

LOWENSTEIN SANDLER PC CLIENT ALERT

INVESTMENT MANAGEMENT

Practice Group

ATTORNEY ADVERTISING

COMPLIANCE ISSUES

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To Our Clients and Friends:

As 2009 has come to a close and 2010 has begun, it is an appropriate time to review certain of the past year's important legal developments that may affect your business and to remind you of issues to assure your compliance with applicable law, regulation and best practices. As a direct result of the recent financial crisis, state and federal regulatory bodies have proposed a wide range of new legislation that would have a significant effect on hedge funds, private equity funds, federally registered investment advisers, unregistered investment advisers and broker-dealers. This summary will address significant legislative developments over the past year, and review yearly compliance obligations for private investment funds and registered investment advisers. For further guidance regarding any of the information discussed below, please contact a member of the Lowenstein Sandler Investment Management Group.

SIGNIFICANT DEVELOPMENTS IN 2009

Proposed Legislation

Proposed Financial Regulation

Since the beginning of the recent financial crisis, both houses of Congress have considered a series of sweeping financial regulatory reform proposals. On December 11, 2009, the House of Representatives passed H.R. 4173, a comprehensive financial regulatory reform bill entitled the "Wall Street Reform and Consumer Protection Act of 2009." The House bill is a composite of several of the earlier regulatory

reform proposals that have been circulated in the House since the beginning of the recent financial crisis. A similar proposal is currently under consideration in the Senate. Several provisions found in both bills will have a direct and substantial effect on hedge funds, private equity funds, and other pooled investment advisers.

Certain key aspects of the new legislation are as follows:

1. **Registration of private fund advisers** - the new bill would end the exemption from federal registration for investment advisers with fewer than fifteen clients found in Section 203(b)(3) of the Investment Advisers

Act of 1940 (the "Advisers Act"), and require private fund advisers to register with the Securities and Exchange Commission ("SEC") and comply with periodic reporting requirements. The scope of this regulation remains unclear - both the House and Senate have included an exemption for venture capital funds, and the Senate has retained an exemption for private equity funds. However, registration of at least some percentage of pooled investment advisers appears likely.

2. **Disclosure of incentive-based compensation arrangements** -

the new legislation would require "covered financial institutions," which includes broker-dealers and investment advisers with assets under management of \$1 billion or more, to disclose details of their incentive-based compensation arrangements to federal regulators.

3. **Establishment of "too-big-to-fail" regulations for the banking industry** - the new bill would establish a new federal agency, the Financial

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Services Oversight Council, which would have the authority to identify companies that could pose a threat to the financial stability of the economy, and work with other federal agencies to develop stricter prudential standards such as risk-based capital requirements, recommended leverage limits, and liquidity requirements.

4. Increased regulation of certain derivatives - the new legislation will impose several new restrictions on the derivatives trading market, including mandatory clearing of swaps, reporting of swaps that are unable to be cleared, reservation of capital and margin by swap dealers and major participants, and segregation of collateral posted to swap dealers.

5. General investor protection measures - the new bill would increase individual investor protection by granting the SEC authority to prohibit mandatory arbitration clauses in brokerage contracts, implementing a uniform fiduciary duty on broker-dealers and investment advisers, and establishing whistleblower protections.

A link to the January 5, 2010 Lowenstein Sandler client alert analyzing the new bill is available [here](#).

Pay-to-Play Regulation

On August 3, 2009, the SEC released a proposed rule designed to address certain “pay to play” practices of investment advisers seeking to manage funds of state or local government entities (the “Proposed Rule”). The Proposed Rule would apply to any investment adviser registered (or required to be registered) with the

SEC, as well as to investment advisers to “covered investment pools,” which would include most hedge funds, private equity funds, and venture capital funds, as well as registered investment companies.

