2015 Proskauer Annual Review and Outlook for Hedge, Private Equity and Other Private Funds

Proskauer

2015 Proskauer Annual Review and Outlook for Hedge, Private Equity and Other Private Funds

The following annual review (**Annual Review**) is a summary of some of the significant changes and developments that occurred in the past year and certain recommended practices that investment advisers to hedge funds, private equity funds and other private funds (collectively, **private funds**) should consider when preparing for 2016.

Table of Contents

2015 Developments and Outlook for 2016 1

SEC Examination Priorities and Initiatives 1

Continued SEC Focus on Conflicts Disclosures, Fees and Expenses 2

Other SEC Enforcement Highlights 4

Insider Trading Updates 5

Whistleblower Updates 8

First SEC Action on Employee Confidentiality Agreements 8

First SEC Whistleblower Award to a Former Company Officer 9

Whistleblower Award in the SEC's First Retaliation Case 9

SEC Interpretive Rule on the Definition of "Whistleblower" 10

Cybersecurity Updates 10

Cybersecurity Examinations 10

Cybersecurity Enforcement 11

New SEC Cybersecurity Guidance 12

NFA Cybersecurity Interpretive Notice 13

Other SEC Guidance and Updates 13

New Guidance on "General Solicitation" under Regulation D 13

Compliance Date for Pay-to-Play Rule's Ban on Third Party Solicitation 15

New Guidance on Personal Securities Transactions Reporting 15

Proposed Amendments to Form ADV and Performance Information Recordkeeping Requirements 16

Proposed Amendments to SEC Administrative Proceedings 16

Speech by SEC Chief of Staff on Chief Compliance Officer Responsibilities 16

Volcker Rule Updates 17

New Guidance on Investments in Third-Party Funds by Non-U.S. Banking Entities 17

Extension of Conformance Deadline for Legacy Covered Funds 18

CFTC Updates 18

CFTC Supplemental Proposal on Aggregation Rules for Position Limits 18

FCPA Updates 19

Anti-Money Laundering Updates 22
FinCEN Proposed Rules for Registered Investment Advisers 22
BEA Filing Updates 23
Antitrust Enforcement Updates 24
Tax Updates 25
Continued FATCA Implementation 25
Proposed Regulations Issued on Management Fee Waivers 26
Basket Swap Notices 27
A Shift Towards Market Sourcing 28
New 871(m) Regulations 28
Tax Treatment of Partnerships 29
ERISA Updates 30
DOL's New Proposed Rules Defining Fiduciary Investment Advice 30
Executive Compensation Trends and Developments 32
Protecting the Firm: Compensation Recovery under New York's Faithless Servant Doctrine 32
Employment Law Updates 33
FLSA Overtime Proposed Regulations 33
New DOL Guidance on Independent Contractors 33
Classification of Unpaid Interns 34
Trend of Laws Restricting Background Checks Continues 35
Social Media in Hiring 37
Pregnancy Discrimination 37
Religious Accommodations 38
Estate Planning Updates 39
Gift Tax Annual Exclusion 39
2015 Gift Tax Returns 40
IRA Required Minimum Distributions Deadline 40
New York Raises Basic Exclusion Amount 40
Reorganization and Chapter 11 Developments 41
Recent Litigation Involving Section 316(b) of the Trust Indenture Act 41
European Union Regulatory Updates 44

AIFMD ... 44
MiFID II and MiFIR ... 47
Market Abuse Directive II ... 49
Fourth Money Laundering Directive ... 50
Bank of England Letter ... 51
U.K. Disguised Investment Management Fee Rules ... 51
Changes to the Taxation of Carried Interest in the United Kingdom ... 52
China Regulatory Updates ... 52
New Regulations on Mutual Recognition of Funds Between Mainland China and Hong Kong ... 52
Shenzhen QDIE Pilot Program ... 54
Hong Kong Regulatory Updates ... 54
Standardization of Regulatory Obligations of Licensed Operators of Alternative Liquidity Pools for the Benefit of Users ... 54
Phased Introduction of Regime for the OTC Derivatives Market ... 55
Shenzhen-Hong Kong Stock Connect ... 56
Annual Compliance Review and Filing Requirements ... 57
Offering Document Updates ... 57
Compliance Policies and Procedures Review and Employee Training ... 57
Rule 506(d) Bad Actor Due Diligence ... 57
Broker-Dealer Registration Issues ... 58
Identity Theft Red Flags Policies ... 58
Business Continuity and Disaster Recovery Plans ... 59
Anti-Money Laundering Policies ... 59
Annual and Other Periodic Filing Requirements ... 59
Form ADV ... 60
Form PF ... 60
Form D and Blue Sky Filings ... 61
Form 13F ... 62
Schedules 13D and 13G ... 62
Forms 3, 4 and 5 ... 63
Form 13H ... 64

CFTC Annual Reaffirmations and Periodic Reports 64
TIC Form B 66
TIC Form S 67
TIC Form SLT 68
BE-13 68
Annual U.S. Tax Elections and Filings 69
Other Annual Requirements and Considerations 70
Audited Financial Statements Delivery 70
Privacy Policy Delivery 70
Schedule K-1 Delivery 71
New Issues Investor Reaffirmations 71
ERISA/VCOC Annual Certifications and Compliance 71
California Finance Lenders Law Requirements 71
Lobbyist Registration 72
Liability Insurance 72
2016 Federal Filings and Other Document Delivery Calendar 73
Acknowledgements 88
Contacts 89

2015 Developments and Outlook for 2016

SEC Examination Priorities and Initiatives

In 2015 (as with the prior several years), private funds and their investment advisers were subject to heightened regulatory scrutiny. We continued to see a fairly steady pace of examinations of registered investment advisers by the Office of Compliance Inspections and Examinations (**OCIE**) of the Securities and Exchange Commission (**SEC**), including examinations of newly-registered investment advisers and examinations of investment advisers that had not been previously examined.

While investment advisers have reported a wide range of experiences, the examinations we have seen thus far in 2015 have tended to be shorter than in the past. In most cases, OCIE provided the adviser with about a week's notice of the examination. In some cases, the examination was conducted entirely off-site through telephone calls and exchanges of documents through the SEC's secure email system. The examinations were also typically more focused and, in some cases, concentrated on a specific fund, strategy, sector or area of concern. For example, several recent examinations have focused on real estate private fund advisers, a group highlighted by SEC Chairperson Mary Jo White in her October 16, 2015 keynote address at a Managed Funds Association conference. Typically, in these examinations, the adviser received one or more customized document request lists scrutinizing, among other things, fees paid to related parties, expenses with respect to underlying real estate investments and conflicts of interest. This recent focus on real estate private fund advisers suggests that there may be more examinations concentrated on a specific industry or sector to come.

Key issues that have been raised in examinations and/or mentioned in deficiency letters in 2015 include:

- Disclosure and appropriateness of specific fees and expenses charged to client accounts, and how expenses are allocated among client accounts, portfolio investments and operating partners (especially with respect to private equity fund advisers);
- Insider trading (including potential issues involving other fund managers and investors connected to the industry and the use of consultants);
- Marketing materials, due diligence materials, responses to requests for proposals, and other materials provided to prospective clients and investors (including, in particular, inconsistencies between descriptions of investment strategies and restrictions in marketing materials as compared to actual portfolio investments and experiences, and explanations of any such material inconsistencies);
- Past performance presentations (including accuracy of calculation, adequacy of back-up documentation, presentation of past performance of only selected investments, portability of prior performance at a former employer, accuracy of claims and disclosures about hypothetical or pro forma performance, calculation of composite performance figures and disclosures of material differences among accounts);
- Conflicts of interest (including adequacy of disclosure of potential conflicts, issues related to allocation of investment opportunities and expenses, issues related to side letters, issues related to soft dollar practices, and identification and tracking of potential conflicts and other issues related to conflicts due to the existence of certain relationships and preferential treatment, such as issues

involving fund investors who may be affiliated with broker-dealers, other private funds or other entities with which a fund or adviser may have dealings);

- Personal trading by principals and employees, especially by investment personnel;
- Use of social media by principals and employees;
- Whistleblower violations and restrictive language in confidentiality agreements with the potential to stifle the whistleblowing process;
- Term extensions of illiquid funds where the investment adviser has continued to charge a management fee and/or is effectively deferring a general partner clawback (often referred to as "zombie funds");
- Compliance with the Pay-to-Play Rule (as defined below);
- Compliance with the Custody Rule (as defined below);
- Valuation issues;
- Portfolio management (including the use of high frequency trading and quantitative trading models); and
- Adequacy of compliance programs and annual compliance review.

Interestingly, we have not seen issues regarding cybersecurity, proxy voting or Form PF filings raised in recent examinations to date in 2015, but we expect more questions on these topics to come in the future given recent SEC public statements.

As always, we urge all registered investment advisers to give serious thought and planning as to how to prepare for and respond to an SEC examination by, among other things, carefully reviewing recent OCIE document request lists in order to ensure that all required records are being maintained and can be made available promptly; identifying custodians of key documents, records and information; identifying key personnel who will interact with the SEC staff; preparing key personnel for interviews; reviewing the results of any prior SEC exams (especially any prior deficiency letters); maintaining adequate written documentation of annual compliance reviews; and adequately documenting key risks, potential conflicts of interest and responsibilities.

Continued SEC Focus on Conflicts Disclosures, Fees and Expenses

In 2015, the SEC has continued its focus on fees and expenses in the context of private funds and their investment advisers. This focus has resulted in several very significant recent settlements with the SEC's Enforcement Division in areas involving (i) the allocation of operational, administrative and compliance expenses; (ii) the distribution of costs incurred in unconsummated portfolio company acquisitions; and (iii) the disclosure of accelerated monitoring fees upon the sale of, or public offering by, a portfolio company. As the SEC continues its review of the private fund industry's treatment and disclosure of fees and expenses, it is likely that additional investigations and actions will follow in these and others areas that have yet to be identified.

On April 29, 2015, the SEC settled an investigation involving a hedge fund adviser and its founder/chief executive officer that focused on violations of the anti-fraud provisions of the Investment Advisers Act (**Advisers Act**). The SEC alleged that the undisclosed use of fund assets to pay manager-related expenses

violated the adviser's fiduciary duties owed to investors. The SEC order further stated that the adviser failed to disclose the funds' assumption of expenses as compensation as required by Form ADV. Finally, as a result of the inadequate disclosure of related party transactions, the adviser's financial statements distributed to the fund's investors between 2009 and 2012 were also not GAAP-compliant, and this consequently resulted in a violation of the Custody Rule. To settle the SEC's charges, the adviser and the principal agreed to pay disgorgement and prejudgment interest of nearly $500,000 and a civil penalty of $200,000.

On June 29, 2015, the SEC settled an investigation involving a prominent private equity fund adviser that involved the adviser's failure to provide disclosure to investors that certain affiliated investment vehicles (available only to principals of the adviser and select co-investors) were not allocated, and did not bear, a portion of any "broken deal" or other similar types of expenses related to unsuccessful investments of the client funds. The SEC order found that for a period of at least five years, the adviser failed to disclose this fact to other investors in the adviser's client funds in violation of the anti-fraud provisions of the Advisers Act. The order also found that the adviser's failure to adopt written policies and procedures addressing allocations of broken deal expenses violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which requires registered investment advisers to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules. In settlement of these allegations, the adviser paid disgorgement and prejudgment interest of approximately $18.7 million and a civil penalty of $10 million.

On October 7, 2015, the SEC settled an investigation involving a well-known private fund complex that claimed certain fund advisers within the firm had breached their fiduciary duty to investors by failing to disclose arrangements that enabled the firm to collect accelerated monitoring fees. Monitoring fees are commonly charged to portfolio companies by fund advisers in return for the fund adviser providing advisory and consulting services to the portfolio company. The term of monitoring agreements between fund advisers and portfolio companies can be for 10 years or longer and typically include provisions providing that the payment of any future monitoring fees will be accelerated upon a merger, acquisition or initial public offering by paying a lump sum to the advisers in an amount equal to the amount of future monitoring fees under the monitoring agreement even though the services may not ultimately be performed. The SEC order found that the adviser violated its fiduciary duty to its investors by failing to provide proper disclosure to investors at the time of their investment in client funds of the monitoring fee arrangements with its portfolio companies and that such fees, including accelerated fees, would be kept by the advisers and would not offset the management fee payable in respect of the client funds by their investors. The SEC finally alleged that the payment of these accelerated monitoring fees correspondingly reduced the value of the portfolio companies upon their sale or initial public offering, which in turn reduced the amounts to be received by the funds' limited partners. To resolve the SEC's charges, the adviser agreed that its fund advisers would pay disgorgement and prejudgment interest of approximately $28.9 million and a civil penalty of $10 million.

On November 3, 2015, the SEC settled an investigation involving a private equity fund adviser alleging it had failed to disclose conflicts of interests to fund investors in connection with payments made by portfolio companies of one of the adviser's funds to an affiliated entity of the firm. The payments at issue related to monitoring services agreements between the adviser and five portfolio companies, where up to 80% of the payments would be used to offset the advisory fees to be received by the adviser from the fund. In 2011 and 2012, the adviser terminated these agreements with the five portfolio companies and caused the portfolio companies to enter into similar agreements with an affiliated entity, which was

principally owned and operated by three of the adviser's executives. As a result, $5.74 million of payments from the portfolio companies to the affiliated entity were not used to offset the advisory fees received by the adviser. The SEC order alleged that the adviser's principals failed to provide disclosure of the related party relationship with the affiliate, and the corresponding loss of the advisory fee offset benefit, in either the fund's organizational documents or to the fund's investor advisory board, which had the express authority to approve or disapprove of material conflicts of interest. The SEC also alleged that the adviser had failed to disclose the compensation received by the affiliated entity from the portfolio companies as related party transactions in its 2011 and 2012 audited financial statements. To resolve the SEC's charges, the adviser and its executives agreed to disgorge over $8.7 million and pay a civil penalty of approximately $1.5 million.

Marc Wyatt, Acting Director of OCIE, delivered a speech on May 13, 2015 that highlighted several recent SEC initiatives related to private funds. First, Acting Director Wyatt noted the additions of OCIE staff with specialized industry expertise in areas including private equity, trading, cybersecurity, options, high frequency trading, pricing and valuation. In addition, he emphasized the creation of the Private Funds Unit which is based in four of the SEC's regional offices and is dedicated to examining advisers to private funds.

Acting Director Wyatt concluded his remarks by highlighting several areas where OCIE would continue to focus future time and attention on the private fund industry. He noted that OCIE staff would continue its review of the allocation of fees and expenses between investment advisers and the funds they advise. Also, practices involving the allocation of co-investment opportunities would be reviewed, including the proper disclosure to all investors in a pooled vehicle of any negotiated priority co-investment rights of other investors in that pooled vehicle. Finally, OCIE would review the disclosure practices of real estate advisers that provide ancillary property management, construction management and leasing services to determine if any fees attendant to these services which are charged to the funds are properly identified to investors in offering materials. Many of these same points were reiterated by Chairperson White in her recent keynote address at a Managed Funds Association conference.

Other SEC Enforcement Highlights

After the record-breaking year in 2014, the number of SEC enforcement actions and the amount of disgorgements and penalties obtained continued to reach new highs in 2015. In the fiscal year ending September 2015, the SEC filed 807 enforcement actions covering a wide range of misconduct and obtained orders totaling approximately $4.2 billion in disgorgement and penalties, up from 755 enforcement actions and $4.16 billion, respectively, in the 2014 fiscal year.[1]

The SEC also brought a number of first-of-their-kind and other notable cases in 2015. As we discussed above, the SEC brought several significant enforcement actions against investment advisers for improper allocation and disclosure of fees and expenses, including a first-ever case against a large private equity investment adviser for misallocating broken deal expenses. In addition, as we discuss in further detail below in our section on Whistleblower Updates, the SEC also brought its first enforcement action under Rule 21F-17 of the Securities Exchange Act (**Exchange Act**) in April against a company for using improperly restrictive language in confidentiality agreements with the potential to constrain the whistleblowing process.

[1] The SEC's announcement summarizing its 2015 enforcement actions is available here.

Below are some of the other issues we have seen in SEC enforcement actions and investigations in 2015:

Pay-to-Play Rule Compliance. Rule 206(4)-5 (**Pay-to-Play Rule**) of the Advisers Act prohibits, among other things, an investment adviser from providing investment advisory services for compensation to a state or local government entity if the investment adviser or any of its "covered associates" has made a political contribution to an elected official, or a candidate for such elective office, within the preceding two years, and the holder of the elective office is in a position to direct or otherwise influence the award of the government entity's investment advisory business. Last year, the SEC brought its first enforcement action brought under the Pay-to-Play Rule. This year, we have seen several SEC investigations targeting Pay-to-Play Rule compliance by registered investment advisers and exempt reporting advisers (and, in particular, financial and non-financial contributions by individuals affiliated with the adviser). Investment advisers should be aware that failure to comply with the Pay-to-Play Rule may affect an investment adviser's ability to charge management fees and performance compensation on investments by government entities. As we enter an election year, it is recommended that investment advisers redouble their vigilance in reviewing and administering their Pay-to-Play Rule policies and procedures (especially given that several of the presidential candidates are also state governors).

