading advisors, and commodity pool operators. The checklists appear after the legislative and regulatory summary. For more information regarding any matter covered in this update, please contact one of the attorneys in our Investment Management Group.

SELECT LEGISLATIVE AND REGULATORY DEVELOPMENTS

SEC Amends Form ADV and Recordkeeping Rules

Synopsis: On August 25, 2016, the Securities and Exchange Commission (the "SEC") adopted a final rule-making amendment to Form ADV providing for (i) the disclosure of additional information regarding advisers, including information about their separately managed accounts, (ii) a method for private fund adviser entities operating a single advisory business to register using a single Form ADV, and (iii) certain clarifying, technical, and other amendments to certain Form ADV items and instructions. The SEC also adopted amendments to the books and records rule under the Investment Advisers Act of 1940 (the "Advisers Act"). Compliance with the amendments adopted in the final rule is generally required on or after October 1, 2017. Advisers should familiarize themselves with the revisions to Form ADV and the recordkeeping rules, and begin the process of implementing procedures for complying therewith, including procedures for gathering information pursuant to the new disclosure requirements of Form ADV.

Status: Amendments to Item 5 of Part 1A and Section 5 of Schedule D of Form ADV require advisers to report aggregate information about their separately managed accounts, which the SEC considers to include all advisory accounts other than those that are pooled investment vehicles (i.e., registered investment companies, business development companies, and pooled investment vehicles that are not registered).

Further amendments permit advisers to use umbrella registration subject to a number of conditions, which are consistent with the conditions required under previous guidance. To use umbrella registration, the adviser is required to file, and update as required, a single Form ADV (Parts 1 and 2) that relates to and includes all information concerning the adviser and each relying adviser, and must include this same information in any other reports or filings it must make under the Advisers Act. Each relying adviser must file a new Schedule R to Part 1A, providing identifying information, the basis for SEC registration, and ownership information about such relying adviser. A new question on Schedule D requires the identification of the filing adviser and relying advisers who manage or sponsor the funds reported on Form ADV.

Other amendments require several additional new disclosure items in Form ADV, including disclosure of: (i) all social media accounts and the address of each social media page (in addition to all websites); (ii) information concerning the total number of offices along with the 25 largest offices and information concerning their employees, businesses, and activities; (iii) information concerning any employment or compensation of the chief compliance officer by a party other than the adviser; (iv) identifying information regarding certain financial service providers; (v) information concerning the adviser's balance sheet assets; (vi) information concerning the number of clients across certain specified categories and the total regulatory assets under management by category; and (vii) information concerning whether sales of fund interests in funds formed under Section 3(c)(1) of the Investment Company Act of 1940 (the "Company Act") are limited to qualified clients.

Amendments to the recordkeeping rules under Rule 204- 2(a) of the Advisers Act require that (i) records supporting performance claims in communications be maintained, even if distributed only to a single person and (ii) advisers maintain originals of certain categories of written communications relating to the performance or rate of return of managed accounts or relating to securities recommendations.

The Lowenstein Sandler LLP Investment Management Group alert analyzing this final rulemaking is available here.

Department of Labor Issues Final Rules Expanding the Scope of Advisors Who Are Considered ERISA Fiduciaries

Synopsis: On April 6, 2016, the U.S. Department of Labor ("DOL") issued new regulations (collectively, the "Fiduciary Rule") expanding when a person who provides investment advice would be a "fiduciary" under the Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code of 1986, as amended (the "Code"). The Fiduciary Rule, which generally becomes effective April 10, 2017, will turn many advisors of employee benefit plans and individual retirement accounts ("IRAs") into ERISA-covered fiduciaries. It is uncertain whether implementation of the Fiduciary Rule will be delayed, but given its fast-approaching effective date, advisors should take steps now to ensure compliance.

Status: Prior to the Fiduciary Rule, the DOL applied a long-standing five-part test to determine if an advisor is a fiduciary under ERISA. Under that test, an advisor is considered a fiduciary if the advisor makes investment recommendations on a regular basis pursuant to a mutual understanding that the advice would serve as a primary basis for investment decisions and would be individualized to the particular needs of the plan. Under the Fiduciary Rule, those treated as fiduciaries are subject to the prohibited transaction restrictions of ERISA and the Code, which, among other things, prohibit fiduciaries from receiving compensation that varies based on their investment advice. Under the new Fiduciary Rule, a person will be treated as an ERISA fiduciary if the person recommends investments or provides certain other investment advice for a fee (direct or indirect) to a plan, plan fiduciary, participant, beneficiary, or IRA owner.