The Proposed Rule seeks to address perceived harms of “pay to play” practices by (i) prohibiting a covered investment adviser from providing advisory services to a government entity for compensation for a period of two years after such adviser, or its covered associates, makes a contribution to certain government officials of such government entity; and (ii) prohibiting a covered investment adviser and its covered associates from providing payment to any third party for soliciting advisory business from any government entity on behalf of such investment adviser. The Proposed Rule also prohibits a covered investment adviser and its covered associates from soliciting from others, or coordinating, contributions to any government official of a government entity, where such investment adviser is providing or seeking to provide advisory services to such government entity.

The Proposed Rule contains several exemptions for cases in which the SEC believes the risk of pay-to-play practices is low, such as allowing covered associates to make contributions of up to \$250 to political candidates for whom they are entitled to vote. Also, a covered adviser may petition the SEC for an exemption from the two-year ban on compensation; the SEC will address these petitions on a facts-and-circumstances basis.

In addition to prohibiting certain courses of conduct, the Proposed Rule contains proposed amendments to the record-keeping requirements of Rule 204-2 under the Advisers Act. The amendments would require advisers who are registered (or required to be registered) with the SEC and either seeks or currently has government clients or provides advisory services to a “covered investment pool” in which a government entity invests or is solicited to invest, to maintain certain records relating to contributions made by such investment adviser or its covered associates. A link to the August 11, 2009 Lowenstein Sandler client alert analyzing the Proposed Rule is available [here](#).

Offshore Fund Tax Legislation

Both houses of Congress have proposed legislation that seeks to limit the use of foreign tax havens. Senate Bill 506, proposed in March 2009 and known as the “Stop Tax Haven Abuse Act,” would tax as domestic corporations all foreign corporations, including offshore investment funds, that are managed and controlled in the United States and are either regularly traded on an established securities market or hold gross assets of \$450 million or more.

Most significantly, the Stop Tax Haven Abuse Act would:

- treat certain foreign corporations managed and controlled primarily in the United States as domestic corporations;
- establish legal presumptions against the validity of transactions involving offshore secrecy jurisdictions

- increase the period for Internal Revenue Service (“IRS”) review of tax returns involving offshore secrecy jurisdictions;
- require tax withholding agents and financial institutions to report certain information about beneficial owners of foreign-owned financial accounts and accounts established in offshore secrecy jurisdictions; and
- disallow tax advisor opinions validating transactions in offshore secrecy jurisdictions.

Under the proposed act, an offshore fund for which investment decisions are made in the United States is generally considered to be managed and controlled in the United States so that the act, if adopted, would cause many offshore investment funds to be subject to U.S. corporate income tax on their net income. The Stop Tax Haven Abuse Act also would require funds to establish anti-money laundering programs and report suspicious transactions, and would close the “offshore dividend tax loophole” by requiring withholding tax on payments of certain dividend equivalents and substitute dividend amounts to non-U.S. investors. A link to the June/July 2009 Lowenstein Sandler client update newsletter, which analyzes the Stop Tax Haven Abuse Act, is available [here](#).

More recently, in October, both houses of Congress considered versions of the “Foreign Account Tax Compliance Act of 2009,” which seeks to revise and add reporting and other requirements relating to income from assets held abroad.

Most significantly, the Foreign Account Tax Compliance Act of 2009 would:

- require foreign financial institutions (which is defined broadly to include most foreign hedge funds and private equity funds) to determine which of its equity holders are United States persons and to report this information to the IRS or otherwise be subject to a 30% withholding tax on its U.S.-source income and the proceeds of certain sales and other dispositions;
- deny a tax deduction for interest on non-registered bonds issued outside the United States;
- require any individual who holds more than \$50,000 in a depository or custodial account maintained by a foreign financial institution to report on such accounts;
- impose an enhanced tax penalty for underpayments attributable to undisclosed foreign financial assets;
- extend the limitation period for assessment of underpayments with respect to assets held outside the United States;
- require certain tax advisors who assist U.S. individuals in acquiring a direct or indirect interest in a foreign entity to file an information return disclosing the identity of the foreign entity and the individual investors;
- require shareholders of a passive foreign investment company to file informational returns;
- enhance tax rules and penalties relating to foreign trusts with U.S. beneficiaries; and
- require withholding of tax on

dividend equivalent payments received by foreign individuals.