Valuation of Illiquid Securities. On July 1, 2015, the SEC charged an investment adviser and its principals for fraudulently inflating the prices of illiquid securities held by hedge funds managed by the adviser and thereby violating the Advisers Act's antifraud provisions. The SEC alleged that while the adviser had historically relied on independent price quotes from registered representatives of two reputable broker-dealers, over time the adviser began to supply its own valuations to the registered representatives and have those representatives misrepresent the quotes as their own to the funds' administrator and auditor. By doing so, the adviser was able to overstate the value of the illiquid securities and increase the management fees and performance compensation it collected from the funds. Please see our July 6, 2015 post on our Corporate Defense and Disputes Blog for more information about the July enforcement action.

Long-Dated Funds. We have seen an informal investigation against an investment adviser on whether the adviser extended the terms of several funds without a corresponding benefit accruing to investors (commonly known as "zombie funds"). In that case, the investment adviser had sponsored four venture capital funds, three of which have been extended multiple times, both under the terms of the fund agreements and by amendment to the fund agreements. The SEC appeared to be focused on the amount of fees charged during the extensions and the risk of triggering a general partner clawback provision in connection with one of the funds.

Trading in Pre-IPO Technology Companies. We have seen an SEC investigation of a private fund adviser and its trading of pre-initial public offering (**IPO**) company shares. There, the SEC was investigating whether such pre-IPO trading violated provisions in the Dodd-Frank Wall Street Reform and Consumer Protection Act (**Dodd Frank**) that govern security-based swaps, and specifically whether the transactions constitute security-based swaps with persons who are not eligible contract participants, and whether the transactions should have been effected on a national securities exchange.

Insider Trading Updates

The year 2015 was the year of the personal benefit requirement in insider-trading jurisprudence. The Second Circuit's December 2014 decision overturning convictions in *United States. v. Newman*, 773 F.3d

438 (2d Cir. 2014), a criminal prosecution of two hedge fund portfolio managers, appeared to revolutionize insider-trading law by narrowing the type of "personal benefit" that can create tipper and tippee liability. But the Ninth Circuit struck back in July 2015 with a decision that seemed to disagree—or at least to create tension—with *Newman* and might have created a circuit split on the personal benefit requirement. The Supreme Court's October 2015 refusal to review the *Newman* decision means that the private fund industry must continue to grapple with reconciling highly fact-specific and potentially inconsistent approaches to the personal benefit requirement.

Second Circuit's *Newman* Decision. As we noted in our 2014 annual review, the *Newman* case involved a criminal prosecution of hedge fund portfolio managers who had allegedly traded on the basis of material nonpublic information. The government contended that employees at two technology companies had disclosed inside information on the companies' earnings before the numbers were released to the public and that the information had made its way through a "cohort of analysts," ultimately reaching the two portfolio managers, who were three or four steps removed from the initial tippers.

The portfolio managers argued that the government had not met its burden of proving that (i) the original tippers had breached their fiduciary duties by providing inside information *in exchange for a personal benefit*; and (ii) the portfolio managers had *known* about any such personal benefit to the tippers. The district court, however, did not require the jury specifically to find that the tippees had known about the tippers' receipt of a personal benefit. The portfolio managers were ultimately convicted.

The Second Circuit reversed the convictions and dismissed the indictments with prejudice. It held that the district court had erroneously instructed the jury that it could convict the portfolio managers without proof beyond a reasonable doubt that the managers "knew that an insider disclosed confidential information *and* that he did so in exchange for a personal benefit." This portion of the Second Circuit's ruling was relatively uncontroversial (with the emphasis on "relatively"). The Second Circuit went further and held that the tippers had not received a legally cognizable personal benefit in the first place. That holding—which could narrow the breadth of insider-trading liability under § 10(b) of the Exchange Act—inflamed the government and led to the government's unsuccessful certiorari petition to the Supreme Court.

The personal benefit requirement stems from the Supreme Court's 1983 decision in *Dirks v. SEC*, 463 U.S. 646 (1983), which established the framework for tippee liability. In *Dirks*, the Supreme Court held that tippee liability depends on tipper liability and that a tipper breaches a fiduciary duty by disclosing confidential information only if he or she benefited directly or indirectly from the disclosure. The Supreme Court defined the "personal benefit" that constitutes the insider's breach of duty as including "a pecuniary gain or a reputational benefit that will translate into future earnings." "The elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend."

The Second Circuit's *Newman* decision construed (or narrowed, depending on one's view) *Dirks*'s language and held that "the mere fact of friendship, particularly of a casual or social nature," does not prove receipt of a personal benefit. An inference of personal benefit based on a mere personal relationship between the tipper and the tippee "is impermissible in the absence of proof of a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature. In other words [...] this requires evidence of a relationship between the insider and the recipient that suggests a *quid pro quo* from the latter, or an

intention to benefit the [latter].” Thus, “the personal benefit received in exchange for confidential information must be of some consequence.”

The Second Circuit held that the evidence of the tippers’ personal benefits in *Newman* did not meet the standard set out in *Dirks*. The tippers and their direct tippees had not had a close personal relationship, and the tippers had not received anything resembling a classic *quid pro quo*. One of the tippers had known his direct tippee for years, having attended the same school and worked together at the same company. But the tipper had received only “career advice” from the tippee, the kind of “encouragement one would generally expect of a fellow alumnus or casual acquaintance.” The other tipper purportedly had had even less of a relationship with his direct tippee: the two had been “merely casual acquaintances,” “family friends” who had met through church and had “occasionally socialized together.”

Ninth Circuit’s *Salman* Decision. Seven months later, the Ninth Circuit appeared to rebuff, or at least be uncomfortable with, aspects of the Second Circuit’s effort to circumscribe liability for insider trading. The Ninth Circuit held in *United States v. Salman*, No. 14-10204 (9th Cir. July 6, 2015) that insiders can engage in insider trading if they disclose material nonpublic information with the intent to benefit a trading relative or friend, even if they do not receive a pecuniary gain or other *quid pro quo* type of benefit in exchange for the tips. The Ninth Circuit’s opinion was written by Judge Jed Rakoff, a Senior District Judge for the Southern District of New York, who sat by designation on the Ninth Circuit panel and whose recent opinions in New York seem to have chafed at the Second Circuit’s decision in *Newman*.

The *Salman* case arose from an alleged insider trading scheme involving members of an extended family. The tipper, who worked for an investment bank, had allegedly provided confidential information to his brother about upcoming transactions involving the bank’s clients. In so doing, the tipper had known that his brother would trade on the information. The brother then tipped Salman, whose sister had become engaged to and later married the tipper. The brother eventually pled guilty to insider trading and testified for the government against Salman.

The evidence at trial showed that the tipper and his brother had enjoyed “a close and mutually beneficial relationship.” The tipper testified that he “‘love[d] [his] brother very much’ and that he gave [him] the inside information in order to ‘benefit him’ and to ‘fulfill[] whatever needs he had.’” The evidence also showed that Salman had been aware of the brothers’ “close fraternal relationship.” The jury convicted Salman, and the Ninth Circuit affirmed the conviction.

The Ninth Circuit held that the case was governed by *Dirks’s* statement that “‘[t]he elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend.’” The tipper’s “disclosure of confidential information to [his brother], knowing that [the brother] intended to trade on it, was precisely the ‘gift of confidential information to a trading relative’ that *Dirks* envisioned.” The court also found sufficient evidence that Salman had known the initial source of the tip and “could readily have inferred [the tipper’s] intent to benefit [his brother].”

The *Salman* decision would probably have ended there, but for Salman’s contention on appeal that the Second Circuit’s *Newman* decision required a more rigorous interpretation of the type of personal benefit needed to establish a breach of duty. Salman argued that the direct tippee’s familial relationship with his tipper-brother was insufficient to demonstrate that the tipper had received a benefit. Instead, he contended that the tipper needed to have received “at least a potential gain of a pecuniary or similarly valuable nature,” and that the trial record did not contain evidence of any such benefit.

The Ninth Circuit rejected that argument, holding that, "[t]o the extent *Newman* can be read to go so far, we decline to follow it. Doing so would require us to depart from the clear holding of *Dirks* that the element of breach of fiduciary duty is met where an 'insider makes a gift of confidential information to a trading relative or friend.'" The court added that, if evidence of a desire to benefit a friend or relative could not suffice to establish a tipper's breach of duty, insider trading could proliferate: "a corporate insider or other person in possession of confidential and proprietary information would be free to disclose that information to her relatives, and they would be free to trade on it, provided only that she asked for no tangible compensation in return."

One could read *Salman* to apply only to situations involving family members or equivalent relationships, where the tipper's receipt of some sort of personal benefit can be *presumed* because of the closeness of the personal relationship between the tipper and the direct tippee. But *Salman* does appear to express some tension, if not disagreement, with *Newman*'s holding that mere friendships and personal relationships do not constitute a personal benefit to the tipper without "an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature."

Please see our December 11, 2014 and July 6, 2015 client alerts for more information on *Newman* and *Salman*.

Other Avenues to Attack Insider Trading? Perhaps to avoid the murky factual issues about the type of personal benefit needed to create tipper and tippee liability, the government has been exploring other approaches to prosecuting insider trading. In *United States v. Slawson*, No. 14-cr-00186-RWS-JFK (N.D. Ga. May 20, 2014), for example, the government brought insider-trading charges against a tippee under the criminal statute prohibiting securities fraud (18 U.S.C. § 1348) as well as under the criminal wire fraud statute (18 U.S.C. § 1343). The defendant moved to dismiss the indictment, arguing that the elements of insider trading required under § 10(b) of the Exchange Act (including the tipper's breach of duty and receipt of a personal benefit, and the tippee's knowledge of the tipper's breach of duty and receipt of the personal benefit) also apply under the criminal securities fraud statute. The court rejected that argument and held that the elements of § 1348 do not include § 10(b)'s personal benefit requirements. The defendant got the last laugh: the jury acquitted him at trial. But the Department of Justice (**DOJ**) could view § 1348, as well as the wire-fraud statute, as a way to circumvent *Newman*'s personal benefit requirement. The SEC, however, cannot use these criminal statutes.

Meanwhile, three bills are pending in Congress to define insider trading and overrule *Newman*. Perhaps not surprisingly, not much seems to be happening with those bills. And with an election year coming, don't hold your breath.

Whistleblower Updates

Given the continued expansion of its enforcement efforts as described above and the SEC's view of itself "as the whistleblower's advocate," we expect the SEC to continue expanding its whistleblower program in 2016 by promoting whistleblower awards and protecting whistleblowers from retaliation.

Below is a summary of some of the notable developments from 2015:

First SEC Action on Employee Confidentiality Agreements

On April 1, 2015, the SEC announced its first settlement of an enforcement action under Rule 21F-17 of the Exchange Act, which prohibits any person from taking "any action to impede an individual from

communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement with respect to such communications." The SEC's announcement came on the heels of prior comments by Sean McKessy, Chief of the SEC's Office of the Whistleblower, cautioning both in-house and outside counsel who draft confidentiality agreements and company policies that the SEC will actively pursue remedies against companies and attorneys who promulgate or draft policies that the SEC might view as chilling employees' abilities to communicate with the SEC about potential securities law violations. The enforcement action concerned a confidentiality agreement that the company had used in some of its internal investigations. Notably, the SEC found that it was unaware of any instance in which a company employee had in fact been prevented from communicating directly with the SEC or in which the company had taken any action to enforce its confidentiality agreement to impede or chill any such communications. Nevertheless, the company was fined $130,000. Please see our April 3, 2015 client alert for more information on this enforcement action.

While investment advisers (and their counsel) have obvious interests in encouraging—if not requiring—confidentiality in certain circumstances (for example, to prevent witness tampering in internal investigations, protect attorney-client privilege or protect trade secrets and proprietary information), they must make sure that such confidentiality provisions and agreements do not impede an employee's ability to report potential misconduct directly to governmental agencies. Investment advisers, in consultation with counsel, should therefore carefully examine operating agreements, company policies and employment-related agreements (including, for example, confidentiality policies, internal investigation protocols, offer letters, severance agreements and noncompetition agreements) to ensure that all harmoniously contain the appropriate terms to promote compliance with applicable laws and regulations protecting potential whistleblowers.

First SEC Whistleblower Award to a Former Company Officer

On March 2, 2015, the SEC announced an expected award of $475,000 to $575,000 to a former company officer "who reported original, high-quality information about a securities fraud that resulted in an SEC enforcement action with sanctions exceeding $1 million." The officer reported information to the SEC more than 120 days after other responsible compliance personnel at the company in possession of the information purportedly failed to adequately address the issue. This was the first award of its kind under the SEC's whistleblower program and the first award announced in 2015. According to the SEC order, although officers who learn of fraud through other employees or the company's internal compliance processes are generally not eligible for whistleblower awards under the Dodd-Frank bounty program (given that such information is not derived from the officer's "independent knowledge or independent analysis"), the officer in this case could receive an award under the exception for officers who report to the SEC more than 120 days after other responsible individuals at the company were in possession of the information and failed to take appropriate actions to address the issue.

Please see our March 4, 2015 post on Proskauer's Whistleblower Defense Blog for more information.

Whistleblower Award in the SEC's First Retaliation Case

On April 28, 2015, the SEC announced a maximum whistleblower award payment of 30% of amounts collected in connection with the SEC's first retaliation case. After the whistleblower provided key original information that led to a successful SEC enforcement action, the employer immediately engaged in a series of retaliatory actions against the whistleblower, including removing the whistleblower from the whistleblower's then-current position, tasking the whistleblower with investigating the very conduct the

whistleblower reported to the SEC, changing the whistleblower's job function, stripping the whistleblower of supervisory responsibilities and otherwise marginalizing the whistleblower.[2] Sean McKessy, Chief of the SEC's Office of the Whistleblower, said, "My hope is that the award today encourages potential whistleblowers to come forward in light of our demonstrated commitment to protect them against retaliatory conduct and make significant financial awards to whistleblowers who suffer employment hardships as a result of reporting possible securities law violations."

SEC Interpretive Rule on the Definition of "Whistleblower"

On August 4, 2015, the SEC issued an "interpretive rule" clarifying that individuals who have only made an internal complaint of an alleged securities law violation but have not reported the alleged misconduct to the SEC may nevertheless qualify as "whistleblowers." In issuing its clarification, the SEC states that the definition of "whistleblower" for purposes of Dodd-Frank's employment retaliation provision is "ambiguous" but that the SEC's interpretation "best comports with our overall goals in implementing the whistleblower program." The SEC further states that "by providing employment retaliation protections for individuals who report internally first to a supervisor, compliance official, or other person working for the company that has authority to investigate, discover, or terminate misconduct, our interpretive rule avoids a two-tiered structure of employment retaliation protection that might discourage some individuals from first reporting internally in appropriate circumstances and, thus, jeopardize the investor-protection and law-enforcement benefits that can result from internal reporting."

The SEC's interpretive rule was issued in response to a sharp disagreement amongst courts regarding the scope of Dodd-Frank's employment retaliation protections. On July 17, 2013, the Fifth Circuit in *Asadi v. G.E. Energy (USA), L.L.C.*, 720 F.3d 620 (5th Cir. 2013) became the first circuit court to address this issue when it held that the text of the statute requires that a "whistleblower" report an alleged violation to the SEC to be covered by Dodd-Frank's anti-retaliation provision. Some district courts have followed *Asadi* while others (including recent decisions by the Northern District of California and the District of New Jersey) have rejected *Asadi* and held that an internal complaint of an alleged securities law violation is sufficient to invoke Dodd-Frank's anti-retaliation protection. On September 10, 2015, a divided panel of the Second Circuit in *Berman v. Neo@Ogilvy LLC*, 801 F.3d 145 (2d Cir. 2015) created a circuit split when it rejected *Asadi* and held that Dodd-Frank also protects internal whistleblowers. On October 14, 2015, the Second Circuit issued an order staying the mandate pending the appellees' filing and the disposition of a certiorari petition with the Supreme Court. Appellees' certiorari petition is due on December 9, 2015, and this case is a strong candidate to ascend to the Supreme Court.

Please see our August 7, 2015 client alert and September 10, 2015 post on our Whistleblower Defense Blog for more information.

Cybersecurity Updates

Cybersecurity Examinations

Results from the SEC's First Round of Cybersecurity Examinations. On February 3, 2015, OCIE published a risk alert summarizing its findings from its examinations of over 100 registered investment advisers and broker-dealers. The examinations were conducted as part of OCIE's cybersecurity examination initiative, announced in April 2014,[3] to assess cybersecurity preparedness in the securities

[2] Please see our June 23, 2014 client alert for a summary of the underlying whistleblower enforcement action.

[3] Please see our April 24, 2014 client alert for more information on the announcement.

industry and gather information on common practices and trends among registered firms. OCIE interviewed key personnel and reviewed documents at 49 registered investment advisers and 57 registered broker-dealers. OCIE's findings focused on how registered investment advisers and broker-dealers:

- Identify cybersecurity risks;
- Establish cybersecurity policies, procedures and oversight processes;
- Protect their networks and information;
- Identify and address risks associated with remote access to client information, funds transfer requests and third-party vendors; and
- Detect and handle unauthorized activities and other cyber-attacks.

The examinations were designed to discern differences in the level of cybersecurity preparedness among the examined firms. While OCIE examined the accuracy of the firms' responses and the extent to which policies and procedures were implemented, it did not test the technical sufficiency of the firms' cybersecurity programs.

Please see our February 6, 2015 client alert for more details on OCIE's findings.

Second Round of SEC Cybersecurity Examinations Announced. On September 15, 2015, OCIE issued a risk alert announcing its second round of examinations of registered investment advisers and broker-dealers under its cybersecurity examination initiative. Whereas the first round of examinations consisted primarily of interviews and document reviews, OCIE expects that the second round of examinations will involve more testing to assess implementation of a firm's procedures and controls. The examinations are expected to focus on the following key areas:

- Governance and risk assessment;
- Access rights and controls;
- Data loss prevention;
- Vendor management;
- Staff and vendor training; and
- Cybersecurity incident response.