ERISA fiduciaries may not receive compensation from third parties in connection with their investment advice where such compensation could present a conflict of interest. Investment professionals often receive compensation for services to retirement investors in the retail market through a variety of arrangements which might violate the prohibited transaction rules applicable to plan fiduciaries. These include commissions paid by the plan, participant, beneficiary, IRA, commissions, sales loads, 12b-1 fees, revenue sharing, and other payments from third parties that provide investment products. A fiduciary's receipt of such payments would generally violate the prohibited transaction provisions, unless such payments meet the requirements of an exemption. The DOL previously granted several exemptions that generally focused on specific advice arrangements and provided relief for narrow categories of fiduciary and advisory compensation. In contrast to these earlier exemptions, the new Best Interest Contract exemption, which was issued in association with the Fiduciary Rule, allows advisors to receive compensation with respect to retail retirement investors under circumstances where the advice rendered may impact their fees, provided they give advice that is in their customers' best interest and that certain basic protections are implemented regarding conflicts of interest. In connection with the Fiduciary Rule, the DOL also issued a class exemption that permits a fiduciary to engage in certain transactions with a retirement investor from its own account (principal transactions) subject to certain basic protections.

The Fiduciary Rule eases the scope of earlier versions of the rule proposed by the DOL. However, the Fiduciary Rule will cause many advisors to be tagged with ERISA fiduciary status.

The Lowenstein Sandler LLP Investment Management and Employee Benefits/Executive Compensation Groups' alert analyzing the Fiduciary Rule is available here.

SEC Examination Priorities for 2017

Synopsis: On January 12, 2017, the SEC's Office of Compliance Inspections and Examinations ("OCIE") announced its 2017 examination priorities. The examination priorities reflect several new areas of focus along with a continuing focus on certain previously identified areas.

Status: OCIE's examination priorities reflect certain practices and products that OCIE perceives to present heightened risk to investors and/or the integrity of U.S. capital markets. The 2017 examination priorities fall under three broader categories: (i) retail investors; (ii) senior investors and retiring investors; and (iii) market-wide risks.

Retail Investors. OCIE will continue a multiyear initiative launched in 2015 to assess risks to retail investors seeking information, advice, products and services, with an added focus on (i) "robo-advisers" delivering advice through electronic mechanisms; (ii) wrap fee programs; (iii) exchange-traded funds; (iv) never-before examined advisers; (v) recidivist representatives and their employers; (vi) multi-branch advisers; and (vii) share class selection.

Senior Investors and Retiring Investors. OCIE will give additional scrutiny to (i) the exploitation of senior investors; (ii) services to retirement accounts, including advisers and broker-dealers offering variable insurance products and target-date funds; and (iii) public pension advisers.

Market-wide Risks. Areas of focus include (i) Regulation Systems Compliance and Integrity; (ii) anti-money-laundering rules; (iii) compliance by money market funds with newly amended SEC rules; (iv) payment for order flow; (v) clearing agencies; (vi) inspections of the operations and regulatory programs, including a focus of the Financial Industry Regulatory Authority Inc. ("FINRA") resources on examinations of individual broker-dealers; (vii) implementation of cybersecurity procedures and controls by individual advisers and broker-dealers; and (viii) risk-based inspections of the national securities exchanges.

The Lowenstein Sandler LLP Investment Management Group alert analyzing the SEC's 2017 examination priorities is available here.

FINRA Examination Priorities for 2017

Synopsis: On January 4, 2017, FINRA announced its 2017 examination priorities. The examination priorities reflect several new areas of focus along with continued emphasis on certain previously identified areas.

Status: FINRA's 2017 examination priorities reflect guidance for FINRA-regulated members regarding areas that it will pay most attention to this year; they fall under several broader categories: (i) high-risk and recidivist brokers; (ii) sales practices; (iii) financial risks; and (iv) operational risks.

High-Risk and Recidivist Brokers. FINRA will focus on the hiring and monitoring of such brokers, included whether firms establish appropriate supervisory and compliance controls.

Sales Practices. FINRA intends to focus on: (i) senior investors; (ii) product suitability and concentration; (iii) excessive trading of long-term products; (iv) outside business activities and private securities transactions; and (v) social media and electronic communications retention and supervision.

Financial Risks. FINRA will focus on liquidity risks and financial risk management practices.

Operational Risks. FINRA will focus on cybersecurity and anti-money laundering.

Other areas of concern for 2017 expressed by FINRA include: (i) firms' market access controls in accordance with the Market Access Rule; (ii) firms' duties of best execution; (iii) firms' supervisory procedures and systems to monitor for manipulative conduct; (iv) trading examinations of smaller, never-before-examined firms; (v) segregation of client assets in accordance with Rule 15c3-3 of the Securities Exchange Act of 1934's (the "Exchange Act"); (vi) firms' supervisory controls testing, registration of municipal advisors, as well as credit risk policies, procedures and risk limit determinations under FINRA Rule 4210; (vii) use of its Order Audit Trail System to detect and deter market manipulation; (viii) FINRA's Audit Trail Reporting Early Remediation Initiative; (ix) data requirements of the Tick Size Pilot; (x) compliance with Regulation SHO; (xi) firms' data integrity programs; and (xii) the accuracy of submitted data related to transactions in U.S. Treasury securities.

The Lowenstein Sandler LLP Investment Management Group alert analyzing FINRA's 2017 examination priorities is available here.