A link to the October/November 2009 Lowenstein Sandler client update newsletter, which analyzes the Foreign Account Tax Compliance Act of 2009, is available [here](#).

On December 9, 2009, the House of Representatives passed H.R. 4213, the “Tax Extenders Act of 2009.” Title V of the Tax Extenders Act is a revised version of the proposals set forth in the Foreign Account Tax Compliance Act of 2009.

It is unclear whether any of these bills will receive serious consideration in 2010.

Carried Interest Legislation

On December 9, 2009, the House of Representatives passed H.R. 4213, the “Tax Extenders Act of 2009.” Title VI of the Tax Extenders Act would tax income and gain from carried interests in certain investment services partnerships as ordinary income. The carried interest proposal in the Tax Extenders Act is the same as the proposals in prior bills (H.R. 3996 – The Temporary Tax Relief Act of 2007 and H.R. 6275 – The Alternative Minimum Tax Relief Act of 2008).

The Tax Extenders Act, if enacted, would overhaul the tax treatment of carried interests by treating as ordinary income (i) income received from an “investment services partnership interest”; and (ii) gain on the disposition of an investment services partnership interest, except to the extent such income or gain is attributable to a partnership interest acquired on account of a contribution

of cash or other property. Moreover, the legislation would subject such ordinary income to self-employment tax. The legislation would also require that gain be recognized by a partnership in the case of distributions of appreciated property by the partnership with respect to any investment services partnership interest as if the partnership had sold the property at the time of the distribution.

Unrelated Business Taxable Income

H.R. 3497 was introduced in July 2009. The legislation would allow U.S. tax-exempt investors to invest in domestic funds without incurring unrelated business income tax ("UBIT") by adding a special rule providing that "acquisition indebtedness" would not include indebtedness incurred by such partnership in purchasing or carrying certain qualified securities or commodities.

State Regulation

In addition to the significant increase in the regulatory power of the federal government contemplated by the above proposals, investment advisers may face increased state regulation as well in the coming year. In October 2009, the North American Securities Administrators Association ("NASAA") issued a press release calling for an increase in state regulation of investment advisers. State regulation would presumably cover smaller investment advisers with assets under management below the thresholds contemplated to trigger the registration requirements in the Congressional financial regulatory bill, which is expected to fall in the \$100-

150 million range. Within the last year, several states, including Massachusetts, Connecticut, and New Jersey, have introduced bills in their state legislatures that range from increasing investor privacy rights to increasing registration requirements and regulatory standards for investment advisers to the extent not preempted by federal law.

Final Legislation

Custody Rules

On December 30, 2009, the SEC issued final rules regarding amendments to Rule 206(4)-2 under the Advisers Act relating to the custody of client assets by registered investment advisers. The amendments are designed to provide additional safeguards relating to the protection of client funds or securities.

The most significant requirements of the new legislation are:

- mandatory annual surprise examination of advisers by an independent public accountant to verify client assets with exceptions for (i) investment advisers to pooled investment vehicles subject to an annual audit by an independent public accountant that is registered with and subject to regular inspection by the Public Company Accounting Oversight Board (the "PCAOB") (provided that the audited financial statements are delivered to the pool's investors within a specified timeframe), (ii) investment advisers that have custody solely because of their authority to deduct advisory fees from client accounts, and (iii) investment advisers that have custody solely as a result of their "related persons" holding client assets, if such investment adviser is

"operationally independent" from such related persons. Investment advisers to pooled investment vehicles must still obtain a surprise examination for any non-pooled investment vehicle assets unless a separate exemption from such requirement applies;