Registered investment advisers and broker-dealers should note that the topics highlighted above are not exhaustive and that OCIE examiners may select other areas of focus based on risks identified during the course of examinations. To assist firms in evaluating their cybersecurity preparedness, OCIE has included a sample document request as an appendix to its risk alert.

Please see our September 16, 2015 client alert for more information.

Cybersecurity Enforcement

On September 22, 2015, the SEC announced the settlement of an enforcement action against a St. Louis-based registered investment adviser brought under Rule 30(a) of Regulation S-P (**Safeguards Rule**). The SEC order charged the adviser with violating the Safeguards Rule by failing to adopt written cybersecurity policies and procedures reasonably designed to protect customer records and information. According to

the SEC order, the adviser had stored sensitive personally identifiable information (**PII**) of its clients and other persons on its third party-hosted web server without adopting written policies and procedures that accounted for the security, confidentiality and protection of the PII from anticipated threats or unauthorized access. Subsequently, an unauthorized and unknown intruder gained access to the data on the server, thereby rendering the PII of more than 100,000 individuals, including clients of the adviser, vulnerable to theft. Without admitting or denying the findings set forth in the SEC order, the adviser agreed to be censured, to cease and desist from committing or causing any violations and any future violations of the Safeguards Rule and to pay a civil penalty of $75,000 to the SEC.

We note that as of the date of the SEC order, the investment adviser had not learned of any information indicating that a client had suffered any financial harm as a result of the cyberattack. This enforcement action highlights the SEC's willingness to bring an enforcement action against a registered investment adviser despite there being no apparent financial harm to such adviser's clients, as well as the importance for registered investment advisers to have adequate cybersecurity policies to prevent and remedy cybersecurity threats.

Please see our September 24, 2015 client alert for more information.

New SEC Cybersecurity Guidance

On April 28, 2015, the SEC released a guidance update on the importance of cybersecurity and the steps registered investment advisers (and registered investment companies) should consider in light of growing cybersecurity risks. The guidance update suggests certain areas that advisers should periodically assess to help identify potential cybersecurity threats and vulnerabilities so as to better prioritize and mitigate risk:

- Nature, sensitivity and location of information that the adviser collects, processes and/or stores, and the technology systems utilized;
- Internal and external cybersecurity threats to and vulnerabilities of the adviser's information and technology systems;
- Security controls and processes currently in place;
- Impact on the adviser in the event that the information or technology systems become compromised; and
- Effectiveness of the governance structure for the management of cybersecurity risk.

In addition, the guidance update also suggests that investment advisers should, among other things: (i) consider developing and testing certain strategies in order to prevent, detect and respond to cybersecurity threats; (ii) address cybersecurity threats through the creation of specific policies and procedures, personnel training and ongoing testing and monitoring; (iii) educate investors and clients on reducing their exposure to cybersecurity risks with respect to their accounts; (iv) assess the adequacy of the cybersecurity measures employed by their service providers and determine whether their service-provider contracts sufficiently address technology issues and related responsibilities that arise in the case of a cyberattack; and (v) consider whether insurance coverage related to cybersecurity risks is necessary or appropriate.

Please see our May 5, 2015 client alert for more information.

NFA Cybersecurity Interpretive Notice

In October 2015, the Commodity Futures Trading Commission (**CFTC**) approved the National Futures Association's (**NFA**) Interpretive Notice 9070, which the NFA had submitted to the CFTC for approval in August. The interpretive notice will apply to all NFA membership categories (including, for example, registered commodity pool operators (**CPOs**) and commodity trading advisors (**CTAs**)) and require member firms to adopt and enforce information systems security programs (**ISSPs**) for protecting customer data and access to their electronic systems. The interpretative notice will become effective on March 1, 2016.

Under the interpretive notice, member firms will be required to adopt and enforce a written ISSP. The interpretive notice uses a principles-based approach, allowing firms to have a certain degree of flexibility in designing an ISSP that suits their business needs and circumstances. Nevertheless, the interpretive notice also states that an ISSP should contain:

- A security and risk analysis;
- A description of the safeguards against identified system threats and vulnerabilities;
- The process used to evaluate the nature of a detected security event, understand its potential impact and take appropriate measures to contain and mitigate the breach; and
- A description of the firm's ongoing education and training related to information systems security for all appropriate personnel.

The ISSP must be approved by an executive-level official of the firm. Each member firm must monitor and regularly review (*i.e.*, at least every 12 months) the effectiveness of the ISSP, including the efficacy of safeguards that the member firm has deployed, and make adjustments as appropriate. Moreover, member firms must provide employees upon hiring, and periodically during their employment, with cybersecurity training that is appropriate to the security risks the member firm faces and the composition of its workforce. Finally, the ISSP must address risks posed by critical third-party service providers.

Other SEC Guidance and Updates

New Guidance on "General Solicitation" under Regulation D

On August 6, 2015, the SEC issued a new series of compliance and disclosure interpretations (**C&DIs**) and a no-action letter (**No-Action Letter**) addressing what constitutes "general solicitation" within the meaning of Rule 502(c) of Regulation D under the Securities Act (**Securities Act**).

C&DIs. While portions of the new guidance are reiterations of views previously expressed by the SEC, the new guidance also contains some helpful clarifications on permissible communications and activities under Regulation D's prohibition against general solicitation:

- **Factual Business Information**. The C&DIs clarify that dissemination by an issuer of "factual business information" on a publicly available website would not constitute general solicitation. What constitutes factual business information is a question of facts and circumstances. Factual business information typically is limited to information about the issuer, its business, financial condition, products, services or advertisement of such products or services. It does not include predictions, projections, forecasts or opinions with respect to valuation of a security or, in the case of a continuously-offered fund, its past performance.

- **Pre-Existing, Substantive Relationship**. The C&DIs affirm that an offer of securities made to a person with whom the issuer, or a person acting on its behalf, has a "pre-existing, substantive relationship" would not constitute general solicitation. While prior SEC guidance generally looked to relationships formed by registered broker-dealers, the C&DIs clarify that issuers may also rely on relationships formed by registered investment advisers.
- **Pre-Existing Relationship**. A "pre-existing" relationship is one that the issuer has formed with an offeree prior to the commencement of the securities offering or, alternatively, that was established through either a registered broker-dealer or investment adviser prior to its participation in the offering. The C&DIs, however, also confirm prior no-action letter guidance that an individual who qualifies as an accredited or sophisticated investor may, after the end of a waiting period, purchase securities in 3(c)(1) and 3(c)(7) hedge fund offerings that were posted on a website platform prior to the investor's subscription to the platform, in view of the fact that hedge fund offerings are made on a semi-continuous basis (quarterly or annually).
- **Substantive Relationship**. A "substantive" relationship is one in which the issuer (or a person acting on its behalf) has sufficient information to evaluate, and does, in fact, evaluate, a prospective offeree's financial circumstances and sophistication. A check-the-box self-certification by a prospective offeree, without more, would be insufficient for forming a "substantive" relationship.
- **Angel Investor Networks**. The C&DIs also clarify that issuers and persons acting on their behalf may rely on introductions by a member of an "angel investor" network (or other similar network of experienced investors) to other members in the network, and may rely on the network for establishing a reasonable belief that other offerees in the network have the requisite financial experience and sophistication. However, whether the solicitation constitutes general solicitation would still be a fact-specific determination.

No-Action Letter. The SEC confirmed in its no-action letter issued to an online venture capital firm that the firm's use of a website for offering interests in special purpose vehicles (**SPVs**) would not constitute general solicitation. According to the request letter, the venture capital firm operates a website for facilitating indirect portfolio company investments by the website's qualified members through SPVs organized and managed by the venture capital firm's wholly-owned subsidiary.[4] While the website's homepage is publicly accessible, a prospective investor must apply and qualify for membership to access the password-protected sections of the website. Firm policies require that the prospective investor complete an accredited investor questionnaire and undergo a "relationship establishment period," during which the firm would collect information as it deems sufficient for evaluating the investor's qualifications. A prospective investor will not be able to view investment opportunities and related offering materials on the website until it is admitted as a member. The SEC concurred in its no-action letter that the firm's policies are sufficient for creating a substantive, pre-existing relationship between the firm and prospective investors, such that its use of the website would not constitute general solicitation under Regulation D. The SEC also emphasized that a "substantive" relationship is one where the issuer or its agent has sufficient information for evaluating the offeree's qualifications and that there is no specific duration of time or short form questionnaire that can be relied upon solely to create such a relationship.

[4] According to the request letter, the subsidiary will register as an investment adviser with the SEC once it has assets under management of $150 million, unless the venture capital fund adviser exemption or other applicable exemption applies.

Compliance Date for Pay-to-Play Rule's Ban on Third Party Solicitation

On June 25, 2015, the SEC issued a notice setting a compliance date of July 31, 2015 for the ban on payments by registered investment advisers to third parties who are not "regulated persons"[5] for the solicitation of advisory business from any government entity under the Pay-to-Play Rule. At the same time, the SEC also clarified in an FAQ that it would not recommend an enforcement action against an investment adviser or its "covered associates" for the payment to any person to solicit a government entity for investment advisory services until the later of (i) the effective date of a FINRA pay-to-play rule; or (ii) the effective date of a MSRB pay-to-play rule. As of the date of this Annual Review, neither FINRA nor the MSRB has finalized its own pay-to-play rules. Thus, until both the FINRA and MSRB pay-to-play rules are in effect, investment advisers and their covered associates will not be subject to enforcement actions for third-party solicitation under the Pay-to-Play Rule.

Please see our July 15, 2015 client alert for more information.

New Guidance on Personal Securities Transactions Reporting

In June 2015, the SEC issued a guidance update on personal securities transactions reporting, which clarified when advisory personnel would be deemed to have "no direct or indirect influence or control" over a personal account, such that securities transactions in the account would be exempt from the reporting requirements. Rule 204A-1 of the Advisers Act requires a registered investment adviser to establish and maintain a written code of ethics that requires, among other things, its directors, officers, partners, and any other supervised persons who (i) have access to nonpublic information regarding any clients' purchase or sale of securities or nonpublic information regarding the portfolio holdings of any of the adviser's funds; or (ii) are involved in making securities recommendations to clients or who have access to such recommendations that are nonpublic (collectively, **Access Persons**) to report their personal securities transactions to the adviser. However, pursuant to an exemption (**Exemption**) from Rule 204A-1, an Access Person would not be required to report personal transactions in an account over which the Access Person has "no direct or indirect influence or control" (*e.g.*, a "blind trust" for which a trustee manages funds for the benefit of an Access Person and over which the Access Person has no right to intervene and no knowledge of the specific portfolio investments made by the trustee).

The guidance update clarifies how the Exemption would apply to arrangements outside of a blind trust, such as (i) a trust managed by a third-party trustee for which an Access Person is a grantor or beneficiary and has limited involvement in the trust affairs; or (ii) a personal account managed by a third-party manager who has discretionary investment authority over the account. Under the guidance update, that the Access Person has granted investment authority to a third-party trustee or manager would not, by itself, be sufficient to establish that the Access Person is eligible to rely on the Exemption, given that the Access Person may still suggest or direct investments to the trustee or manager or consult with the trustee or manager as to particular investments. The guidance update suggests certain steps (including, among other things, specific certifications) that an investment adviser may adopt to determine whether the Access Person actually has direct or indirect influence or control over the trust or account.

Please see our July 1, 2015 client alert for more information.

---

[5] "Regulated person" is defined under the Pay-to-Play Rule to include (i) a registered investment adviser; (ii) a registered broker or dealer subject to pay-to-play rules adopted by a national securities association (*e.g.*, the Financial Industry Regulatory Authority, Inc. (**FINRA**)); or (iii) a registered municipal adviser subject to the Municipal Securities Rulemaking Board's (**MSRB**) pay-to-play rules.

Proposed Amendments to Form ADV and Performance Information Recordkeeping Requirements

On May 20, 2015, the SEC released proposed amendments to Form ADV and Rule 204-2 of the Advisers Act. The proposed amendments, if adopted, would require investment advisers to provide additional information on Form ADV and expand their obligation to maintain records of performance calculations and performance-related communications.

Proposed Amendments to Form ADV. Under the proposed amendments, an investment adviser would be required to report additional information on its separately managed account clients and other facets of its advisory business. Moreover, the proposed amendments would codify the umbrella registration process set forth in existing SEC guidance for private fund adviser entities operating as a single advisory business. While the SEC had previously offered guidance on when multiple private fund adviser entities may be deemed as operating a single advisory business and therefore be eligible to file a joint Form ADV, the umbrella registration process is limited by the fact that Form ADV is designed for an adviser operating as a single legal entity. The proposed amendments would revise Form ADV and its general instructions to add details on the umbrella registration process and the timing of filings, as well as to specify which questions in Form ADV should be answered solely with respect to the filing adviser, as opposed to the filing advisers and its relying advisers.

Proposed Amendments to Rule 204-2. Rule 204-2 of the Advisers Act requires registered investment advisers to maintain supporting documentation for performance claims contained in any communication that is distributed to 10 or more persons. The proposed amendments to Rule 204-2 would expand this obligation by removing the "10 or more persons" condition and extending the duty to keep supporting documentation to performance claims in a communication that is distributed to any person. In addition, the proposed amendments would require registered investment advisers to maintain originals of all written communications received and copies of written communications sent by a registered investment adviser relating to the performance or rate of return of any or all managed accounts or securities recommendations.

Please see our May 22, 2015 client alert for more information on the proposed amendments.

Proposed Amendments to SEC Administrative Proceedings

On September 24, 2015, the SEC announced proposed amendments to its Rules of Practice governing its administrative proceedings. The proposed amendments, if adopted, would change the current Rules of Practice by, among other things: (i) adjusting the timing of administrative proceedings, including by extending the time before a hearing occurs in appropriate cases; (ii) permitting parties to take depositions of witnesses as part of discovery; and (iii) requiring parties to submit filings and serve each other electronically and to redact certain sensitive personal information from such filings. The proposed amendments would also simplify the requirements for seeking SEC review of an initial decision and provide added transparency into the timing of the SEC's decisions in such appeals. The public comment period for the proposed amendments is expected to end on December 4, 2015.

Speech by SEC Chief of Staff on Chief Compliance Officer Responsibilities

On October 14, 2015, the SEC's Chief of Staff, Andrew Donohue, spoke at an investment adviser and broker-dealer compliance conference and outlined nine sets of issues that a chief compliance officer of a registered investment adviser should actively examine:

- Laws, regulations and other requirements applicable to the investment adviser and its activities, based on the firm's business model and the jurisdictions in which it operates;
- Organization and operations of the investment adviser, including the areas of the firm with respect to which he or she acts as chief compliance officer, interactions between different areas of the firm, and the firm's supervisory structure;
- Identification, review, resolution, disclosure of actual and potential conflicts of interest;
- Clients of the investment adviser and the types of services and products offered;
- Compliance and other technology platforms utilized by the investment adviser;
- Policies and procedures of the investment adviser and their application;
- Marketing and business practices of the investment adviser;
- Existence of a strong culture of compliance; and
- Identification of potential risks and gaps in knowledge.

We note that the list above is not intended to be exhaustive. Moreover, while Donohue stated that the SEC is not targeting compliance personnel, the SEC has also brought a number of enforcement actions this year against the chief compliance officers of investment advisers for failing to adopt and implement written compliance policies and procedures.

Volcker Rule Updates

New Guidance on Investments in Third-Party Funds by Non-U.S. Banking Entities

On February 27, 2015, the Federal Reserve Board (**FRB**), the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the SEC and the CFTC released an FAQ on the Volcker Rule.

The Volcker Rule generally prohibits banking entities from acquiring or retaining an ownership interest in or sponsoring a "covered fund."[6] However, under an exemption to the Volcker Rule, referred to as the "SOTUS Exemption," non-U.S. banking entities may invest in covered funds subject to certain conditions, including the requirement that "no ownership interest in the covered fund is offered for sale or sold to a resident of the United States" (**Marketing Restriction**). The FAQ clarifies that the Marketing Restriction only applies to the activities of the non-U.S. banking entity investing in a covered fund and not to the activities of a third party that is unaffiliated with the non-U.S. banking entity. Therefore, a non-U.S. banking entity may invest in "covered funds" that are marketed to U.S. residents by unaffiliated third parties, as long as the non-U.S. banking entity (including its affiliates) does not engage in the offer or sale of interests in the covered funds (and provided certain other conditions are met). The FAQ also clarifies that a non-U.S. banking entity that sponsors or serves, directly or indirectly, as the investment adviser, CPO or CTA to a covered fund will be considered to be engaged in the offering and sale of ownership interests in such fund, and thus the SOTUS Exemption will not be available to the non-U.S. banking entity if such ownership interests are offered or sold to U.S. residents.

[6] The Volcker Rule permits a banking entity to act as sponsor to, and to acquire and retain a *de minimis* ownership interest in, a covered fund organized in connection with the provision of advisory services by the banking entity to its customers. Covered funds include private funds that would be investment companies but for Section 3(c)(1) or 3(c)(7) of the Investment Company Act and certain commodity pools.

Accordingly, while a non-U.S. banking entity may not invest in a covered fund with respect to which the non-U.S. banking entity (including its affiliates) offers or sells ownership interests to U.S. residents, a non-U.S. banking entity may invest in a covered fund sponsored by an unaffiliated third party with respect to which an unaffiliated third party offers or sells ownership interests to U.S. residents, subject to certain conditions.