FINRA's New Limited Registration for Capital Acquisition Brokers

Synopsis: In response to industry demand, on August 18, 2016, the SEC approved a FINRA proposal establishing a new, limited registration regime for broker-dealers who (i) meet the newly created definition of capital acquisition broker ("CAB") and (ii) elect to be governed under the new CAB rule set through conversion or a new membership application.

Status: FINRA has stated that the purpose of the CAB rules is to establish a streamlined set of conduct rules and reduce the regulatory burden for CAB entities without diminishing investor protections. FINRA estimates that as many as 750 current FINRA members could be eligible to become CABs due to their limited activities. Further, FINRA believes that the reduced regulatory and compliance requirements of the CAB rules may encourage nonmember firms currently engaged in similar activities to register as CABs.

A CAB is defined as any broker who solely engages in one or more of the following activities: (i) advising an issuer, including a private fund, concerning its securities offerings or other capital-raising activities; (ii) advising a company regarding its purchase or sale of a business or assets, or regarding its corporate restructuring, including a going private transaction, divesture, or merger; (iii) advising a company regarding its selection of an investment banker; (iv) assisting in the preparation of offering materials on behalf of an issuer; (v) providing fairness opinions, valuation services, expert testimony, litigation support, and negotiation and structuring services; (vi) effecting securities transactions solely in connection with the transfer of ownership and control of a privately held company consistent with the limitations in the SEC's M&A Broker no-action letter dated January 31, 2014; and (vii) qualifying, identifying, soliciting, or acting as a placement agent or finder with respect to "institutional investors" in connection with purchases or sales of newly issued unregistered securities.

A CAB does not, however, include any broker or dealer who (i) carries or acts as an introducing broker with respect to customer accounts; (ii) holds or handles customers' funds or securities; (iii) accepts orders from customers to purchase or sell securities either as principal or as agent for the customer (except as otherwise permitted by the CAB rules); (iv) has investment discretion on behalf of any customer; (v) engages in proprietary trading of securities or market-making activities; or (vi) participates in or maintains an online platform in connection with offerings of unregistered securities pursuant to Regulation Crowdfunding and Regulation A.

While the definition of institutional investor for purposes of the CAB rules includes qualified purchasers (along with banks, insurance companies, registered investment companies, and similarly situated investors), it does not include accredited investors. Thus, in the private fund context, the CAB rules will only permit CABs to market interests in funds formed under Section 3(c)(7) of the Company Act. The CAB rules present a second obstacle in the private fund context by prohibiting an associated person of a CAB from participating in any manner in private securities transactions as defined in FINRA Rule 3280, meaning such a person cannot work concurrently with the CAB and the private fund.

The Lowenstein Sandler LLP Investment Management Group alert analyzing the CAB rules is available here.

BEA Change in Reporting Requirements

Synopsis: The Bureau of Economic Analysis ("BEA") has implemented a change in reporting requirements as of January 1, 2017. Certain private funds are no longer required to report to BEA as a result of this change.

Status: The reporting change will apply to investments by U.S. entities of a 10% or more voting interest in a foreign private fund, and to investments by foreign entities of a 10% or more voting interest in a U.S.-domiciled private fund. Prior practice was to report to BEA these types of investments as *direct* investments because the purchases involved a 10% or more voting interest. However, some of these investments do not involve operating companies (companies that are not other private funds or holding companies) and therefore display the characteristics of *portfolio* investment rather than *direct* investment.

BEA, in cooperation with the U.S. Department of Treasury, will instruct reporters with investments that display characteristics of *portfolio* investment to report in the future through the Treasury International Capital ("TIC") reporting system, where other related portfolio investments are already being reported. This change will be effective with surveys conducted in 2017. Direct investment in operating companies, including investment by and through private funds into operating companies, will continue to be reported to BEA.

Detailed information published by the BEA regarding this change, including summaries and flow charts, is available here.

New Partnership Audit Rules

Synopsis: For tax years beginning after 2017, significantly revised rules applicable to federal income tax audits of all entities treated as partnerships will be in effect (the "New Partnership Audit Rules"). The New Partnership Audit Rules replace the current "TEFRA audit" system with a new system that, absent an election, imposes partnership-level liability in respect of audit adjustments.