- except for investment advisers to pooled investment vehicles subject to an annual audit by a PCAOB registered independent public accountant, investment advisers are required to have a reasonable belief, formed after "due inquiry," that account statements are sent by a qualified custodian directly to advisory clients;
- where an adviser, or a related person of an adviser, maintains client funds and securities as a qualified custodian, the investment adviser is required to obtain an internal control report from a PCAOB registered independent public accountant (and the surprise examination summarized above must also be conducted by a PCAOB registered independent public accountant); and
- advisers to pooled investment vehicles that distribute the pool's audited financial statements to investors must, in addition to obtaining an annual audit by a PCAOB registered independent public accountant, obtain a final audit of the pool's financial statements upon liquidation of the pool and distribute the financial statements to pool investors promptly after the completion of the audit.

Registered advisers must comply with the revised rule by March 12,

2010, except as described below:

- advisers required to obtain a surprise examination must enter into a written agreement with an independent public accountant that provides that the first examination will take place by December 31, 2010;
- advisers required to obtain an internal control report must obtain the report within six months of becoming subject to the requirement; and
- advisers must provide responses to the revised Form ADV in their first annual amendment after January 1, 2011.

Regulation of Short Sales

On October 15, 2008, the Securities and Exchange Commission (the "SEC") adopted an interim final rule (the "Interim Rule") requiring institutional investment managers to file information on Form SH disclosing their short sales of and positions in section 13(f) securities, other than options. The rule extension was set to expire on August 1, 2009. However, on July 27, 2009, the SEC issued Rule 204, which makes the Interim Rule permanent, with some important changes.

Like the Interim Rule, Rule 204 seeks to curtail abusive "naked" short selling by making certain information available to the public through reports by self-regulatory organizations ("SROs"). However, Form SH, which imposed detailed restrictions on short sales under the Interim Rule, was allowed to expire under Rule 204. Instead, the SEC is currently working directly with SROs to determine how best to make available to the public information concerning short sales. In

particular, the SEC has articulated a desire to increase disclosure of daily short sale volume and transaction information, and to require twice monthly fails-to-deliver data.

FBAR Filing Deadline

A U.S. person or entity that has a financial interest in, or signature or comparable authority over, any foreign financial account must annually file a Report of Foreign Bank and Financial Accounts ("FBAR") with the IRS if the value of such account exceeds \$10,000 at any time during the year. The IRS has taken the position that offshore hedge funds are foreign financial accounts for FBAR purposes, and therefore, U.S. investors in offshore hedge funds should file an FBAR. Failure to do so may result in civil and criminal penalties.

The IRS deadline for FBAR filing for 2008 generally was June 30, 2009. However, the IRS pushed back the filing deadline to June 30, 2010 for persons with a financial interest in, or signature authority over, a foreign financial account in which the assets are held in a commingled fund, such as a hedge fund. A link to the August/September 2009 Lowenstein Sandler client update newsletter, which analyzes FBAR filing obligations and the FBAR filing extension, is available [here](#).

Red Flags Rule

As of June 1, 2010, businesses in the financial industry, including SEC-registered broker-dealers and investment advisers, are required to be in compliance with the "Red Flags Rule," which requires certain financial

institutions and creditors to develop and implement written Identity Theft Prevention Programs to detect, prevent, and mitigate identity theft and other fraudulent activity in relation to customer accounts. The Federal Trade Commission ("FTC") initially mandated that businesses subject to the Red Flags Rule develop and implement Identity Theft Programs by November 1, 2008. However, the FTC has extended the deadline several times, most recently to June 1, 2010.