Please see our March 10, 2015 client alert for more information.

Extension of Conformance Deadline for Legacy Covered Funds

On December 18, 2014, the FRB issued an order giving banking entities until July 21, 2016[7] (rather than July 21, 2015) to conform investments in and relationships with covered funds and foreign funds that were entered into on or prior to December 31, 2013 (**Legacy Covered Funds**) with the requirements of the Volcker Rule. We note that the extension applies only to Legacy Covered Funds and does not apply to investments in and relationships with covered funds and foreign funds that were entered into *after* December 31, 2013. Any such investments and relationships needed to be in conformance with the requirements of the Volcker Rule by July 21, 2015.

CFTC Updates

CFTC Supplemental Proposal on Aggregation Rules for Position Limits

On September 22, 2015, the CFTC approved for public comment a supplemental proposal (**Supplemental Proposal**) to the CFTC's November 2013 proposed aggregation rules (**2013 Proposed Rules**) on position limits for related entities. In particular, the Supplemental Proposal revises how the CFTC proposes to address situations when aggregation is required on the basis of ownership of greater than 50% in another entity.

The 2013 Proposed Rules generally set forth the CFTC's proposed amendments to Part 150 of the CFTC's regulations, including proposed rules for determining when positions held by related entities must be aggregated. Among other things, under the 2013 Proposed Rules, where an entity has a 10% to 50% interest in another entity, such entity may be permitted to disaggregate the positions of the owned entity by making a notice filing with the CFTC (assuming that certain specified conditions are met). In contrast, where an entity has an ownership interest of greater than 50% in another entity, such entity would have to apply on a case-by-case basis to the CFTC for permission to disaggregate and would have to wait for the CFTC's determination as to whether the entity has met certain specified conditions and is eligible for disaggregation. The Supplemental Proposal would simplify the foregoing process by allowing an entity with an ownership interest of greater than 50% to rely on the notice filing process instead of having to apply and wait for the CFTC's approval. As CFTC Chairman Timothy Massad stated in an accompanying statement, the Supplemental Proposal "should create a more practical, efficient rule" for market participants.

We note that all other aspects of the 2013 Proposed Rules will remain the same. The public comment period on the Supplemental Proposal is expected to end on November 23, 2015.

[7] The order also provided that the FRB will act in 2016 to provide a second one-year extension until July 21, 2017.

FCPA Updates

According to the Dow Jones 2015 Anti-Corruption Survey, which is generated from interviews with hundreds of compliance personnel worldwide, 68% of businesses canvassed delayed or stopped working with a business partner due to concerns about violating anti-corruption regulations. Over 60% of companies delayed or called off business endeavors due to difficulties in obtaining information to assess the corruption risk. This is an increase in both categories from last year.

Private funds seeking to maximize capital and a return on their investments must navigate opaque and emerging business environments with potential partners who profess to have unique understanding and connections. Over 50% of businesses surveyed by Dow Jones this year reported that they delayed or refrained from expanding in emerging markets for the reasons noted above. At the same time, those markets and partners may present opportunities with the greatest financial gain. Ultimately, private funds may have no choice but to do business there to satisfy their goals of maximizing returns.

Aggressive expansion of private funds into these emerging markets has drawn the attention of U.S. and non-U.S. law enforcement that are intent on rooting out corrupt activity. By taking proactive steps to minimize anti-corruption exposure, private funds may protect their investments' values while simultaneously averting headline risks, criminal and civil penalties and other devastating collateral consequences.

An Expanding and Aggressive Enforcement Environment. U.S. anti-corruption risks for private funds lie primarily in enforcement of the Foreign Corrupt Practices Act (**FCPA**) by the DOJ and the SEC. The FCPA prohibits corruptly offering or giving anything of value to a foreign official with the intent to obtain or retain business. For over a decade, and with increasing measure lately, the DOJ and the SEC have made FCPA enforcement a priority. Although the number of DOJ enforcement actions for 2015 is modest when compared to prior years, the statistics must be viewed in context: prosecutors have spent a majority of the year entrenched in a fervent trial and preparing for others, and many other indicted cases may exist under seal.

The DOJ has made clear that no company is beyond FCPA risk. The SEC's FCPA Unit Chief Kara Brockmeyer recently confirmed that position when she stated that the SEC will, in addition to large multinationals, focus on the smaller companies that are stepping into foreign markets for the first time and that fail to upgrade their risk assessments accordingly. Individuals too now face heightened scrutiny. On September 9, 2015, the DOJ issued a memorandum on Individual Accountability for Corporate Wrongdoing reaffirming its commitment to prosecuting individuals and instructing prosecutors to drill down on individual accountability when dealing with corporate misconduct. Included is a drastic policy shift requiring corporations to turn over culpable employees (regardless of their position, status or seniority in the company) and provide all relevant facts about their misconduct in order to be eligible for any cooperation credit. In speaking about the new policy, Deputy Attorney General Sally Quillian Yates, who issued the memorandum, explained: "It's all or nothing. No more picking and choosing what gets disclosed. No more partial credit for cooperation that doesn't include information about individuals." Individual prosecutions threaten lengthy jail sentences for culpable offenders and provide an alternative basis for deterrence. The DOJ's new initiative, taken together with the whistleblower provisions under Dodd-Frank, has created a playing field where employees and employers are equally incentivized to turn the other in.

Law enforcement officials interpret the FCPA to cover a range of corrupt payments above and beyond the proverbial "cash in a briefcase," scrutinizing companies' travel and entertainment expenses, gifts and even the hiring of individuals associated with foreign officials. The hiring of individuals associated with foreign officials has received mounting attention as of late. Employing a relative of a friend, business associate or acquaintance is in many respects industry standard and often just good business practice. Yet, authorities have signaled that hiring an individual for the purpose of rewarding or inducing a foreign official to reward business can subject a company to FCPA liability. The finest of lines is being drawn in the sand, with any misstep potentially resulting in catastrophic consequences. To avoid what may feel like an inevitable trap when hiring individuals associated with a foreign official, companies should employ targeted internal controls to prevent and detect improper hiring practices and have additional protocols for the hiring of customers and relatives of customers. This may include confirming that employees associated with foreign government officials are adequately qualified for the position and compensated on scale with other employees and the work performed.

Perhaps most alarming for private funds that are expanding their global footprint is the extraterritorial jurisdiction routinely exerted over activity with nominal connection to the United States. The DOJ has not hesitated to investigate foreign nationals working for foreign companies who pay bribes to foreign officials in connection with wholly foreign transactions, even where there is only a single minor connection to the United States. Activities performed entirely outside the United States by non-U.S. persons have been prosecuted where the only U.S. connection was a bank account. Emails routed through a U.S. server likewise has served as the jurisdictional basis for a prosecution of a non-U.S. person for conduct otherwise entirely outside the United States.

The DOJ's expansive interpretation of the FCPA's jurisdictional reach was curtailed this year in *United States v. Hoskins*, No. 12 Cr. 238, 2015 WL 4774918 (D. Conn. Aug. 13, 2015). There, the district court held that non-resident foreign nationals who are not agents of a "domestic concern"[8] and do not commit acts while present in the United States cannot be subject to FCPA liability under an accomplice liability theory. The practical implication is that the DOJ cannot tag a person with FCPA liability who would not otherwise be subject to direct liability under the statute due to lack of jurisdiction by charging such person with aiding and abetting or conspiring to commit a FCPA violation. We note, however, that the DOJ has employed other avenues, such as money laundering statutes, to achieve the same end.

Compounding the risk for private funds operating in foreign markets is the challenge of determining whether their business partner or investor is a government official or instrumentality. Corrupt payments are prohibited by the FCPA when offered to foreign officials in the traditional sense, such as ministers, judges, and government employees. But the statute also proscribes offers to officials whose government connections are less evident but prevalent in the private fund industry, such as employees of governmental pension funds, sovereign wealth funds and other state-owned or -operated instrumentalities. The definition of an "instrumentality" under the FCPA is broadly based on a host of factors, some of which are counter-intuitive. In many countries, such as Russia or China, the government may control a company through a complex chain of subsidiaries, adding layers of difficulty in determining whether a party is an instrumentality.

[8] A "domestic concern" is defined under the FCPA as an "individual who is a citizen, national, or resident of the United States" and "any corporation, partnership, association, joint-stock company, business trust, unincorporated organization, or sole proprietorship which has its principal place of business in the United States, or which is organized under the laws of a State of the United States or a territory, possession, or commonwealth of the United States." 15 U.S.C. § 78dd–2(h)(1).

Capitalizing on the U.S. authorities' successes in obtaining settlement payments under the FCPA, many foreign jurisdictions have enacted and enhanced their own anti-corruption regimes. TRACE International reported that non-U.S. enforcement actions have more than doubled since 2012, and in 2014, non-U.S. enforcement actions concerning bribery of foreign officials outnumbered U.S. enforcement actions. Moreover, the first half of 2015 saw several significant sanctions imposed in anti-corruption actions brought by the World Bank's Integrity Vice Presidency.

In particular, the U.K. Serious Fraud Office (**UK SFO**) has been enforcing the Bribery Act 2010, a more robust, anti-corruption statute than the FCPA, and its predecessor, the Prevention of Corruption Act 1906, with even more vigor. The Bribery Act covers individuals and entities that carry on business in the United Kingdom, regardless of where the corrupt activity takes place. Unlike the FCPA, the Bribery Act prohibits commercial bribery, criminalizes the receipt (not just the offer or provision) of corrupt payments and does not except nominal payments provided to secure ministerial government actions. Taking a page from its U.S. counterparts, the UK SFO recently announced that it would be issuing invitation letters to parties with which it would be willing to negotiate deferred prosecution agreements.

Rapidly expanding economies have also crafted anti-corruption statutes. Ukraine's anti-corruption legislation took effect earlier this year, and in 2014, the Brazilian Clean Companies Act was enacted, imposing strict civil liability on companies operating in Brazil for both domestic and foreign bribery. Brazilian authorities are proving their commitment to combatting corruption with their investigation into a massive corruption scandal at the state-run oil firm Petrobras. India, Mexico and Korea have similar enforcement efforts underway. All of this demands vigilance.

Key Risks for Private Funds. Hedge funds and private equity funds share many of the same anti-corruption risks. The fundamental differences between their business models, however, make some risks more acute than others.

The greatest anti-corruption risks for hedge funds arise when securing capital from foreign officials and government entities, including sovereign wealth funds and government pension funds. Fundraising is often facilitated by local third party agents with intimate familiarity of the investing individual or entity. Once a relationship is formed, local agents may be tasked with maintaining it. These interactions are a primary source of legal risk. In recent years, the majority of FCPA enforcement actions have arisen from the use of third party agents.

Impressive gifts or lavish entertainment are often customary when developing business relationships. However, care must be taken to ensure that creating good will does not transform into paying for business. Breach of that line, which may be sometimes hard to find, cannot be the price of admission to do business. No private fund should engage a local agent to solicit and maintain relationships with foreign government investors with little insight into or protection from that agent's activities. The FCPA confers liability not only for the actions of one's employees, officers and directors, but also for those of one's intermediaries. Mere knowledge of an agent's actions can trigger liability, a low threshold met when a business is willfully blind. Law enforcement officials are quick to take advantage of this risk point.

The DOJ has warned private fund personnel that it is focused on the use of intermediaries and on gifts, entertainment and travel expenses provided when seeking investments. The DOJ made true on its statements, as seen by a large public hedge fund adviser's 2014 disclosure in public filings that it was under a federal investigation of its dealings with a sovereign wealth fund. The day after disclosing the investigation, the adviser's share price dropped significantly. The adviser has also had to defend related

private litigation, further underscoring the far-reaching consequences of improperly navigating the FCPA battleground.

Private equity funds must also take care when using third party agents to secure potential investments and maintain relationships. To a far greater extent than hedge funds, private equity funds' anti-corruption risks arise out of portfolio investments themselves, even when limited to the private sphere. Many private companies in emerging markets have weak or non-existent anti-corruption programs governing their own interactions with foreign government officials. Private equity funds can be held liable for those companies' past, present and future corrupt activities.

Private equity funds, unlike hedge funds, do not ordinarily hold passive investments, a business approach that may insulate hedge funds from liability should a corruption issue arise. Many of the methods customarily employed by private equity funds to generate change in a business and increase profitability also increase risk. Managerial control, board seats, voting rights and veto powers are just some of the indicia of control that can confer liability for an investment's activities, even when holding a minority interest. Actions of joint venture partners can likewise create liability for a private equity fund. The fund can also inherit successor liability for an acquisition's past wrongs. Even absent liability for the corrupt activities of an investment, there are significant headline risks. Any anti-corruption investigation or enforcement action can severely impact a private equity fund's ability to unload an investment and continue to do business.

Government authorities continue to emphasize the theme of voluntary disclosure and cooperation as a method for minimizing financial penalties. Earlier this year, the DOJ's FCPA Unit Chief Patrick Stokes revealed that had one company disclosed the conduct, cooperated at the beginning of the investigation and taken appropriate remedial steps from the start, the resulting penalty could have been reduced by over $500 million. Ultimately, however, prophylactic measures are best. Conducting due diligence on agents, business partners and investments, implementing robust anti-corruption compliance programs, training local representatives on anti-corruption compliance and averting whistleblowers by maintaining anonymous hotlines are just some of the many ways in which a private fund can protect itself while investing on a global scale.

Anti-Money Laundering Updates

FinCEN Proposed Rules for Registered Investment Advisers

On August 25, 2015, the Department of the Treasury's (**Treasury Department**) Financial Crimes Enforcement Network (**FinCEN**) revived a 2003 proposal that would subject registered investment advisers to the anti-money laundering (**AML**) provisions of the Bank Secrecy Act (**BSA**). The proposal comes at a time of renewed regulatory scrutiny and increased enforcement activity in the area of BSA and AML compliance. The comment period on the proposed rule ended on November 2, 2015. A final rule should be anticipated in the new year.

The current proposal would require registered investment advisers to (i) establish AML programs; (ii) report or create, and maintain records of, cash transactions and transfers; and (iii) report suspicious activity to, and respond to requests for information from, the government. The regulation would necessitate the implementation of policies, procedures and controls reasonably designed to prevent the adviser from being used to facilitate money laundering or the financing of terrorist activities and to achieve compliance with the BSA and related regulations. A compliance officer would need to be

appointed to manage the program, and independent auditing of the program and training of relevant staff would be required. Customer identification program (**CIP**) measures, which have long been required of broker-dealers, would not be mandated initially, although FinCEN has signaled its intention to address these requirements in subsequent rulemakings in conjunction with the SEC. Authority to enforce the AML requirements would be delegated to the SEC.

In the years since the previous proposal, many investment advisers have voluntarily implemented AML programs in response to demand from executing brokers, custodians or investors. In some cases, operation of the program, or some of it, has been outsourced to a third party. While the reproposal does not preclude outsourcing of AML activities, advisers would need to put process around outsourcing. Under the proposal, the individual assigned to oversee the AML program must be an officer of the adviser, not another entity. For broker-dealers, this has meant the appointment of a designated AML compliance officer. Delegation of any aspect of the program to a third party will not relieve the adviser of responsibility for compliance with its AML obligations. Thus, the adviser will need to make an initial determination that the third party is capable of performing the outsourced functions effectively and review the third party's performance of the outsourced activities on an ongoing basis to ensure its continued compliance with applicable requirements.

FINRA has issued clear guidance to broker-dealers regarding accountability and supervisory responsibility for outsourced activities. Broker-dealers must conduct a thorough due diligence analysis of any third party service provider to determine its capability to perform the service. A broker-dealer has a continuing responsibility to oversee and supervise the third party's performance of the activities. In this regard, the broker-dealer must institute specific policies and procedures to monitor and assess the service provider's continued fitness and ability to perform the outsourced activities. Similar guidance with respect to outsourcing arrangements has been provided by banking regulators. Investment advisers may wish to review the available guidance in advance of any decision to outsource AML responsibilities under the new rule.

Please see our September 2, 2015 client alert for more information on FinCEN's proposal.

BEA Filing Updates

Certain forms issued by the Department of Commerce Bureau of Economic Analysis (**BEA**) track, among other things, cross-border "direct investments," which is the ownership or control of 10% or more of the voting equity securities of an incorporated or unincorporated business. In general, only U.S. persons contacted individually by the BEA are required to report on such BEA forms. From time to time, however, the BEA has and may propose forms that track direct investments that must be filed by any U.S. person that meets the relevant thresholds regardless of whether the BEA makes contact. In late 2014 and early 2015, the BEA released three reports required to be filed by U.S. persons (including U.S. private fund advisers): the BE-10, BE-13 and BE-180 reports.

BE-10. BE-10 is a five-year benchmark form that tracks U.S. direct investment abroad, *i.e.*, the ownership by U.S. persons of 10% or more of the voting securities of non-U.S. entities. BE-10 was due by May 29, 2015 and covered holdings from the 2014 fiscal year.

BE-180. BE-180 is another five-year benchmark form that collects data on transactions between U.S. persons that are financial services providers (including, for example, investment advisers to private funds and separate accounts) and non-U.S. persons. A BE-180 report was required from each U.S. person that is

a financial services provider that (i) had sales or purchases of financial services with non-U.S. persons in excess of $3,000,000 for the 2014 fiscal year; or (ii) had been contacted by the BEA, even if the reporting threshold was not met. BE-180 was due by October 1, 2015.