Status: The Internal Revenue Service ("IRS") recently released Proposed Regulations regarding the implementation of the New Partnership Audit Rules. Accordingly, the rules are still in flux. However, it is advisable for partnerships to consider how they may be affected by the new tax audit regime. Generally, the New Partnership Audit Rules provide that if there is an IRS adjustment to the amount of any item of income, gain, loss, deduction, or credit of a partnership, or of any partner's distributive share of such items, for a tax year (the "Reviewed Year"), the partnership itself is responsible for paying the tax deficiency resulting from the audit in the tax year that the IRS finally determines the adjustment (the "Adjustment Year"). Accordingly, persons who are partners in the Adjustment Year, rather than persons who were partners in the Reviewed Year, will bear the burden of the audit adjustment. The partnership can avoid this potential shifting of economic burden by making a timely election to utilize a special procedure under which the partners in the Reviewed Year will be responsible for their additional tax liability from the adjustment, plus penalties and interest. However, the Reviewed Year partners will be subject to an interest rate on the tax deficiency resulting from the adjustment that is 2% higher than the regular underpayment rate. All partners will generally be bound by tax adjustments determined in partnership proceedings, with a more limited ability to determine their own tax results from the past system. Certain partnerships will be eligible to elect out entirely of applying the new rules discussed above (and have adjustments made at the partner level). Additionally, the New Partnership Audit Rules eliminate the role of a "tax matters partner" and introduce the concept of a new "partnership representative" that has the exclusive authority to act on behalf of the partnership in connection with potential adjustment proceedings. Notably, the partnership representative does not have to be a member of the partnership.

Upcoming Tax Changes

Synopsis: The change of Presidential administrations is likely to cause significant changes in federal tax policy.

Status: Specific legislative proposals have not yet been circulated and therefore it is too early to predict what will occur during the Trump administration. However, it is possible that income tax rates on individuals and businesses may be reduced and the tax treatment of carried interest may change.

SEC Adjusts Qualified Client Threshold for Inflation

Synopsis: As of August 15, 2016, the SEC amended the definition of a "qualified client," which increased the dollar amount threshold under the net worth test for qualified client status from \$2 million to \$2.1 million. The dollar amount threshold under the assets-under-management test for qualified client status remains unchanged at \$1 million.

Status: Section 205(a)(1) of the Advisers Act generally prohibits investment advisory contracts which provide for performance compensation or performance fees, including incentive fees or carried interest. Rule 205-3 under the Advisers Act provides an exemption from such prohibition when the client is a qualified client.

Section 205(e) of the Advisers Act now provides that a client (including an investor in a fund relying upon the exemption from registration provided under Section 3(c)(1) of the Company Act, constitutes a qualified client if either (i) immediately after entering into a contract with a federally registered investment adviser, such client has at least \$1 million under management of the investment adviser; or (ii) immediately prior to entering into a contract with a federally registered investment adviser, the investment adviser entering into the contract (and any person acting on its behalf) reasonably believes such client has a net worth (together with assets held jointly with a spouse) of more than \$2.1 million.

The Lowenstein Sandler LLP Investment Management Group alert analyzing the change to the qualified client threshold is available here.

Transaction Fees and Portfolio Companies: SEC Settles Enforcement Action with Private Equity Fund Manager

Synopsis: On June 1, 2016, the SEC announced that Blackstreet Capital Management ("Blackstreet") and its owner agreed to pay more than \$3.1 million to settle charges relating to in-house brokerage services performed in connection with the acquisition and disposition of portfolio companies by Blackstreet's funds and other securities law violations.

Status: The SEC's enforcement action arose from an inspection and examination of Blackstreet. While fully disclosing to fund investors that Blackstreet would charge transaction or brokerage fees in exchange for providing brokerage services, the SEC found a violation of the Exchange Act provisions requiring registration as a broker or dealer by "any person engaged in the business of effecting transactions in securities for the account of others." Other violations were found relating to conflicted transactions and inadequate disclosure of other fees and expenses.

Advisers to private equity funds should review their receipt of transaction and other types of fees from portfolio companies in light of the SEC's position with respect to Blackstreet. The SEC's order with respect to Blackstreet is available here.

COMPLIANCE CHECKLISTS

Private Investment Funds and Their Advisers

- ☐ Conduct periodic review of compliance policies.
- ☐ Provide/collect new issues certifications regarding whether funds/investors are "restricted persons."
- ☐ Conduct periodic review and update of offering documents.
- ☐ Consult counsel regarding annual Form D amendments and blue-sky and local securities matters in connection with offers or sales.
- ☐ File Schedule 13G year-end amendments by February 14, 2017.
- ☐ File Schedule 13H year-end amendments by February 14, 2017.
- ☐ File Form 13F for fourth quarter of 2016 by February 14, 2017.
- ☐ File Form PF quarterly updates and annual updates.
- ☐ Conduct periodic review of Section 13 and Section 16 filings.
- ☐ Conduct periodic review of BEA and TIC forms.
- ☐ Monitor compliance with 25% ERISA limitation with respect to benefit plan investors.
- ☐ Prepare annual VCOC Certification (if required) for benefit plan investors.
- ☐ Prepare Form 5500 Schedule C fee disclosures for ERISA plan investors.
- ☐ Prepare year-end audits and distribute financial statements as appropriate.
- ☐ Collect annual holdings reports and annual certifications from access persons and other personnel.

- Renew "bad actor" questionnaires and conduct placement agent verifications.
- Conduct annual training of personnel.
- Update risk assessment.
- Conduct periodic anti-money laundering verifications (e.g., OFAC verifications).
- Distribute privacy notices, if required.