The Red Flags Rule applies to "financial institutions" and "creditors" that maintain "covered accounts." A covered account includes any account that a financial institution or creditor offers or maintains, primarily for personal, family, or household purposes, that involves or is designed to permit multiple payments or transactions (i.e., consumer accounts). The definition also encompasses, however, "any other account" that a "financial institution or creditor offers or maintains for which there is a reasonably foreseeable risk to customers or to the safety and soundness of the financial institution or creditor from identity theft, including financial, operational, compliance, reputation, or litigation risks." This second element of the definition of "covered accounts" targets small business and sole proprietorship accounts, which are presumably more vulnerable to identity theft and other fraudulent activity than accounts carried on behalf of large businesses or sophisticated parties. SEC-registered broker-dealers carrying customer accounts are subject to the Red Flags Rule.

Although the Red Flags Rule does not specify the contents of a regulated entity's Identity Theft Prevention Program, the FTC has issued "Guidelines" to assist in its design. The Guidelines identify twenty-six possible Red Flags, falling into five categories: (i) alerts, notifications, or warnings from a consumer reporting agency; (ii) suspicious documents; (iii) suspicious personally identifiable information (e.g., a social security number that does not match the Social Security Administration's Death Master File); (iv) unusual use of—or suspicious activity relating to—a covered account; and (v) notice from customers, victims of identity theft, law enforcement, or other persons regarding possible identity theft in connection with covered accounts held by a financial institution or creditor.

Failure to comply with the Red Flags Rule may result in enforcement action by the FTC, including civil liability for nominal, actual or punitive damages, and attorneys' fees. A link to the October/November 2009 Lowenstein Sandler client update newsletter, which analyzes the Red Flags Rule, is available [here](#).

Massachusetts Privacy Regulations

Privacy regulations adopted by the Massachusetts Office of Consumer Affairs and Business Regulation (201 CMR 17.00: Standards for the Protection of Personal Information of Residents of the Commonwealth) require that any person or entity (including private investment funds based outside of Massachusetts) maintaining personal information of a

Massachusetts resident, whether in paper or electronic form, develop and implement a written information protection and security program, as well as adhere to certain other privacy guidelines. The deadline for compliance with the regulations is March 1, 2010. A link to the October/November 2009 Lowenstein Sandler client update newsletter, which discussed the Massachusetts regulations and the compliance deadline extension, is available [here](#).

New York Legislation Changes Requirements for Effectiveness of Powers of Attorney Executed by Individuals

Legislation in the state of New York amended the New York General Obligations Law pertaining to powers of attorney, effective as of September 1, 2009. The legislation requires that powers of attorney executed by individuals in the state of New York be signed by both the principal and the agent (with each signature being notarized) and contain certain conspicuous legends noting both warnings to the principal and duties of the agent in order to be valid. The legislation does not affect powers of attorney executed by entities. Although the legislation also does not impact the validity of individual powers of attorney previously executed in New York, the legislation does currently provide that execution of any power of attorney after September 1, 2009 will revoke all prior powers of attorney unless expressly provided otherwise.

YEAR END CHECKLISTS

Private Investment Funds

Compliance Policies. As we have noted in prior Investment Management Alerts, the requirements pertaining to registered investment advisers and to unregistered advisers have continued to merge, and more and more unregistered managers are adopting best practices and improving their existing compliance policies. Whether your firm is currently federally registered or will be required to register in the near future, you should review your compliance policies periodically to verify that they are adequate and that your firm is adhering to them.

New Issues Certifications. If you purchase "new issues" (defined by NASD Rule 2790 as adopted by FINRA to mean 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 the rule. To do so, you must re-certify the status of investors in your fund as restricted persons or unrestricted persons. Please contact us if you require documentation to obtain such re-certifications from your investors.

Updating Offering Documents. Offering documents should be reviewed from time to time to verify that they contain a current, complete and accurate description of your fund's strategy, management, soft dollar and brokerage practices; that they comply with current law and regulation; and that they reflect current disclosure trends. We would be happy to assist

you in reviewing and, if necessary, updating your offering documents to reflect changes in law, regulation and disclosure practices.