BE-13. In 2014, the BEA released BE-13, which collects data on new foreign direct investment in the United States from U.S. persons that meet the reporting requirements, even if such U.S. person has not been contacted by the BEA. BE-13 reports were due by January 12, 2015 by any entity that crossed the reporting threshold on or after January 1, 2014. An ongoing filing obligation exists for U.S. entities that partake in reportable transactions. Please see the section below on BE-13 for more information.

Antitrust Enforcement Updates

On August 24, 2015, the Federal Trade Commission (**FTC**) announced the settlement of an enforcement action against three hedge funds and their investment adviser for failing to observe the filing and waiting requirements of the Hart-Scott-Rodino Act (**HSR Act**) before acquiring shares in a company. Under the HSR Act's premerger notification program, parties to certain acquisitions that meet a specified dollar threshold (currently $76.3 million) are required to submit notification with the FTC and the DOJ's Antitrust Division and observe a statutory waiting period prior to the completion of such acquisitions. However, the HSR Act also exempts acquisitions "solely for the purpose of investment" that fall below 10% of the target company's outstanding stock.

The August enforcement action illustrates the FTC's historically narrow view of the passive investor exemption. While neither the statute nor the regulations define what constitutes "solely for the purpose of investment," the FTC has stated in speeches, informal interpretations and enforcement actions that any intent at the time of the acquisition to influence the basic business decisions of the company or to participate in management will render the exemption inapplicable, without regard to actions taken or not taken or to actual ability to effect influence. According to the government's complaint, the defendants took steps that were inconsistent with an investment-only intent, including, among other things, contacting certain individuals to gauge their interest and willingness to become the chief executive officer or potential board candidate of the issuer; taking other steps to assemble an alternate slate of board of directors for the issuer; and internally discussing the possible launch of a proxy battle for directors of issuer. Notably, there was no indication that the defendants succeeded in placing representatives on the board or otherwise exercising control or influence over the issuer.

We note that less than two months after the August enforcement action, the FTC announced the settlement of another enforcement action for failures to comply with the HSR Act's filing and waiting obligations, this time against a broker-dealer for improperly relying on the institutional investor exemption. Investment advisers should carefully evaluate their HSR Act filing obligations prior to making large stock acquisitions in excess of the HSR Act threshold. Application of the HSR Act's requirements and exemptions requires a thorough understanding of not only the rules, but also the agency's formal and informal interpretations on the application of the rules, and thus must be undertaken with the advice of experienced counsel in all cases.

Please see our September 2, 2015 and October 1, 2015 client alerts for more information on the HSR Act and the enforcement actions described above.

Tax Updates

Continued FATCA Implementation

Background. The Foreign Account Tax Compliance Act (**FATCA**) was enacted to help the Internal Revenue Service (**IRS**) combat perceived tax evasion by U.S. persons holding assets through offshore accounts. FATCA generally requires "foreign financial institutions" (**FFIs**) to register with the IRS and either (i) enter into an agreement with the IRS to, among other things, report certain information to the IRS about their U.S. account holders and investors; or (ii) in the case of a "Model 1" jurisdiction with an intergovernmental agreement (**IGA**) in effect with the United States with respect to FATCA (as described further below), comply with local laws that implement that IGA and report similar information to their own government. FFIs that fail to comply with FATCA are subject to a 30% withholding tax on a wide range of U.S.-source payments.

There are currently two categories of IGAs, and the Treasury Department's list of jurisdictions treated as having an IGA in effect can be found here (currently, 112 jurisdictions). An FFI falling within a Model 1 jurisdiction will be deemed compliant with FATCA and thus not required to enter into an FFI agreement or comply with the U.S. FATCA regulations. Instead, the FFI must register with the IRS, comply with local law implementing the IGA and report directly to its own government. The Model 1 jurisdiction will, in turn, exchange information directly with the U.S. government. An FFI falling within a "Model 2" jurisdiction still must register and enter into an FFI agreement with the IRS, and generally must comply with the U.S. FATCA regulations and report information directly to the IRS.

Compliance. FATCA withholding on fixed, determinable, annual or periodical (**FDAP**) income (*e.g.*, U.S.-source dividends and interest) paid to FFIs and "non-financial foreign entities" (**NFFEs**) that fail to comply with FATCA is generally currently in effect; withholding on gross proceeds from the sale of property that produces U.S.-source dividend or interest income is now set to begin on January 1, 2019 as a result of the extension provided in Notice 2015-66. Additionally, as of January 1, 2015, pre-FATCA Forms W-8 can no longer be accepted (subject to exceptions with respect to certain "preexisting entity accounts").

In order to register with the IRS for FATCA purposes, an FFI must register via the IRS's online FATCA portal and obtain a Global Intermediary Identification Number (**GIIN**), unless an exemption applies. The IRS updates its list of registered FFIs monthly, and FFIs must register and appear on the FFI list in order to avoid FATCA withholding.

For FFIs in Model 1 jurisdictions, registration with the local government is also required.

Transitional Period. This year continues a transitional period for FATCA implementation that is intended to ease compliance obligations, with the IRS taking into account good faith efforts to comply with FATCA. Along these lines, FFIs subject to an IGA generally have only had to withhold for FDAP income, if at all. Notice 2015-66 extended the deadline for Sponsored FFIs to register for their own GIIN until December 31, 2016, and they are able to use the GIIN of their sponsoring entity until then. Further, FATCA withholding on "foreign passthru payments" (*i.e.*, the portion of payments from a non-U.S. entity that is treated as U.S.-source for purposes of FATCA) made to non-compliant FFIs and NFFEs will not begin until the later of January 1, 2019 or six months following publication of regulations defining foreign passthru payments.

Fund Requirements. Non-U.S. funds are generally FFIs under FATCA and therefore, to avoid the 30% withholding tax, must generally register with the IRS and put processes in place to identify and report

their U.S. investors. Although U.S. funds do not have to register with the IRS, they do have to put processes in place to assess the FATCA status of their investors, withhold 30% of certain payments made to noncompliant investors and report certain information about any withholdings to the IRS.

The first FATCA information reports (covering 2014) were due this year. Going forward, the general deadline for participating FFIs to file FATCA information reports covering the previous year with the IRS will be March 31, while FFIs in Model 1 IGA jurisdictions will generally have until September 30 to file these same reports with their home jurisdiction.

It also should be noted that FATCA compliance is ultimately an issue of local law when a Model 1 IGA is in place. One direct consequence of this preemption was evident last year when U.K. law did not track the IRS's amendments to the on-boarding processes for new entity accounts opened between July 1 and December 31, 2014, and U.K. entities consequently were required to obtain self-certification for new customers months before entities in the Cayman Islands and British Virgin Islands were required to do so.

"**Non-U.S. FATCA**." Jurisdictions outside the United States have also implemented, or are in the process of implementing, their own tax information exchange regimes and IGAs with which funds may have to comply. The United Kingdom, for example, has established an automatic exchange of tax information relating to U.K. tax resident persons and entities. In addition, the European Union (**EU**) has recently agreed on amendments to the Directive on Administrative Cooperation which will impose due diligence and reporting obligations set out in the Common Reporting Standard published by the Organisation for Economic Co-operation and Development (**OECD**) from January 1, 2016. On a more global scale, the OECD is moving forward with its Base Erosion and Profit Shifting project, which will include certain additional reporting requirements. While it is unclear exactly how this will all play out, fund managers should expect to see reporting requirements continue to evolve in the coming years.

Proposed Regulations Issued on Management Fee Waivers

On July 22, 2015, the Treasury Department and the IRS issued proposed Treasury Regulations (**Proposed Regulations**) under Section 707(a)(2)(A) of the Internal Revenue Code (**Code**), addressing management fee waiver arrangements. Under the Proposed Regulations, certain management fee waiver arrangements will be treated for U.S. federal income tax purposes as disguised payments for services, resulting in ordinary income treatment (and possibly significant penalties under deferred compensation rules). Furthermore, the Treasury Department and the IRS believe that the Proposed Regulations generally reflect current law.

Management Fee Waiver Arrangements. In a typical management fee waiver arrangement, the general partner of a private investment fund (owned by the fund managers) is permitted to satisfy all or a portion of its capital commitment to the fund with "deemed" capital contributions, and the fund managers similarly are deemed to satisfy all or a portion of their capital contribution obligations to the general partner. In connection with the deemed contribution, there is a reduction in the management fee payable by the fund (where the fee is payable either to the general partner or to a management company owned by one or more of the owners of the general partner of the fund).

The general partner is entitled to a priority allocation of subsequent net profits of the fund, if and when they occur, equal to the amount of its deemed capital contributions to the fund. If such priority profit allocation includes net long-term capital gain or qualified dividend income, the fund's general partner (and its partners) would be subject to tax at the lower U.S. federal capital gains tax rate as compared to the higher ordinary income tax rate that otherwise would have applied to the waived management fee.

The priority allocation may also result in deferral of the tax that would have been due if management fees had not been waived.

Analysis of Management Fee Waiver Arrangements under the Proposed Regulations. The Proposed Regulations provide that whether an arrangement between a partner and a partnership constitutes a payment for services depends on all of the facts and circumstances, and identifies six non-exclusive factors to consider. The most important factor is the entrepreneurial risk of the arrangement: an arrangement that lacks significant entrepreneurial risk is treated as a payment for services without regard to any other factor. Whether an arrangement lacks significant entrepreneurial risk is based on the service provider's entrepreneurial risk relative to the overall entrepreneurial risk of the fund.

Fund managers should review any potential or existing management fee waiver arrangements in light of the Proposed Regulations. The Proposed Regulations mandate no gross income allocations and strongly suggest that the management fee waiver arrangement should be economically at risk—and supported by an enforceable return obligation—to the extent amounts received by reason of the fee waiver exceed the cumulative net profits over the life of the fund. Accordingly, fund managers should consider structuring their arrangements to conform with these guidelines.

The Proposed Regulations modify an example under existing regulations Section 1.707-1(c), which applies to partners both for payments made to a partner for services and for the use of capital. A partner entitled to the greater of a percentage allocation of partnership income or a minimum guaranteed payment can no longer treat the entire income allocation amount (if it exceeds the minimum guaranteed payment) as a distributive share. The entire minimum payment will now be treated as a guaranteed payment. One of the consequences of this treatment is that partners might have to include a preferred return under a distribution "waterfall" as taxable income even if the partnership does not have net income.

Although the Proposed Regulations are not expected to be finalized until next year, there has been public pressure in the Senate to finalize these regulations as soon as possible.

For more detail about the Proposed Regulations, please see our July 24, 2015 client alert.

Basket Swap Notices

In Notice 2015-47, the Treasury Department and the IRS identified "basket option contracts" and "substantially similar transactions" as listed transactions. Notice 2015-48 went further by creating the broader category of "basket contracts" (which may include notional principal contracts, forward contracts, and other derivatives) as transactions of interest. These notices depict basket contracts as vehicles used to defer income recognition and convert short-term capital gain and ordinary income to long-term capital gain. However, the IRS subsequently issued Notice 2015-73 and Notice 2015-74 to revoke the previous notices, which narrowed the overbroad scope of the transactions under scrutiny (as discussed further below).

Very generally, basket option contracts are a type of financial derivative in which the holder of the basket option has the right to buy or sell a group of underlying assets (*i.e.*, the "basket"), or to let the option expire, by a certain date. Short-term trading gains and ordinary periodic income generated from the basket's performance are deferred until the basket contract terminates, which means the entire gain is treated as long-term capital gain if the basket contract is held for more than one year.

The revised notices specified that transactions must meet certain criteria in order to be treated as listed transactions or transactions of interest, including (i) the taxpayer receives a return based on the

performance of the reference basket; (ii) the contract is not fully settled at intervals of one year or less; (iii) the taxpayer has exercised discretion to change the assets in the reference basket or trading algorithm; and (iv) the taxpayer's return for the taxable year reflects a tax benefit. Specifically excluded from such listed transactions are (i) contracts traded on certain regulated securities exchanges or boards of trade; and (ii) contracts treated as a contingent payment debt instrument or a variable rate debt instrument.

Taxpayers who have participated in basket option contracts or basket contracts on or after the January 1, 2011 effective date are required to report these transactions—even retroactively and for years for which they have already filed tax returns. Furthermore, those deemed to have "participated" in a relevant transaction for these purposes include the taxpayer and the counterparty, as well as each general partner if the taxpayer is a limited partnership and each managing member if the taxpayer is a limited liability company (**LLC**). However, nonresident aliens and foreign corporations not engaged in a U.S. trade or business that have provided a valid withholding certificate or documentary evidence are excused from the reporting requirements.

Fund managers should be aware that they have a new obligation to report basket contract transactions to the IRS or face penalties. Accordingly, advisers should review existing side letter provisions to determine whether they have any obligations with respect to reportable transactions.

A Shift Towards Market Sourcing

An increasing number of states have transitioned from a "cost of performance" to a "market-based sourcing" regime for apportioning service-based revenue and intangibles receipts to a particular state for state income tax purposes. This transition means that the traditional approach of sourcing revenue and receipts to the state where the service was performed (or where the "income producing activity" occurred) has been eclipsed by an approach that generally allocates these amounts to the state that receives the benefit of the service, although it is not always a simple matter to determine where someone receives that benefit. Ultimately this could impact the sourcing of management fees, which may have to be based where investors are resident. Fund managers receiving fees from investors resident in a market sourcing state (*e.g.*, California) might have state tax liabilities and filing obligations even if they have no other presence in that state (although whether these rules apply may depend on whether investors have invested in a partnership or in a corporate fund). Additionally, these new regimes are not uniform between states and create complexities for multijurisdictional taxpayers. Going forward, fund managers will have to pay extra attention to the different state tax requirements.

New 871(m) Regulations

On September 17, 2015, the IRS and the Treasury Department issued final, temporary, and proposed regulations under Section 871(m) of the Code (collectively, the **New Regulations**) that provide rules for withholding on "dividend equivalent payments" on derivatives that reference U.S. equity securities. In general, the rules contain a number of changes from proposed regulations issued in 2013, including:

- Limiting the scope of derivatives subject to withholding (under the New Regulations, the delta threshold in order for a "simple contract" to be subject to withholding is 0.80 or more, rather than 0.70 as it was under the 2013 proposed regulations, thereby requiring a stronger correlation between the contract and the underlying securities);
- Delaying the effective date that would have applied under the 2013 proposed regulations (under the New Regulations, withholding is imposed on equity derivatives issued after 2015 that are still

outstanding in 2018, and on all equity derivatives issued after 2016, while the 2013 proposed regulations generally would have applied to all payments made on an equity derivative after 2015, regardless of when the derivative was entered into);

- Clarifying that, to avoid double withholding on the same amounts, a dividend equivalent in a Section 871(m) transaction should be reduced by amounts treated as dividends with respect to the underlying security under Section 305;
- Revising the underlying security exception for qualified indices, including permitting greater flexibility for rebalancing indices and permitting *de minimis* short positions in a qualified index;
- Creating rebuttable presumptions for a short party that is a broker that transactions properly reflected on separate trading books and transactions entered into two or more days apart are not entered into in connection with each other; and
- Limiting the application of Section 871(m) to derivatives that reference a partnership so that it applies only if the partnership (i) carries on a trade or business of dealing or trading in securities; (ii) holds significant investments in securities; or (iii) holds (directly or indirectly) an interest in a lower-tier partnership described in (i) or (ii).

The primary challenge remaining with respect to the regulations under Section 871(m) is that withholding obligations may be imposed on phantom income in certain cases, including upon the lapse of an option and in certain situations involving dividend equivalents, with the result that a withholding agent may have to remit withholding tax at times when no corresponding cash payment is being made.

In response to these Section 871(m) revisions, the International Swaps and Derivatives Association, Inc. (**ISDA**) published new protocol enabling market participants to amend their ISDA master agreements to allocate the withholding tax to the party that takes the long position.

Tax Treatment of Partnerships

Effective for tax years that begin after December 31, 2017, the Bipartisan Budget Act of 2015 (**BBA**), which President Obama signed into law on November 2, 2015, significantly alters the U.S. tax treatment of partnerships (including LLCs taxed as partnerships). Unlike prior proposals, these new rules do not impose joint and several liability for audit-related deficiencies on partners or individual managers. However, the BBA does create new partnership-level audit rules under which the partnership itself will, in the year of IRS review, take into account any adjustments of partnership items for the reviewed year and generally assume liability for any deficiencies (including interest and penalties). The BBA also requires partners to report their partnership items consistently with the partnership unless the IRS is notified of inconsistent treatment. One liberalizing change from these new audit rules is that the designated partnership representative who acts on behalf of the partnership and deals with the IRS will no longer need to be a member of the relevant partnership or LLC.

A partnership may avoid this entity-level tax liability by issuing to each partner an adjusted information return showing the partner's share of the audit or other adjustment, though with this procedure the deficiency interest rate is set at 2% above the applicable federal rate applicable to most other tax deficiencies. Alternatively, a partnership's corresponding tax liability may be reduced if a partner files an amended return reflecting the discrepancy and pays the tax due, or if the relevant income items are attributable to foreign or tax-exempt partners who would not be subject to tax on that income. The BBA also permits certain small partnerships (with 100 or fewer qualifying partners, counting any S corporation

shareholders on a "look-through" basis) to opt out of the new audit rules, but this election is available only to partnerships whose partners consist exclusively of individuals, corporations and the estates of deceased partners.