Discussion

Compliance Policies. The compliance and operating requirements pertaining to registered investment advisers and unregistered advisers (including exempt reporting advisers) have continued to merge, and more and more unregistered managers are adopting best practices and upgrading their compliance policies to meet the demands of regulators and/or investors. Whether your firm is currently federally registered or will be required to register in the future, you should review your compliance policies periodically to verify that they are adequate and appropriately tailored to your business risks and verify that your firm is adhering to them.

New Issues Certifications. If you purchase "new issues" (i.e., equity securities issued in an initial public offering), your broker (or, if you are a fund-of-funds that invests indirectly in new issues, the underlying funds) will require that you certify each year as to whether the fund is a "restricted person" within the meaning of FINRA Rules 5130 and 5131. To make the certification, you must determine the status of investors in your fund as either restricted persons or unrestricted persons.

Offering Documents. Offering documents should be reviewed from time to time to verify that they: (i) contain a current, complete, and accurate description of the fund's strategy, management, and soft-dollar and brokerage practices; (ii) comply with current laws and regulations; and (iii) reflect current disclosure best practices.

Form D Amendments and Blue Sky and Local Securities Matters. You should continue to inform counsel of all offers or sales of fund interests. Ongoing offerings may necessitate an amendment to a private fund's Form D (typically required on an annual basis on or before the first anniversary of the most recent notice previously filed). Additionally, offers to U.S. persons may trigger filing obligations in a given investor's state of residence, while offers to foreign persons may require filings in the country of an investor's residence.

Beneficial Ownership Reporting Requirements. If you have filed Schedule 13G and the information reflected in the schedule is different as of December 31, 2016 from that previously reported, you are generally required to amend the schedule by February 14, 2017. Form 5 must be filed within 45 days of the end of the issuer's fiscal year (February 14, 2017 for issuers with a December 31, 2016 fiscal year-end). Year-end serves as a convenient time to confirm that all relevant Section 13 and Section 16 filings are current and complete.

BEA and TIC Forms. The beginning of the calendar year is a good time to conduct a review of the applicable BEA and TIC forms and filing requirements applicable to your firm. TIC forms may be due on a monthly, quarterly, or annual basis and are subject to frequent updates. BEA forms may be due, as applicable, within 45 days of a relevant transaction or quarterly, annually, or every five years. Of particular note for 2017, the BEA's Form SHC (required every five years regarding holdings of foreign portfolio securities by U.S. holders of more than $200 million in foreign portfolio securities and others notified by the BEA) must be filed by March 3, 2017.

Form 13H. Section 13(h) of the Exchange Act established a reporting system and filing requirements for "large traders" (i.e., persons effecting transactions in certain securities in amounts equal to 2 million shares or $20 million (determined by fair market value of the shares) in one calendar day or 20 million shares or $200 million in one calendar month). Persons meeting these thresholds must file Form 13H no later than 10 days after the identifying activity level is reached. Amended filings must be effected promptly after the end of a calendar quarter during which any of the information contained in Form 13H becomes outdated or inaccurate. Large traders may file amended filings more often than quarterly but are not required to do so. Annual amendments (regardless of the number of amended filings previously effected) are due within 45 days of the end of each calendar year. Persons may now satisfy both the amended fourth quarter filing as well as the annual update to Form 13H, as long as such filing is made within the period permitted for the fourth quarter amendment (i.e., by January 10, 2017 for the 2016 fourth quarter and annual filings).

Form 13F. Section 13(f) of the Exchange Act requires "institutional investment managers" with investment discretion over $100 million or more of certain equity securities to file quarterly reports on Form 13F. Form 13F must be filed within 45 days of the end of each calendar quarter. An initial Form 13F must be filed at the end of the first year in which an institutional investment manager exceeds the $100 million threshold. To the extent that you have a Form 13F filing obligation, you must file your Form 13F for the fourth quarter of 2016 by February 14, 2017.

Form PF. Many smaller private advisers and large private equity advisers will be required to file an annual update to Form PF by May 1, 2017 (120 days after the end of their fiscal year). Quarterly updates to Form PF are required of large hedge fund advisers (by March 1, 2017 or 60 days after the end of their fiscal quarter) and large liquidity fund advisers (by January 17, 2017 or 15 days after the end of their fiscal quarter).

Monitor Compliance with 25% ERISA Limitation on Benefit Plan Investors. If the aggregate amount invested in a fund by "benefit plan investors" (e.g., employee benefit plans, individual retirement accounts, Keogh plans, and entities -- the underlying assets of which include "plan assets" but excluding governmental plans, foreign plans, and certain church plans) equals 25% or more of the total value of any class of equity interests in the fund (excluding investments by the fund's managers that are not benefit plan investors), the fund will generally be deemed to hold plan assets subject to various ERISA requirements and prohibitions, unless the venture capital operating company ("VCOC") exception (described below) or another regulatory exception applies. Accordingly, many funds (particularly those that do not qualify as VCOCs, such as hedge funds) limit equity participation by benefit plan investors to less than 25%. If you sponsor such a fund, you should continuously monitor (i.e., upon subscriptions, capital calls, redemptions, transfers) the level of investments by benefit plan investors to ensure the 25% threshold is not exceeded.