Blue Sky and Local Securities

Matters. You should continue to inform us of all offers or sales of fund interests. Offers to U.S. persons may trigger filing obligations in a given offeree's state of residence. Offers to foreign persons may require filings in the country of a given offeree's residence.

Privacy Notices. Investment advisers and investment funds must have privacy policies in place. In addition to being distributed at the time of subscription, privacy notices must be distributed at least once per year and more often if there are any changes to the policy/notice. We believe that the best time for the annual distribution of the notice is with your annual financial statements and/or tax reports.

Beneficial Ownership Reporting

Requirements. If your fund (including, for this purpose, affiliated investment funds) acquires more than five percent (5%) of a class of equity securities registered under the Securities Exchange Act of 1934, as amended (the "1934 Act") (i.e., the equity securities of most publicly traded companies), you must monitor and comply with the reporting requirements of the Williams Act by filing a Schedule 13D or a Schedule 13G. A Schedule 13D must be amended upon any material change in the facts contained therein, including the acquisition or disposition of securities in an amount equal to one percent or more of the class being reported. If, on the other hand, you have filed a short-form Schedule 13G, and the

information reflected in the schedule is different at December 31 than that previously reported, you are generally required to amend the schedule by February 14 of the following year (February 16 for 2010).

In addition, if the fund (again, including affiliated funds) acquires a greater than ten percent (10%) interest in a class of equity securities registered under the 1934 Act, the fund has an obligation to file reports of beneficial ownership on Forms 3, 4 and 5, as well as corresponding potential liability for short-swing profits under Section 16 of the 1934 Act.

Furthermore, quarterly reports of equity holdings by institutional investment managers are required on Form 13F where certain equity assets under management total \$100,000,000 or more. If the fund (together with all affiliated investment funds) reaches this threshold, please let us know, and we will provide information regarding how and when to file Form 13F and the required weekly reports of short sale activity on Form SH.

Registered Commodity Pool

Operators. If your fund is a commodity pool, you must prepare an annual report for each pool in accordance with the rules of the Commodity Futures Trading Commission ("CFTC") and file such report with the CFTC and the National Futures Association. In addition, unless your fund qualifies for an exemption, you must update your disclosure documents periodically, as you may not use any document dated more than nine (9) months prior to the date of its intended use. Furthermore, documents that are materially

inaccurate or incomplete must be corrected and the correction must be distributed to pool participants within twenty-one (21) days of discovering the defect.

Investment Company Act

Compliance. If your fund is a 3(c)(1) fund—that is, it relies on the exemption from registration as an investment company because it has one hundred (100) or fewer investors—you must continually monitor the number of investors and the attribution rules under the Investment Company Act of 1940, as amended. The attribution rules provide that if an investor that is itself relying upon Section 3(c)(1) or Section 3(c)(7) (for example, a "fund of funds") holds more than ten percent (10%) of the equity interests in the fund, the fund must "look through" this investor and count as the hedge fund's own investors each of the partners or shareholders of the fund investor. Therefore, potential investments greater than ten percent (10%) of the fund's equity made by entities must be analyzed to verify that they will not subject the fund to regulation as an investment company by exceeding the one hundred (100) investor limit. In addition, if an entity not relying on Sections 3(c)(1) or 3(c)(7) invests more than forty percent (40%) of its total assets in the fund, regulators will "look through" such entity for purposes of counting beneficial owners. Furthermore, if an entity is created for the purpose of investing in a 3(c)(1) fund, then the regulators also will "look through" the entity, regardless of its percentage ownership.

ERISA Compliance. If the aggregate amount invested in the fund by

benefit plan investors (e.g., employee benefit plans, individual retirement accounts (IRAs) and entities the underlying assets of which include plan assets) were to equal or exceed twenty-five percent (25%) of the aggregate investments in the fund (excluding investments by the fund's managers), the fund would be subject to various Employee Retirement Income Security Act of 1974 ("ERISA") requirements. Prior federal legislation has modified the types of plans that are to be counted for the purposes of the twenty-five percent (25%) threshold (i.e., governmental plans, church plans and foreign plans are no longer counted for the purposes of the twenty-five percent (25%) threshold). You should monitor on an ongoing basis the level of investments by benefit plan investors, and, to the extent your fund approaches the twenty-five percent (25%) threshold, you should contact us to discuss the application of ERISA rules and the alternatives for compliance.