Fund managers should evaluate their partnership and LLC agreements to ensure that they reflect these new audit rules and address items such as the distribution of this partnership-level economic burden among partners, including the division of prior-year tax liabilities among current partners.

Please see our November 5, 2015 client alert for more information.

ERISA Updates

DOL's New Proposed Rules Defining Fiduciary Investment Advice

On April 14, 2015, the Department of Labor (**DOL**) issued its highly anticipated re-proposed regulation addressing when a person providing investment advice with respect to an employee benefit plan or individual retirement account (**IRA**) is considered to be a fiduciary under the Employee Retirement Income Security Act (**ERISA**) and the Code. As discussed below, the new proposal offers a general definition of fiduciary investment advice that would significantly expand the group of people who would be considered fiduciaries. The proposal contains a number of carve-outs for particular types of communications that the DOL does not consider to be fiduciary in nature. The DOL also has proposed a new set of prohibited transaction exemptions and certain amendments to existing class exemptions applicable to fiduciaries that would allow certain broker-dealers, insurance agents and others who provide investment advice to continue to engage in certain transactions and to receive common forms of compensation that would otherwise be prohibited as conflicts of interest.

Background. Section 3(21)(A)(ii) of ERISA provides that "a person is a fiduciary with respect to a plan to the extent [...] he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so." Pursuant to a 1975 regulation, in order for a person to be held to ERISA's fiduciary standards with respect to investment advice for a fee, such person must (i) make recommendations as to investing in, purchasing or selling securities or other property, or give advice as to their value; (ii) on a regular basis; (iii) pursuant to a mutual understanding that the advice; (iv) will serve as a primary basis for investment decisions with respect to plan assets; and (v) will be individualized to the particular needs of the plan.

The DOL first published a new proposed regulation on October 22, 2010. In doing so, the DOL stated its belief that the current regulatory scheme no longer adequately protects plans, participants and beneficiaries. The DOL's initial proposal would have broadened significantly the scope of individuals considered to be fiduciaries under ERISA. Facing immense pressure, on September 19, 2011, the DOL stated that the proposal would be withdrawn and that a new proposal would be issued at a later date. Since then, lobbyists on both sides of the issue have been voicing their concerns and views about the DOL's proposal.

Now, nearly four years later, the DOL has proposed a new set of rules. The DOL has stated that the new proposal is necessary because the current regulatory scheme no longer adequately protects plans, participants, beneficiaries, and, in particular, IRA owners (to which ERISA's current fiduciary rules regarding prudence and loyalty do not apply) from conflicts of interest, imprudence and disloyalty. The DOL explained that many investment professionals are not subject to ERISA's fiduciary standards and thus, in its view, have the ability to operate with undisclosed conflicts of interest. Addressing concerns raised over

the past several years, the DOL stated that it has consulted with other federal regulators, including the SEC, concerning whether the proposal would subject investment professionals who provide investment advice to requirements that are overly burdensome or conflict with their obligations under other federal laws.

The Proposed Regulation. The proposal consists of: (i) a delineation of categories of advice that could be considered fiduciary conduct; (ii) specific carve-outs from the definition of investment advice; and (iii) new and amended prohibited transaction exemptions.

Expanded Categories of Advice. The proposal provides that certain types of advice (*i.e.*, investment recommendations, investment management recommendations, appraisals/valuations of investments, and recommendations of investment advisers), which, when provided in exchange for a fee or other compensation, directly or indirectly, and given under certain circumstances (described below) would be "investment advice." Except with respect to the category covering appraisals and valuations, the proposed regulation is structured so that a communication must constitute a "recommendation" in order to be treated as fiduciary investment advice. The proposal defines "recommendation" to mean "a communication that, based on its content, context, and presentation, would reasonably be viewed as a suggestion that the advice recipient engage in or refrain from taking a particular course of action." Unless one of a limited number of carve outs apply, a category of advice described above would constitute "investment advice" if the person providing the advice, either directly or indirectly (*e.g.*, through or together with any affiliate): (i) represents or acknowledges that he or she is acting as a fiduciary within the meaning of ERISA or the Code with respect to the advice described above; or (ii) renders the advice pursuant to a written or verbal agreement, arrangement, or understanding that the advice is individualized, or that such advice is specifically directed to the advice recipient for consideration in making investment or management decisions with respect to securities or other property of the plan or IRA.

New Prohibited Transaction Class Exemptions and Amendments to Existing Class Exemptions. The DOL's proposal also includes two new prohibited transaction class exemptions, as well as amendments to several existing class exemptions, that are intended to preserve the ability of certain fiduciary advisers, broker-dealers and insurance agents to continue to receive common forms of compensation that would otherwise be prohibited as conflicts of interest. In addition, the DOL proposed to revoke certain parts of existing class exemptions in recognition that the transaction would be covered by one of the new exemptions or proposed amendments to other existing class exemptions. Of particular importance and focus in the industry is the new "Best Interest Contract Exemption," which is designed to promote the provision of investment advice that is in the best interest of retail investors, including plan participants and beneficiaries, IRA owners and "small" plans (less than 100 participants); however, compliance with this new exemption as proposed may be extremely burdensome or impossible in certain cases, and, as currently drafted, the "Best Interest Contract Exemption" does not cover the purchase, sale or holding of interests in private investment funds potentially impacting the flow of investors to private funds.

If these proposed rules are finalized in a form similar to the form proposed, certain standard practices engaged in during the marketing process and the terms of certain fund documents, such as subscription agreements, will need to be reviewed and will likely need to change.

Please see our April 20, 2015 client alert for more information.

Executive Compensation Trends and Developments

Protecting the Firm: Compensation Recovery under New York's Faithless Servant Doctrine

Overview. The relationships between an investment adviser and the partners and employees of the firm are based on trust. But what happens if an investment professional turns out to be a "bad apple" and steals from the firm, engages in insider trading or otherwise breaches his or her duty of loyalty to the firm? And what happens if this conduct occurred over long periods of time, during which the culprit has been paid significant compensation by the firm, whether it be bonuses or a share of management fees or performance compensation? We have seen instances of this over the years. For example, in 2015, as reported by the Wall Street Journal, a partner in a venture firm allegedly carried out a scheme to defraud the firm of millions of dollars. We have also seen portfolio managers who violated insider trading policies and exposed the firm to significant penalties, as well as private equity professionals who concealed option grants or other compensation paid to them by portfolio companies.

In New York, there is a recognized legal basis for an employer to seek the recovery of all past compensation paid to this type of "bad actor" during the period of bad acts. The "faithless servant" doctrine, which arises under New York common law (rather than statute or regulation), is available to employers who operate in New York or who have a reasonable basis for choosing New York law to apply to their employment relationships. It can serve as a practical and powerful tool for an employer to augment restitution payments (if the employee has been subject criminal proceedings) or to assert as a counterclaim to actions by a former employee to recover compensation or carry. Of course, the doctrine is not a complete panacea, given that the former employee may be judgment proof or the amount subject to recovery may be dwarfed by other damages suffered by the firm.

Elements of the Faithless Servant Doctrine. There are some important aspects of the "faithless servant" doctrine:

- First, it requires that the level of misconduct be substantial and permeate the employee's services or at minimum amount to a breach of the duty of loyalty or good faith. While the case law is not a model of clarity, a single isolated bad act (without any ancillary cover-up) may not be enough.
- Second, if the requisite level of "faithless conduct" is established, then all compensation earned after the first bad act is subject to forfeiture and recovery. The employer's recovery is not limited to any compensation just associated with the bad act in question. For example, if an employee submitted falsified financial information to secure an enhanced bonus payment, all compensation of any nature from that date forward would be vulnerable to recovery, not just the enhanced bonus payment.
- Third, there could be special situations where a court will cut back on the breadth of recovery and apportion the "bad acts" to only certain compensation. This typically occurs in cases involving commission payments generated on a "task-by-task" basis. In one recent case, this narrow rule was not found to apply to a percentage interest that a "bad actor" hedge fund portfolio manager had in management and incentive fees, which were tied to the overall performance of the firm, and not separate tasks of the employee.

Further Thoughts. Unfortunately, if an employer finds itself thinking about the applicability of the "faithless servant" doctrine, then it is already facing a difficult situation. It still pays, however, to be aware of the doctrine and consult with outside counsel regarding its applicability. It may help to make a bad situation somewhat better and provide an alternative recovery option and strategy.

Employment Law Updates

FLSA Overtime Proposed Regulations

On June 30, 2015, the DOL unveiled its long anticipated proposed rule that, if enacted, would raise the minimum salary threshold required to qualify for exemption from the minimum wage and overtime requirements under the Fair Labor Standards Act (**FLSA**). The proposal seeks to increase the current minimum salary requirement for the executive, administrative, professional and computer employee exemptions from $455 per week ($23,660 per year) to $970 per week ($50,440 per year). The proposed rule also seeks to increase the threshold for exemption as a "highly compensated employee" (**HCE**) from $100,000 to at least $122,148. Under the DOL's proposal, both the minimum salary level for exemption and the HCE threshold would be increased on an annual basis after the new regulations become effective. The DOL projects that, if enacted, 4.7 million workers would be affected by these changes.

The increase to $970 per week reflects a "standard salary level" equal to the 40th percentile of earnings for full-time salaried workers and more than doubles the current salary requirement for exempt status. If enacted, the proposed salary threshold would outstrip even more generous state wage and hour law requirements.

The comment period for the proposed regulations closed on September 4, 2015. After the DOL drafts a final regulation that responds to any public comments, the Office of Information and Regulatory Affairs (**OIRA**) will conduct a final review, approve the text of the regulation and publish it in the Federal Register. The period for OIRA to review a draft regulation is limited by Executive Order 12,866 to 90 days, with the possibility of a single 30-day extension. This would be in addition to however long it takes the DOL to submit the final rule to OIRA. The effective date for the amended regulations will most likely be sometime in 2016.

The DOL's proposed changes will likely trigger activity by private litigants and federal and state agencies challenging the exempt status of workers. Employers should review the classification of jobs and prepare to make changes to pay and timekeeping practices.

Please see our June 30, 2015 post on Proskauer's Law and the Workplace Blog for more information.

New DOL Guidance on Independent Contractors

On July 15, 2015, David Weil, Administrator of the DOL's Wage and Hour Division (**WHD**), released Administrator's Interpretation No. 2015-1, titled "The Application of the Fair Labor Standards Act's 'Suffer or Permit' Standard in the Identification of Employees Who Are Misclassified as Independent Contractors." The Administrator's Interpretation (**AI**) provides the DOL guidance for determining whether a worker is properly classified as an independent contractor under the FLSA, the primary federal law governing minimum wages and overtime pay, as well as other statutes like the Family and Medical Leave Act (**FMLA**) that adopt the FLSA's definition of "employee." This guidance represents a continuation of DOL's efforts to "crack down" on perceived misclassification of employees as independent contractors.

The new guidance does not purport to change DOL policy but rather "provides additional guidance regarding the application of the standards for determining who is an employee" under the FLSA, which "may be helpful to the regulated community in classifying workers and ultimately in curtailing misclassification." The AI's guidelines are considered an interpretive rule and so do not carry the force and effect of law. Courts as well as the DOL, however, will likely rely on the AI, at least in part, in making classification determinations.

The AI is an effort to tilt the FLSA's economic realities test further in favor of finding employee status. Indeed, the AI emphasizes how "broad" the definition of employee is under the FLSA, concluding that "*most workers are employees under the FLSA's broad definitions*." Its interpretation of the economic realities test clearly aims to make this observation a reality. In particular, the AI appears to emphasize the importance of the "integral to the business" prong of the test, suggesting that work that is integral to the putative employer's business can only be performed by employees. It also identifies as correct employee-friendly interpretations of the factors in the test, while criticizing those interpretations that make independent contractor findings less onerous.

Companies, including investment advisers, that utilize independent contractors should re-examine their independent contractor relationships in light of the AI to assess whether they are likely to withstand scrutiny under the DOL's new interpretation of the economic realities test. Of course, these guidelines only address independent contractor classification under the FLSA's test. Companies that utilize independent contractors need to be aware that different tests applicable under other statutes and regulations, both state and federal, remain in effect.

Please see our July 17, 2015 post on Proskauer's Law and the Workplace Blog for more information.

Classification of Unpaid Interns

On July 2, 2015, the United States Court of Appeals for the Second Circuit issued its decisions in *Glatt et al. v. Fox Searchlight Pictures, Inc. et al.*, 791 F.3d 376 (2d Cir. 2015) and *Wang et al. v. The Hearst Corp.*, No. 13-4480-cv., 2015 WL 4033091 (2d Cir. July 2, 2015), the two unpaid intern lawsuits heard in tandem by the court on January 30, 2015. The Second Circuit's opinion in *Glatt*, and summary order in *Wang*, adopted the employer-proposed "primary beneficiary" test to determine whether an unpaid intern should be considered an "employee" under the FLSA and the New York Labor Law (**NYLL**) and thus entitled to compensation.

The Second Circuit rejected the six-factor test promoted by the DOL and applied by the district court in *Glatt*, finding that it was "too rigid" and ill-suited to apply to the "particular facts [of] all workplaces." The "primary beneficiary" test examines "whether the intern or the employer is the primary beneficiary of the relationship." This test was preferred because "it focuses on what the intern receives in exchange for his work" and "accords courts the flexibility to examine the economic reality as it exists between the intern and the employer."

In applying the "primary beneficiary" test, the Second Circuit provided seven factors, none of which is dispositive, to aid lower courts in examining the lawfulness of an unpaid internship. These factors are not exhaustive, and a court may consider any other relevant factor. The determination requires "weighing and balancing all of the circumstances." The seven factors are as follows:

- The extent to which the intern and employer clearly understand that there is no expectation of compensation (any promise of compensation, express or implied, suggests that the intern is an employee, and vice versa);
- The extent to which the internship provides training that would be similar to that which would be given in an educational environment, including the clinical and other hands-on training provided by educational institutions;
- The extent to which the internship is tied to the intern's formal education program by integrated coursework or the receipt of academic credit;

- The extent to which the internship accommodates the intern's academic commitments by corresponding to the academic calendar;
- The extent to which the internship's duration is limited to the period in which the internship provides the intern with beneficial learning;
- The extent to which the intern's work complements, rather than displaces, the work of paid employees while providing significant educational benefits to the intern; and
- The extent to which the intern and the employer understand that the internship is conducted without entitlement to a paid job at the conclusion of the internship.

While the factors include several of the six factors previously urged by the DOL as relevant to the analysis, one previous requirement is excluded (that the "employer that provides the training derives no immediate advantage from the activities of the intern; and on occasion its operations may actually be impeded"). The exclusion of this factor was notable because it was the most difficult for any employer to satisfy in the context of an unpaid internship.

These decisions established new law in the realm of unpaid internships and provided explicit guidance to district courts in the Second Circuit as to how this test should be applied.

Please see our July 8, 2015 post on Proskauer's Law and the Workplace Blog for more information.

Trend of Laws Restricting Background Checks Continues

Although federal law permits employers to conduct conviction and credit history checks on applicants and employees so long as they follow the procedures set forth in the Fair Credit Reporting Act, states and municipalities continue to pass laws restricting these types of background checks. Ten states and a number of municipalities prohibit credit checks except in limited circumstances. Even more states and municipalities restrict conviction history screens or the extent to which convictions can be the basis for withdrawing an offer of employment or terminating employment. New York City recently passed two of the most restrictive laws in the country in this regard.

Stop Credit Discriminations in Employment Act. On September 3, 2015, the Stop Credit Discrimination in Employment Act (**SCDEA**) went into effect in New York City. The SCDEA prohibits most employers from inquiring into or considering a prospective or current employee's credit history when making employment decisions. The ban effectively eliminates the use of credit history for many employers in the City. The law expansively defines credit history to include not only a consumer credit report or credit score, but information directly obtained from the applicant or employee regarding his or her (i) prior bankruptcies, judgments or liens; or (ii) number of credit accounts, late or missed payments, charged-off debts, items in collections, credit limit or prior credit report inquiries.

The ban does contain exceptions, some of which include:

- Positions with (i) signatory authority over third party funds or assets valued at $10,000 or more; or (ii) authority to enter into financial agreements valued at $10,000 or more on behalf of the employer;
- Employers required to consider credit history for employment purposes under state or federal law or regulations or by a self-regulatory organization (as defined by the Exchange Act); and
- Positions requiring bonding under federal, state or city law (*e.g.*, certain positions in finance).

The New York City Commission on Human Rights (**NYCCHR**) has issued guidance on the SCDEA providing that the exemptions will be read narrowly and no exemption applies to an entire employer or industry. Also, when running a credit check, employers must inform the applicant or employee of the claimed exemption and keep an exemption log.

Finally, employers should be aware that NYCCHR will impose civil penalties of up to $125,000 for violations and up to $250,000 for violations resulting from willful, wanton or malicious conduct, with the amount of the penalty to be determined by considering the severity of the violation, the existence of subsequent violations, the employer's size (in terms of number of employees and revenue) and the employer's actual or constructive knowledge of the SCDEA. Such fines are in addition to the remedies available to people who resolve or prevail on a claim (such as back and front pay and compensatory and punitive damages).

Employers with operations in New York City or other jurisdictions with credit check restrictions should review their hiring portals and documents and update to conform to the requirements of these new laws.

Please see our May 7, 2015 and September 3, 2015 posts on Proskauer's Law and the Workplace Blog for more information.