Annual VCOC Certification. Prior to investing in a venture fund or a private equity fund, ERISA plan investors often require the fund to provide an annual VCOC certification stating that the fund qualifies as a VCOC. A venture fund or a private equity fund that qualifies as a VCOC will not be deemed to hold plan assets subject to ERISA, even if equity participation by benefit plan investors exceeds the 25% threshold (described above). In general, a fund will qualify as a VCOC if (i) at any time during the fund's annual valuation period, at least 50% of the fund's assets (other than short-term investments pending long-term commitment or distribution to investors), valued at cost, are invested in venture capital investments in operating companies for which the fund has management rights; and (ii) the fund, in the ordinary course of its business, actually exercises substantial management rights with respect to one or more of the operating companies in which it invests on an annual basis.

FORM 5500 Schedule C Fee Disclosures. Funds that have ERISA plan investors (including funds that do not allow equity participation by benefit plan investors to exceed the 25% threshold (described above) and, thus, are not subject to ERISA), excluding VCOCs and other entities treated as operating companies, are required to provide plan administrators of their ERISA plan investors with certain fee-related information that is necessary for the completion of Schedule C to the plan's annual report on Form 5500 in advance of the filing deadline for the annual report. The Lowenstein Sandler LLP alert analyzing the Form 5500 Schedule C rules is available here.

Year-End Audit. Now is the time to begin all necessary year-end audits so that funds can distribute financials to investors on a timely basis as required by relevant governing documents and, in certain instances, to comply with the custody rule under the registered or required to be registered under the Advisers Act and/or CFTC requirements.

Annual Holdings Reports and Annual Certifications. The beginning of the calendar year is a good time for investment advisers to have all "access persons" provide their annual holdings reports regarding securities ownership required pursuant to Rule 204A-1 of the Advisers Act. It is also a good time to have all personnel provide their annual certifications of compliance with firm policies and conflict-of-interest questionnaires.

"Bad Actor" Questionnaires and Placement Agent Verifications. The beginning of the calendar year is a good time to have certain personnel and service providers (e.g., directors of offshore private funds) recertify their status with respect to the SEC's bad actor rules in order to rely on the private placement exemption under Rule 506. This bad actor certification is often combined with the annual certification of compliance with firm policies (discussed above). It is also a good time to have placement agents recertify their status with respect to such rules and certain other disciplinary matters.

Conduct Annual Training of Personnel. As a best practice under the Advisers Act, investment advisers should hold annual training sessions with existing employees to remind them of their obligations under the firm's compliance manual and code of ethics.

Update Risk Assessment. As a best practice under the Advisers Act, investment advisers should annually re-evaluate their "risk assessment" (i.e., evaluation of how the firm's activities, arrangements, affiliations, client base, service providers, conflicts of interest, and other business factors may cause violations of the Advisers Act or the appearance of impropriety) to determine that new, evolving, or resurgent risks are adequately addressed.

Periodic Anti-Money-Laundering Verifications. Private investment funds and their advisers have ongoing anti-money-laundering compliance obligations that necessitate periodic verifications, the frequency of which depend upon such funds' and advisers' operations. The beginning of the calendar year is a good time to assess such obligations and conduct renewed verifications such as comparing investor bases with the U.S. Treasury Department's Office of Foreign Assets Control lists.

Privacy Notices. In accordance with applicable federal law, investment advisers and investment funds must have a privacy policy in place. In addition to being provided at the time of initial subscription, privacy notices must generally be distributed at least annually and more frequently if there are any changes to the policy/notice. An exception provides that annual notice is not required where an adviser or fund (a) only shares non-public personal information ("NPPI") with nonaffiliated third-parties in a manner that does not require an opt-out right be provided and (b) has not changed its policies and practices with regard to disclosing NPPI since its most recent distribution of its privacy notice. Now is an opportune time for advisers and funds to determine whether they can rely on this exception. We believe that the best time for the annual distribution of the notice, if required, is with a fund's annual financial statements and/or tax reports. Additionally, some states have privacy regulations in place that may subject investment advisers and investment funds to additional or, in some cases, more stringent privacy requirements.

REGISTERED INVESTMENT ADVISERS AND EXEMPT REPORTING ADVISERS (WHERE INDICATED)

- Prepare annual updating amendments to Form ADV (for registered investment advisers and certain "Exempt Reporting Advisers").
- Deliver Form ADV Part 2A (or portions thereof) to Clients and Fund Investors (for registered investment advisers).
- Comply with state annual filing requirements.
- Conduct periodic review of compliance policies and code of ethics.
- Comply with custody rule annual surprise examination.
- File Form 13F for fourth quarter of 2016 by February 14, 2017.
- Distribute privacy notices, if required.
- Prepare Form 5500 Schedule C fee disclosures for ERISA plan accounts.
- Comply with ERISA Section 408(b)(2) fee disclosure requirements for Covered Plans.