Annual VCOC Certification: As a condition to investment in a venture fund or a private equity fund, an ERISA plan investor may require the fund to provide an annual venture capital operating company ("VCOC") certification stating that the fund qualifies as a VCOC and is deemed not to hold "plan assets" subject to ERISA. A fund will be a VCOC if (a) at least fifty percent of the fund's portfolio investments (as determined on the fund's annual valuation date) are venture capital investments in operating companies for which the fund has management rights, and (b) the fund has and exercises substantial

management rights in at least one of its portfolio companies.

Registered Investment Advisers

Annual Updating Amendments to Form ADV. Any investment adviser who is registered with the SEC must amend its Form ADV at least annually, within ninety (90) days after the end of the adviser's fiscal year. Your annual updating amendment must update all items on the form. Part 1A, however, must be updated electronically on the SEC's electronic Investment Adviser Registration Depository ("IARD") system and must specify that it is an annual updating amendment. In addition to providing the annual updating amendment, a registered adviser is required to amend (and, with respect to Part 1, file) certain parts of its form whenever the information on it becomes inaccurate.

State Filing Requirements. In addition, a given state's laws may require a federally registered adviser to make notice filings and to pay fees in the state if it has clients or a place of business therein. Laws vary significantly from state to state. For example, New York requires that a federally registered investment adviser that has more than five clients residing in the state complete a notice filing by adding New York as a notice filing state on the IARD, and that the adviser submit to the Office of the Attorney General a copy of Part II, Schedule F and any other part of the Form ADV that is not on the IARD. There may also be certain licensing or qualification requirements for representatives of state-registered investment advisors. Please contact us with any state-specific questions.

Compliance Policies and Code of Ethics. Federally registered investment advisers must adopt and maintain detailed compliance policies and a code of ethics, and appoint a Chief Compliance Officer. If you have not already done so, please contact us immediately so that we may assist you in creating and/or documenting compliance procedures tailored to your business. In addition, compliance policies and procedures must be reviewed by the registered adviser at least annually. The first review is required to be conducted within eighteen (18) months after the adoption of the compliance policies. The compliance policies and procedures review should focus on an evaluation of the effectiveness of the policies and procedures and the need for revisions as a result of any compliance issues that arose during the prior year, any changes in the business activities of the investment adviser and/or any regulatory changes. We recommend that this review be conducted relatively early in the year so that it does not conflict with time periods 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, Schedule F of Form ADV must contain a description of the code of ethics and a statement that the adviser will provide upon request the code of ethics to any current or prospective client.

Annual Delivery of Form ADV.

Every year, a federally registered adviser must deliver (or offer in writing to deliver) to each advisory client a written disclosure statement

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containing the information required by Part II of Form ADV. The written offer to deliver the written disclosure statement may be included in other communications with the client, such as in an annual investor letter.

Custody. In order for federally registered investment advisers that advise pooled investment vehicles to avoid both the quarterly statements and surprise examination requirements (discussed in more detail above), audited financial statements prepared in accordance with GAAP must be sent to all investors in such pooled investment vehicles within one hundred twenty (120) days after the end of the pooled vehicle's fiscal year (one hundred eighty (180) days for funds-of-funds). Please contact us if you have any question about what your practice should be.

We trust that this letter is a useful reminder of the regulatory issues relevant to your business. Please contact us if you have any questions or require further information.

We appreciate the opportunity to serve you, our clients, and we value your business. We wish you all the best for 2010 and look forward to working with you throughout the year.

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