Amendments to Human Rights Law. On June 29, 2015, New York City amended its Human Rights Law to further restrict employers from inquiring into or otherwise considering an applicant's or employee's criminal history in employment decisions. The new law forbids employers from stating in any job advertisement or other solicitation or publication that employment is subject to successful completion of a criminal record check. It further prohibits conduct of a criminal record check until after a conditional offer of employment has been made.

New York employers have long been required to engage in a multi-factor analysis under Article 23-A of the New York State Correction Law to determine whether a sufficient nexus exists between the offense and position sought. Now, under the new law, the employer also must follow the below steps before taking adverse action:

- Furnish a written copy of the criminal history inquiry to the applicant in a form determined by the NYCCHR;
- Provide a written Article 23-A analysis to the applicant in a form determined by the NYCCHR, together with "supporting documents" setting forth the basis and reasons for the adverse action; and
- After providing the applicant with the required documentation, allow him or her at least three business days to respond and, during that time, hold the position open for the applicant.

The law does not apply where the employer must take action pursuant to any federal, state or local law that requires criminal background checks for employment purposes or bars employment based on criminal history. For purposes of this exception, "federal law" includes the rules or regulations of a self-regulatory organization as defined by the Exchange Act (such as FINRA).

Please see our June 29, 2015 post on Proskauer's Law and the Workplace Blog for more information.

Social Media in Hiring

Twenty-three states have placed restrictions on employers' access to applicants' and employees' personal social media accounts.[9] Generally, such laws prohibit employers from requesting or requiring applicants and employees to:

- Provide any password or other related account information to gain or demand access to the applicant's or employee's personal account or profile on a social networking website;
- Divulge whether the applicant or employee has such an account;
- Add an employee, supervisor or administrator to the list of contacts associated with such an account; or
- Change privacy settings associated with such an account.

Notably, certain laws expressly restrict an employer's ability to encourage an employee to "friend" or add anyone to the list of contacts for his or her personal social media account. This may include the employer, its agents, supervisors or other employees. For example, the Colorado Social Media and the Workplace Law states that an employer shall not "compel an employee or applicant to add anyone, including the employer or his or her agent, to the employee's or applicant's list of contacts associated with a social media account." As these types of laws proliferate, employers should exercise caution when interacting with employees over social media.

Pregnancy Discrimination

On March 25, 2015, the Supreme Court issued its much-anticipated decision in *Young v. United Parcel Service, Inc.*, 135 S.Ct. 1338 (2015), which involved a claim of pregnancy discrimination under the Pregnancy Discrimination Act (**PDA**).

Young, a UPS driver, claimed that UPS intentionally discriminated against her by refusing to accommodate her pregnancy-related lifting restriction by transferring her to a light duty position. UPS countered that its refusal to accommodate was based on a legitimate, non-discriminatory business reason. Namely, its refusal was based on provisions of a collective bargaining agreement that provided light duty only to drivers who were injured on the job, who had lost their U.S. Department of Transportation certifications and who suffered from a disability covered by the U.S. Americans with Disabilities Act (**ADA**). UPS won dismissal of the claim on summary judgment, which the Fourth Circuit Court of Appeals affirmed.

In a 6-3 vote, the Supreme Court vacated summary judgment for UPS and remanded to the Fourth Circuit to reconsider whether summary judgment is appropriate under a new standard for liability under the PDA. The new standard announced by the Court is a twist on the three-stage burden shifting paradigm established in *McDonnell Douglas Corp. v. Green*, 411 U.S. 792 (1973), used to evaluate disparate treatment discrimination claims. Under the new standard, a plaintiff can show intentional discrimination by showing that a policy relied on as the non-discriminatory reason for the failure to accommodate a pregnancy-related disability imposes a "significant burden" on pregnant workers and that the reasons for the policy are not "sufficiently strong to justify the burden." According to the Court, evidence that an employer "accommodates a large percentage of non-pregnant workers while failing to accommodate a large percentage of pregnant workers" could be evidence of a 'significant burden.'"

---

[9] These states are: Arkansas, California, Colorado, Connecticut, Delaware, Illinois, Louisiana, Maine, Maryland, Michigan, Montana, Nevada, New Hampshire, New Jersey, New Mexico, Oklahoma, Oregon, Rhode Island, Tennessee, Utah, Virginia, Washington and Wisconsin.

Following the Supreme Court's decision in *Young*, on June 25, 2015, the EEOC announced an update to its Enforcement Guidance on Pregnancy Discrimination and Related Issues (**Enforcement Guidance**). The updated Enforcement Guidance echoes the Court's language, stating that "[e]mployer policies that do not facially discriminate on the basis of pregnancy may nonetheless violate [...] the PDA where they impose significant burdens on pregnant employees that cannot be supported by a sufficiently strong justification." It explains, by way of example, that if an employer provides light-duty work to a large percentage of non-pregnant employees but does not provide light-duty work to pregnant workers, this may "establish that the policy or practice significantly burdens pregnant employees." If the employer's reasons for its policy or practice do not justify this burden, it will give rise to an inference of discrimination. The Enforcement Guidance further explains that a plaintiff can establish a prima facie case of discrimination by showing that she is pregnant, that she requested an accommodation, that her request was denied and that her employer accommodated others who were "similar in their ability or inability to work."

Please see our March 27, 2015 and June 30, 2015 posts on Proskauer's Law and the Workplace Blog for more information on the *Young* decision and Enforcement Guidance.

Most recently, on October 21, 2015, New York State Governor Andrew Cuomo signed a group of eight bills, referred to as the Women's Equality Agenda, expanding protections for women in the workplace and elsewhere in New York State. The Protect Women from Pregnancy Discrimination bill specifically clarifies the New York State Human Rights Law to require employers to provide reasonable accommodations for pregnancy-related conditions, unless to do so would cause an undue hardship to the employer. "Pregnancy-related condition" is defined as a condition that still allows an employee to reasonably perform the activities required of the job when given a reasonable accommodation. Reasonable accommodations may include, among other things, job restructuring or modified work schedules. The amendment will come into effect on January 19, 2016.

Religious Accommodations

On June 1, 2015, the Supreme Court held in favor of the EEOC in *EEOC v. Abercrombie & Fitch Store Stores, Inc.*, 135 S.Ct. 2028 (2015), holding that Abercrombie violated Title VII of the U.S. Civil Rights Act (**Title VII**) by refusing to hire a Muslim applicant who wears a headscarf for religious reasons. The decision, penned by Justice Antonin Scalia, reversed a decision by the Court of Appeals for the Tenth Circuit that granted summary judgment to Abercrombie and remanded the case for further consideration in light of the Court's decision.

The plaintiff in this case, a practicing Muslim who wore a headscarf, applied for a job working in an Abercrombie retail store. Although otherwise qualified for the position, she was not hired because wearing a headscarf violated Abercrombie's dress policy. The plaintiff did not affirmatively request an accommodation that would permit her to wear the headscarf at work. It was undisputed that Abercrombie rejected the plaintiff for the position because she wore a headscarf, but the record also indicated that Abercrombie did not know for sure if the reason she wore it was for religious reasons or if she had to wear it at work. Abercrombie argued that it did not have actual knowledge of the plaintiff's need for an accommodation and therefore could not have intentionally discriminated or failed to accommodate the plaintiff. It was on this basis that the Tenth Circuit granted summary judgment for Abercrombie.

However, the Supreme Court held that an applicant "need only show that his need for [a religious] accommodation was a motivating factor in the employer's decision" and that Title VII does not impose a

burden on a plaintiff to demonstrate that a company had actual knowledge of the applicant's or employee's religion or need for an accommodation to show intentional discrimination on the basis of religion. The Court stated that "the rule for disparate-treatment claims based on a failure to accommodate a religious practice is straightforward: An employer may not make an applicant's religious practice, confirmed or otherwise, a factor in employment decisions." The Court noted that a request for accommodation may "make it easier to infer motive, but is not a necessary condition of liability."

In light of this decision, an employer who has any reason to suspect that accommodation may be necessary should consider engaging in an interactive process with the applicant.

Please see our June 1, 2015 post on Proskauer's Law and the Workplace Blog for more information.

Estate Planning Updates

The U.S. American Taxpayer Relief Act, which was signed into law in 2013, has made the following permanent: (i) the reunification of the estate and gift tax regimes; and (ii) the $5 million estate, gift and generation-skipping transfer (**GST**) tax exemptions, as increased for inflation. Below are the tax exemption inflation increases for 2016:

- There will be a $5,450,000 federal estate tax exemption (increased from $5,430,000 in 2015) and a 40% top federal estate tax rate.
- There will be a $5,450,000 GST tax exemption (increased from $5,430,000 in 2015) and a 40% top federal GST tax rate.
- The lifetime gift tax exemption will be $5,450,000 (increased from $5,430,000 in 2015) and a 40% top federal gift tax rate.
- The annual gift tax exclusion will be $14,000 (no increase from 2015).

These increased exemptions create opportunities to make larger lifetime gifts, leverage more assets through a variety of estate planning techniques (such as a sale to a grantor trust) and shift income producing assets to individuals such as children or grandchildren, who may be in lower income tax brackets and/or reside in states with a low income tax rate or no state income tax.

Gift Tax Annual Exclusion

In 2016, the gift tax annual exclusion amount per donee will remain $14,000 for gifts made by an individual and $28,000 for gifts made by a married couple who agree to "split" their gifts. To take advantage of any remaining 2015 gift tax exclusion amount, gifts must be "completed" before December 31, 2015.

In lieu of cash gifts, donors may also consider gifting securities or interests in privately-held companies or other family-owned entities. The assets that are given away now may be worth significantly less than they once were, and their value hopefully will increase in the future. Thus, the $28,000 gift that a married couple makes today may have a built-in discount that the IRS cannot reasonably question. That discount will inure to the benefit of beneficiaries if the value of those assets rises.

Annual exclusion gifts may be made directly to beneficiaries or to trusts that are established for their benefit. It is important to note, however, that gifts to trusts will not qualify for the gift tax annual exclusion unless the beneficiaries have certain limited rights to the gifted assets (commonly known as "Crummey"

withdrawal powers). If a trust has been created that contains beneficiary withdrawal powers, it is essential that the trustees send Crummey letters to the beneficiaries whenever a trust contribution is made.

If an insurance trust has been created, it is important to remember that any amounts contributed to the trust to pay insurance premiums are considered additions to the trust. As a result, the trustees should send Crummey letters to the beneficiaries to notify them of their withdrawal rights over these contributions. Without these letters, transfers to the trust will not qualify for the gift tax annual exclusion.

2015 Gift Tax Returns

Gift tax returns for gifts that are made in 2015 are due on April 15, 2016. However, the due date can be extended to October 15, 2016 if a timely filed request is made for an automatic extension of time to file the 2015 income tax return (the deadline for filing a gift tax return will also be extended).

For trusts created in 2015, accountants should be directed to elect to have the GST tax exemption either allocated or not allocated, as the case may be, to contributions to that trust. It is critical that this step not be overlooked, which must be taken even if gifts do not exceed the annual gift tax exclusion and would, therefore, not otherwise require the filing of a gift tax return.

IRA Required Minimum Distributions Deadline

Owners of traditional IRAs must begin to receive required minimum distributions (**RMDs**) from their IRAs and, subject to narrow exceptions, other retirement plans, by April 1 of the year after the age of 70.5. These distributions must be received by December 31 of each year. Current beneficiaries of inherited IRAs must take RMDs by December 31 of each year regardless of their age. The RMDs must be separately calculated for each retirement account that is owned, and the owner of the IRA, not the financial institution at which the IRA account is held, is ultimately responsible for making the correct calculations. The penalty for not withdrawing RMD by December 31 of each year is an additional 50% tax on the amount that should have been withdrawn.

New York Raises Basic Exclusion Amount

On April 1, 2016, the amount of property that can pass free of New York State estate tax is set to rise to $4.1875 million. Approximately two years ago, the New York State legislature passed, and New York Governor Andrew M. Cuomo signed, the Executive Budget for 2014-2015, which significantly altered New York’s estate tax. The changes to the New York estate tax were made for the ostensible purpose of preventing the exodus of wealth individuals from New York to more tax-favored jurisdictions, but the law will likely not have the desired effect.

The law increases the New York basic exclusion amount, which was previously $1 million per person. As shown below, this increase will be made gradually through January 1, 2019, after which the New York basic exclusion amount will be equal to the federal exemption amount.

Time Period	New York Basic Exclusion Amount from Estate Tax
April 1, 2015 to April 1, 2016	$3,125,000
April 1, 2016 to April 1, 2017	$4,187,500

Time Period	New York Basic Exclusion Amount from Estate Tax
April 1, 2017 to January 1, 2019	$5,250,000
After January 1, 2019	Same as federal exemption amount ($5,450,000 as of January 1, 2016 but increases each year for inflation)

One of the most significant provisions in the law, however, is that no New York basic exclusion amount will be available for estates valued at more than 105% of the New York basic exclusion amount. In other words, New York estate tax will be imposed on the entire estate if the estate exceeds the exemption amount. Due to adjustments to the bracket structure in the new law, those estates that are valued at more than 105% of the New York basic exclusion amount will pay the same tax as they would have under the prior law.

For example, assume that a person dies on February 1, 2016, with an estate valued at $3.3 million. The New York basic exclusion amount will be $3,125,000. Because the value of the estate exceeds 105% of the then available New York basic exclusion amount ($3,125,000 x 105% = $3,281,250), the estate will be subject to New York estate tax on the entire $3.3 million. The New York State estate tax bill will be $210,000, which is the same as the amount that would have been due under the old law. In contrast, if the person had died with an estate valued at $3.1 million, her estate would owe no New York estate tax under the new law because the New York basic exclusion amount will be applied to her estate. Under the old law, however, the decedent's estate would still have owed $190,800 in New York estate tax.

A significant change in New York law involves certain gifts made during a decedent's lifetime. New York has no gift tax. Under prior law, lifetime gifts were not subject to gift tax or included in the New York gross estate. Under the new law, gifts made within three years of a decedent's death will be added back, increasing the New York gross estate, and thus potentially being subject to New York estate tax at a maximum rate of 16%. However, the add back does not include gifts made before April 1, 2014, on or after January 1, 2019, or gifts made during a time when the decedent was not a resident of New York State.

These changes in New York law present further estate planning opportunities using bypass trusts to set aside New York's basic exclusion amount ($4,187,500 after April 1, 2016 for New York State estate tax purposes). The proper disposition of the basic exclusion amount is the cornerstone of estate planning for married couples. Significant tax savings can be achieved if the basic exclusion amount is set aside at the death of the first spouse, therefore "bypassing" estate taxation at the death to the surviving spouse. In addition, any growth that occurs in the trust also escapes estate taxation at the death of the surviving spouse. As New York's basic exclusion amount rises, the potential tax benefits from employing bypass trusts increase as well.

Reorganization and Chapter 11 Developments

Recent Litigation Involving Section 316(b) of the Trust Indenture Act

The U.S. District Court of the Southern District of New York's recent decisions in *Marblegate Asset Management LLC v. Education Management Corp.*, 2015 WL 3867643 (S.D.N.Y. June 23, 2015) and

MeehanCombs Global Credit Opportunities Funds, LP v. Caesars Entertainment Corp., 2015 WL 221055 (S.D.N.Y. Jan. 15, 2015) are of particular significance to private funds and anyone that holds debt governed by the Trust Indenture Act (**TIA**), as they impact the ability of issuers to restructure their debt obligations on an out-of-court basis without gaining the unanimous consent of the holders of affected debt securities.

The issue concerns whether Section 316(b) of the TIA protects only the *legal* right of a note holder to receive payment of principal and interest or whether it also protects the *practical* ability to receive payment. Specifically, Section 316(b) states, "*the right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security*, on or after the respective due dates expressed in such indenture security, or to institute suit for the enforcement of any such payment on or after such respective dates, *shall not be impaired or affected without the consent of such holder*[.]" As the court in *Marblegate* succinctly stated, "the text poses two questions: what does the 'right [...] to receive payment' consist of, and when is it 'impaired or affected' without consent? Read narrowly, Section 316(b) protects bondholders only against involuntary modification of the payment terms or their right to sue for payment; read broadly, it protects bondholders against being forced to accept a lesser payment than they bargained for, absent a restructuring in bankruptcy."

MeehanCombs and Marblegate Adopt the Broader Interpretation. In *MeehanCombs*, Caesars Entertainment Operating Company (**CEOC**), a wholly-owned subsidiary of Caesars Entertainment Corporation (**CEC**), issued two series of notes: the 2016 notes for $730 million and the 2017 notes for $750 million. Both sets of notes were guaranteed by CEC and the indentures governing the notes contained prohibitions against CEOC divesting its assets. The indentures governing the notes also provided that CEC's guarantee terminated if CEOC ceases to be a wholly-owned subsidiary of CEC. In 2014, CEC sold 5% of its interest to a third party automatically releasing the guarantee. Under the proposed transaction, 51% of the holders of the 2016 notes would vote to release the guarantee in exchange for payment of par plus accrued interest. In 2008, "CEOC and CEC executed a series of transactions aimed at transferring assets away from CEOC to its affiliates," and "[t]he amendments left CEC free to transfer CEOC's assets without any obligation to back CEOC's debts." In exchange for receiving all amounts due under the notes, the consenting holders promised to, among other things, support any future restructuring proposed by CEOC, and consent to the termination of the CEC guarantee.