Discussion

Annual Updating Amendments to Form ADV. An investment adviser that (i) is registered with the SEC or (ii) is considered an "Exempt Reporting Adviser" (i.e., an investment adviser relying on the private fund adviser exemption or the venture capital adviser exemption), in each case as of December 31, 2016 (and with a December 31, 2016 fiscal year-end), must file an annual updating amendment of items on the form by March 31, 2017.

Deliver Form ADV Part 2. An investment adviser that is registered with the SEC and whose Form ADV Part 2A has materially changed since such adviser's last annual amendment must deliver either an amended Part 2A (which must include a summary of such material changes) or a summary of such material changes (which must include an offer to provide a copy of the amended Part 2A). Although such delivery requirements only expressly apply to "clients" (as defined in federal securities laws), we recommend that advisers to private funds deliver such items to their fund investors. For advisers with a December 31, 2016 fiscal year-end, such items must be delivered by April 30, 2017.

State Filing Requirements. Applicable state law may require a federally registered investment adviser to make notice filings and to pay fees in the state if he or she has clients or a place of business therein. Laws vary significantly from state to state. There also may be certain licensing or qualification requirements for representatives of investment advisers. Please contact counsel with any state-specific questions.

Compliance Policies and Code of Ethics. Federally registered investment advisers must adopt and maintain comprehensive compliance policies and a code of ethics and also appoint a chief compliance officer. If you have not already done so, please contact counsel immediately so that counsel may assist you in creating and/or documenting compliance procedures appropriately tailored to your business.

In addition, compliance policies and procedures must be reviewed by the adviser at least annually. The compliance policies and procedures review should focus on an evaluation of the effectiveness of the policies and procedures in light of current risks and the need for revisions as a result of (i) any compliance issues that arose during the prior year; (ii) any changes in the business activities of the investment adviser; and/or (iii) any regulatory changes. We recommend that this review be conducted relatively early in the year or staggered throughout the year so that it does not interfere with other time-sensitive activities when quarter-end or year-end matters are pressing. Policies that are materially changed as a result of such review should be redistributed to all appropriate personnel. In addition, Item 11 of Form ADV Part 2A must contain a current description of the code of ethics and a statement that the investment adviser will provide the code of ethics to any current or prospective client upon request.

Custody Rule Annual Surprise Examination. With certain limited exceptions, where the adviser (or its related person) possesses or may possess client funds and securities, the adviser is required to undergo an annual surprise examination by an independent public accountant.

FORM 5500 Schedule C Fee Disclosures. Advisers managing ERISA plan accounts are required to disclose certain fee-related information necessary for plan administrators to complete Schedule C to the plan's annual report on Form 5500 in advance of the date such annual report is required to be filed. The Lowenstein Sandler LLP alert analyzing the Form 5500 Schedule C rules is available here.

Compliance with ERISA Section 408(b)(2) Fee Disclosure Requirements. Advisers providing services directly to an ERISA-covered defined contribution or defined benefit plan as either a fiduciary or a registered investment adviser (as well as fiduciary services to a first-tier ERISA "plan asset" fund in which a covered plan has a direct investment, brokerage and recordkeeping services to certain participant-directed plans to which investment alternatives are made available, and certain other services) are generally required to make detailed fee disclosures to a plan fiduciary in advance of the date the underlying contract or arrangement is entered into, extended or renewed. Additionally, changes to such required fee disclosures must be disclosed as soon as practicable, but in no event more than 60 days from the date on which the adviser becomes informed of such change. Advisers providing such services should monitor ongoing compliance with the ERISA Section 408(b)(2) disclosure requirements. The Lowenstein Sandler LLP alert analyzing the Section 408(b)(2) Fee Disclosure Requirements is available here.

COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

- Registered CPOs and CTAs must conduct annual regulatory compliance reviews and complete certain regulatory requirements, which include preparation of annual questionnaires and annual registration updates.
- Prepare and file certain portions of Form CPO-PQR by March 1, 2017 (CPOs with $1.5 billion or more AUM) or March 31, 2017 (other CPOs).
- Prepare and file certain portions of Form CTA-PR by February 14, 2017.
- Annual affirmation of CPO registration exemption under Sections 4.5, 4.13(a)(1)-(3) or 4.13(a)(5) or exemption from CTA registration under Section 4.14(a)(8) by March 1, 2017.

Discussion

Annual Compliance Reviews/ Regulatory Requirements. Registered CPOs and CTAs must conduct annual compliance reviews. These reviews and requirements include (i) the preparation and filing with the National Futures Association ("NFA") of Annual Questionnaires and Annual Registration Updates within 30 days of the anniversary date of their registration; (ii) completion of the NFA's Self-Examination Checklist (available here); (iii) sending Privacy Policies to every current customer, client and pool participant; (iv) testing disaster recovery plans and making necessary updates; (v) providing ethics training to staff and inspecting the operations of branch offices; (vi) for registered CPOs, preparation of Pool Quarterly Reports within 45 days after the end of the year (and within 45 days after the end of each quarter); and (vii) for registered CTAs that are NFA members, the filing of Form CTA-PR, required within 45 days after the end of the year (and within 45 days after the end of each quarter). Finally, unless the applicable fund(s) qualify for an exemption, registered CPOs and CTAs must update their disclosure documents periodically, as they may not use any document dated more than 12 months prior to the date of its intended use. Disclosure documents that are materially inaccurate or incomplete must be promptly corrected, and the correction must be promptly distributed to pool participants. The NFA's Notice to Members regarding these regulatory compliance matters is available here.

Prepare and File Portions of Form CPO-PQR. CPOs with AUM exceeding $1.5 billion must file Schedules A, B, and C by March 1, 2017 and other CPOs must file Schedule A (and Schedule B if AUM exceed $150 million) by March 31, 2017.

Prepare and File Portions of Form CTA-PR. CTAs are required to complete Form CTA-PR by February 14, 2017 (45 days after the end of the calendar quarter for CTAs who are NFA members and 45 days after the end of the calendar year for other CTAs).

Annual Affirmation of CPO or CTA Exemption. Each person who has filed a notice of exemption from CPO registration under Sections 4.5, 4.13(a)(1)-(3), 4.13(a)(5) or exemption from CTA registration under 4.14(a)(8) must affirm such notice of exemption by March 1, 2017 through the NFA's exemption system.

RECENT PUBLICATIONS AND COMMENTARY

Below are links to recent articles and publications featuring or authored by members of the Investment Management Group.

CLIENT ALERTS AND NEWSLETTERS

- **FINRA Announces 2017 Examination Priorities**
  Investment Management Client Alert, January 24, 2017
  Ethan Silver, Scott Moss

- **OCIE Announces 2017 Examination Priorities**
  Investment Management Client Alert, January 24, 2017
  Ethan Silver, Scott Moss

- **FINRA's New Limited Registration for CABs Has Limited Use and Appeal**
  Investment Management Client Alert, September 19, 2016
  Ethan Silver, Scott Moss, William Brannan

- **SEC Amends Form ADV and Recordkeeping Rules**
  Investment Management Client Alert, September 7, 2016
  Scott Moss, George Danenhauer

- **SEC Adjusts Qualified Client Threshold for Inflation**
  Investment Management Client Alert, August 18, 2016
  Scott Moss, George Danenhauer

- **Department of Labor Issues Final Rules Expanding the Scope of Advisors Who Are Considered ERISA Fiduciaries**
  Investment Management and Employee Benefits/Executive Compensation Client Alert, May 16, 2016
  Andrew Graw, Scott Moss, George Danenhauer, Megan Monson

- **Senate Introduces Bill to Increase Oversight of Activist Investors**
  Capital Markets & Securities and Investment Management Client Alert, April 5, 2016
  Park Bramhall

UPCOMING EVENTS

Below is information regarding upcoming events sponsored by or featuring members of the Investment Management Group. For more information regarding any of these events, please contact events@lowenstein.com.

- **Lowenstein Sandler's Investment Management Group Breakfast Series**
  February 7, 2017
  Lowenstein Sandler's New York Office
  "CCO Benchmarking – An Opportunity to Compare Compliance Notes."

- **Opal's 2017 Winter Family Office Forum**
  March 1, 2017
  Marriot Marquis, New York, NY
  Lowenstein Sandler is a sponsor of the 2017 Winter Family Office Forum in New York.

- **Stocktoberfest East 2017**
  March 29 -30, 2017
  Guastavino's, New York, NY
  Lowenstein Sandler is a sponsor of the 2017 Stocktoberfest East conference in New York.

- **ACA Compliance Group and Lowenstein Sandler Co-Hosted Event 2017**
  Spring 2017
  Lowenstein Sandler's New York Office

- **MFA Legal & Compliance 2017**
  May 9, 2017
  Metropolitan Club, New York, NY
  Lowenstein Sandler is a sponsor of the 2017 MFA Legal & Compliance conference in New York.

- **MFA and Lowenstein Sandler Co-Hosted Event 2017**
  Spring/Fall 2017
  Lowenstein Sandler's New York Office

- **MFA Outlook 2017**
  October 19–20, 2017
  The Pierre Hotel, New York, NY
  Lowenstein Sandler is a sponsor of the 2017 MFA Outlook conference in New York.

contacts

Please contact the attorneys named below for more information on this matter.

Scott H. Moss
646 414 6874
smoss@lowenstein.com

Ethan L. Silver
212 419 5862
esilver@lowenstein.com

Andrew E. Graw
973 597 2588
agraw@lowenstein.com

Brian A Silikovitz
646 414 6888
bsilikovitz@lowenstein.com

George Danenhauer
646 414 6879
gdanenhauer@lowenstein.com

Lesley P. Adamo
646 414 6974
ladamo@lowenstein.com