In ruling on motions to dismiss, the court adopted the reasoning from a prior decision from the same district and opined that stripping the guarantee by CEC of the notes, thereby leaving the holders with an "empty right to assert a payment default from an insolvent issuer," was sufficient to state a claim under Section 316(b). In *Federated Strategic Income Fund v. Mechala Grp. Jam. Ltd.*, 99-10517, 1999 WL 993648 (S.D.N.Y. Nov. 2, 1999), the court wrote:

> By defendant's elimination of the guarantors and the simultaneous disposition of all meaningful assets, defendant will effectively eliminate plaintiffs' ability to recover and will remove a holder's "safety net" of a guarantor, which was obviously an investment consideration from the outset. Taken together, these proposed amendments could materially impair or affect a holder's right to sue. A holder who chooses to sue for payment at the date of maturity will no longer, as a practical matter, be able to seek recourse from either the assetless defendant or from the discharged guarantors.

The *MeehanCombs* court stated that the proposed restructuring was exactly what the statue was designed to prevent.

In *Marblegate,* Education Management Corporation (**EDMC**) was a for-profit education company with secured debt of $1.305 billion (revolver and term loans) and a guarantee obligation with respect to $217 million of unsecured bonds issued by its subsidiary Education Management LLC. EDMC could not seek protection under the bankruptcy code because it would be rendered ineligible to receive federal funds through Title IV of the Higher Education Act. Instead, EDMC sought to achieve an out-of-court restructuring of its debt obligations by: (i) converting the secured debt into new debt and equity in EDMC (resulting in a 55% recovery); and (ii) converting the unsecured notes into equity of EDMC (resulting in a 33% recovery). While EDMC already had the support of 99% of the secured debt and 90% of the unsecured notes, it hoped to achieve unanimous consent by offering the holdouts an alternative: if 100% of the holders of the unsecured notes did not consent, the secured lenders would (i) cause the release of EDMC's guarantee of the notes; (ii) foreclose on "substantially all the assets" of EDMC and its subsidiaries; and (iii) immediately sell these assets back to a new subsidiary of EDMC. This new subsidiary would then distribute debt and equity to the creditors who had consented to the prior restructuring proposal. Under this alternative treatment, non-consenting lenders would continue to have claims against the issuers and any subsidiary that had guaranteed the notes. However, with substantially all of EDMC's assets transferred to the new subsidiary, no assets would be available at EDMC to satisfy the claims of the note holders and note holders would receive no payment on account of the notes.

After reviewing the legislative history of Section 316(b) and its intent, the court concluded that Section 316(b) is violated where a proposed restructuring does not modify any terms of an indenture explicitly governing the right to receive payment of principal and interest on a certain date but leaves bondholders with no choice but to accept a modification of the terms of their bonds. In so ruling, the court agreed with the prior decisions of the district court in *MeehanCombs* and *Federated Strategic Income Fund v. Mechala Grp. Jam. Ltd.*, 99-10517, 1999 WL 993648 (S.D.N.Y. Nov. 2, 1999). Such a "Hobson's choice," the court wrote, was precisely the type of debt restructuring that the statue was designed to forbid by majority consent.

Other Courts Have Adopted a Narrow Interpretation of Section 316(b). The opinions in *Marblegate* and *MeehanCombs* are in contrast to decisions outside the Southern District of New York which have adopted a more narrow view. *See Brady v. UBS Financial Servs., Inc.,* 538 F.3d 1319 (10th Cir. 2008)*; YRC Worldwide Inc. v. Deutsche Bank Trust Co.*, No. 10 Civ. 2106, 2010 WL 2680336 (D. Kan. July 1, 2010); *In re Northwestern Corp.*, 313 B.R. 595 (Bankr. D. Del. 2004). These courts have interpreted Section 316(b), not as a guarantee against an issuer's default but, only as a prohibition against a majority vote to change the legal right to receive payment when due. These cases have reasoned that Section 316(b) "applies to the holder's legal rights and not the holder's practical rights to the principal and interest itself. Plaintiffs' legal rights were not impaired. Again, there is no guarantee against default." In *YRC Worldwide Inc.*, the court did not find that non-consenting holders were denied the practical ability to receive payments due under the notes when the issuer deleted from the indenture (by majority consent) a provision that barred issuer from merging or transferring substantially all of its assets unless the surviving entity assumed the issuer's obligations under the notes and, therefore, such amendment was not a violation of Section 316(b).

The Importance of Section 316(b). If an amendment to the applicable indenture cannot be achieved out-of-court (by unanimous or majority consent) the issuer's only alternative is to file for Chapter 11. The Bankruptcy Code binds holdouts so long as 1/2 in number and 2/3 in amount actually voting support the restructuring. This can be a useful tool in the right circumstances. But where the holdouts are a tiny percentage of the overall holders, using Chapter 11 may be a canon where a fly swatter would do the job. It is always preferable from an economic perspective to reach consensus and avoid a Chapter 11 filing.

Commentators have suggested that the decisions in *Marblegate* and *MeehanCombs* will result in more issuers filing for Chapter 11 in order to restructure their debt obligations because unanimous consent is an extremely high hurdle to overcome. However, Judge Michael E. Wiles of the U.S. Bankruptcy Court for the Southern District of New York stated at a recent conference that these commentators are "overreacting" and the decisions in *Marblegate* and *MeehanCombs* are not necessarily "the 'death knell' to the way restructurings have been done in the past."

Both *Marblegate* and *MeehanCombs* are on appeal to the Second Circuit. The Second Circuit will be the next to decide whether the purpose of Section 316(b) is served by prohibiting modification of the legal right to payment of principal and interest or the practical right to do so. In particular, the Second Circuit will address the "prior practice whereby majority bondholders—often controlled by insiders—used collective or majority action clauses to change the terms of an indenture, to the detriment of minority bondholders." Private funds that own debt governed by the TIA need to pay close attention to the decisions that continue to interpret Section 316(b). These decisions will have a significant impact, one way or another, on the ability of issuers to bind holdouts and consummate out-of-court restructurings. These rulings are especially important to understanding the litigation risk when attempting to impose an out-of-court restructuring on holdouts.

European Union Regulatory Updates

AIFMD

The Alternative Investment Fund Managers Directive (**AIFMD**) reached the first anniversary of its full implementation in July 2015. This has meant that discernible market practices have begun to develop. In addition, AIFMD is moving into new phases of its application outside of the European Economic Area (**EEA**) to non-EEA alternative investment managers (**AIFMs**).

Proposed Extension of Passports to Non-EEA AIFMs. On July 30, 2015, the European Securities and Markets Agency (**ESMA**) published its advice on extending the AIFMD's application, stating that the AIFMD marketing passport, which allows authorized AIFMs to market their funds to professional investors across the EEA, can be extended to managers in Jersey, Guernsey and Switzerland. There is no timeframe proposed for when the passport should be extended for these three jurisdictions, and it remains to be seen if the European Commission decides to delay bringing forward any legislation until ESMA advises that the extension can be applied to a larger number of non-EEA countries. Significantly, ESMA also advised that it will need more time to assess the United States, Hong Kong and Singapore before it can reach a decision on whether the passport can be extended to these jurisdictions.

For the majority of non-EEA AIFMs seeking to market funds in Europe, ESMA's advice means that there is no change to the status quo and that they will need to continue to comply with each EEA country's respective marketing requirements under national private placement regimes (**NPPRs**) for the foreseeable future.

The extension of the passport to non-EEA AIFMs will also set in motion a process whereby the NPPRs may be "switched" off in 2018. If NPPRs are switched off, non-EEA AIFMs will be left with the option of marketing their alternative investment funds (**AIFs**) into the EEA under a marketing passport.

Trends and Market Practices. A non-EEA AIFM currently wishing to raise funds in the EEA faces the daunting prospect of dealing with the specific marketing rules of each EEA country. A non-EEA AIFM of a non-EEA fund may potentially trigger the need to comply with the AIFMD if it markets the fund in an EEA

country. It is important to note that some countries have either not yet implemented AIFMD, have not made a NPPR available to non-EEA AIFMs or have placed conditions on marketing that have the effect of shutting down marketing by non-EEA AIFMs. As noted above, at this stage, the prospect of passports being extended to non-EEA AIFMs is limited. The sanctions for breaching marketing laws vary from country to country, but they can include criminal sanctions, fines and investor rescission rights.

Non-EEA AIFMs have reacted to AIFMD in a variety of ways. At the ends of the spectrum, some managers have chosen to avoid marketing into the EEA altogether, while others have established an AIFM in the EEA that manages and markets an EEA AIF. These approaches are driven by the importance of the European market to the management business. In the case of those managers that are avoiding marketing into the EEA, either the expense of compliance with AIFMD or the risks associated with reverse solicitation are viewed as not worth assuming. In the case of those non-EEA AIFMs that choose to establish a separate AIFM in the EEA to manage and market an EEA AIF, the cost of compliance is warranted when balanced against the number of products it markets in the EEA, the size of the potential EEA investor base, the efficiency created by being able to manage and market an AIF under a passport and the existing resources in the EEA that may readily be built out into an AIFM platform. This second approach is relatively rare and reserved to large managers with a large EEA investor base and frequent fund raising cycles.

The vast majority of the market lies between these two ends of the spectrum and may rely on reverse solicitation, the NPPR of the relevant EEA country or a strategic approach as described in more detail below.

- **What is marketing under AIFMD?** The issue of what constitutes marketing under AIFMD is paramount to non-EEA AIFMs, as marketing in the EEA is what triggers the need to comply with AIFMD. In essence, "marketing" under AIFMD is the offering or placement, at the initiative of the AIFM or on its behalf, of an interest in an AIF managed by the AIFM. Of interest is the interpretation of this definition in various EEA countries. Some countries, such as the United Kingdom, do not regard marketing under AIFMD to have taken place until fund documentation in substantially final form has been issued to investors. This means that an AIFM may engage in a wide range of marketing activities in relation to an AIF without triggering the need to comply with AIFMD. In contrast, some countries, such as France, have a lower threshold, and any marketing of an AIF is likely to trigger the need to comply with AIFMD.

  As referred to below under "Strategic Approach," the manner in which an EEA country defines "marketing" may afford an AIFM some latitude in positioning itself to gauge investor appetite before deciding to market the AIF in a way that triggers AIFMD compliance.

- **Who is the investor under AIFMD?** The trigger for AIFMD compliance by a non-EEA AIFM is the "marketing" of an AIF to an investor domiciled or with a registered office in the EEA. In practice, however, "investors" often will invest through complex structures and rely on third party advisers to which the marketing actually is targeted. Thus, it can be difficult to identify who may be the investor for the purposes of AIFMD. The U.K. Financial Conduct Authority (**FCA**) has issued guidance in the United Kingdom that makes it possible to regard the investor as the person who decides to invest in an AIF. On that basis, an investor who decides to invest in an AIF and actually subscribes to the AIF on its own behalf would be regarded as the investor. Where a custodian or a nominee is subscribing to an AIF on behalf of another party and such other party is one that made the investment decision, the custodian or nominee would be disregarded and the underlying decision maker would be regarded as

the investor. Discretionary managers that decide to invest on behalf of a client without reference to that client would be regarded as the investor, even if the discretionary manager has arranged for the client to subscribe to the AIF. Applying this guidance, it is possible that if, for example, marketing of an AIF by a non-EEA AIFM were targeted at a Middle Eastern sovereign wealth fund, and the sovereign wealth fund decides to subscribe through a UK entity without reference to that UK entity, the sovereign wealth fund would be regarded as the investor.

While this guidance applies in the UK, some AIFMs in other EEA countries have also followed this guidance in practice.

- **Reverse Solicitation**. Reverse solicitation is not defined in AIFMD but is widely regarded as an offering or placement that is at the investor's initiative, rather than that of the AIFM or its agent. For this reason, reverse solicitation is viewed as not being marketing under AIFMD and therefore the related placement or offering by a non-EEA AIFM should not trigger AIFMD compliance. The availability of reverse solicitation and what constitutes a valid reverse solicitation must be determined with reference to the EEA country in which the investor is domiciled or in which it has a registered office. There has been little guidance from EEA regulators on what constitutes a valid reverse solicitation. For example, cap-intro appears to be a gray area that may or may not preclude reverse solicitation depending on the precise facts and EEA countries involved.

  An approach that we have seen is the practice of engaging prospective investors in general advertising that does not involve promotion of a specific AIF and that may lead to an expression of interest by the prospective investor in investing in an AIF, which may then be characterized as a reverse solicitation. Again, this is a gray area, and while it is a feasible approach in some countries, it may not be effective in others. Some countries, such as Austria and France, appear to have strict rules that must be followed and this approach may not work there.

  Other practical difficulties associated with reverse solicitation are that it is generally viewed that a valid reverse solicitation must occur in relation to a particular AIF and that it is prudent for the reverse solicitation to be confirmed in writing. Nevertheless, it is relatively common for investors to issue blanket solicitations of a manager's present and future products and for AIFMs to rely on these solicitations.

- **NPPRs**. NPPRs provide a means for non-EEA managers to access investors in EEA countries. Where NPPRs may be utilized, they generally operate on two levels. First, some form of approval must be obtained or notification must be given to the national regulator of the country in which the AIF is marketed before marketing can take place. Second, with respect to each country into which the AIF is marketed, the core requirements of AIFMD under Article 42 (*e.g.*, pre-investment and ongoing investor disclosure, annual reporting, regulatory reporting and portfolio company requirements) must be met. A third level exists in some countries, which imposes requirements in addition to those under Article 42. An example of this is the requirement in Denmark and Germany to appoint a depositary to the AIF being marketed.

- **Strategic Approach**. This approach involves a country-by-country assessment of the risks, efficiencies and costs against the potential capital sources in the relevant countries and then deploying one or a combination of the approaches outlined above, depending on the assessment made. For example:

  - In Country A, which has a complicated approval process, a lengthy approval waiting period and a requirement to appoint a depositary, the AIFM has a single potential investor that has

reverse-solicited the offering of the AIF. In this situation, the AIFM might take the view that it will rely on reverse solicitation for the single investor rather than marketing under Country A's NPPR.

- In Country B, which has a simple notification procedure with no waiting period and no additional requirements to the core AIFMD requirements, there are fifteen prospective investors, none of which have reverse-solicited the offering of the AIF and which represent a significant potential source of capital. In this situation, the AIFM might take the view that it will comply with the NPPR of Country B.
- In Country C, which allows initial meetings to be held with investors to determine investor appetite but which has an approval process before marketing may commence, a waiting period and a requirement to appoint a depositary, there are three moderate prospective investors. In this case, the AIFM might meet the investors to establish investor interest without triggering AIFMD compliance and, if sufficient interest is demonstrated, make an assessment of whether to proceed further with the investors and comply with Country C's NPPR.

With so many aspects of AIFMD open to interpretation, it is important that AIFMs keep abreast not only of any guidance that is issued by regulators but also market practices that develop in order successfully to market a fund and to navigate AIFMD.

MiFID II and MiFIR

The text of Markets in Financial Instruments Directive (2014/65/EU) (**MiFID II**) and the Markets in Financial Instruments Regulation (Regulation 600/2014) (**MiFIR**) were published in the Official Journal of the EU on June 12, 2014, and came into effect on July 2, 2014. With certain exceptions, member states must adopt and publish measures transposing the MiFID II into national law by July 3, 2016, and must apply those provisions by January 3, 2017. Work is also progressing in formulating Level 2 measures under MiFID II. ESMA has published technical advice to the European Commission and a number of consultation papers on regulatory technical standards (**RTS**) and implementing technical standards (**ITS**) under MiFID II.

A large number of elements of the MiFID II and MiFIR will need to be further specified in delegated acts to be adopted by the European Commission. In most cases, these delegated acts should enter into application in December 2016. The European Commission has requested both ESMA and the European Banking Authority for technical advice to assist it in formulating these delegated acts. ESMA is also required to submit to the European Commission a large number of draft ITS and RTS for approval.

In May 2015, ESMA and the European Commission reached preliminary agreement that the European Commission would conduct an early legal review of the draft technical standards produced by ESMA under a number of regulations and directives, including the MIFID II and MiFIR. However, in a letter to the European Commission, ESMA indicated that there would be a possible delay in the submission of certain final draft technical standards under MiFID II (among other initiatives) until September 2015. ESMA has subsequently delayed the publication timeline to the end of 2015.

There have been a number of ESMA consultations on remaining MiFID II draft ITS over the past year. The main consultations are set out below:

- In December 2014, ESMA published final technical advice (ESMA/2014/1569) to the European Commission and a consultation paper (ESMA/2014/1570) on MiFID II and MiFIR. The consultation paper includes certain draft RTS and ITS under the MiFID II and MiFIR. The technical advice and

consultation paper deal primarily with the regulation of secondary markets and investor protection. In March 2015, ESMA published the responses it received on the consultation paper.

ESMA subsequently published an addendum consultation paper (ESMA/2015/319) in February 2015 on RTS relating to transparency requirements for non-equity financial instruments under MiFIR. This consultation paper covers the assessment of liquidity and the specification of thresholds for pre-trade and post-trade transparency purposes for foreign exchange derivatives, credit derivatives and other derivatives and contracts for difference. The last section of the consultation paper completes draft RTS 9 (transparency requirements in respect of bonds, structured finance products, emission allowances and derivatives), which was published in ESMA's December 2014 consultation paper. ESMA published the responses it received on the addendum consultation paper in March 2015.

A final report (ESMA/2015/1464) on the RTS and ITS that ESMA had consulted on in a May 2014 discussion paper and the December 2014 and February 2015 consultation papers described above was published in September 2015. The final report outlines 28 draft technical standards. The report also describes the feedback ESMA received from its consultations and the rationale behind its final proposals.

- In March 2015, ESMA consulted on draft guidelines on complex debt instruments and structured deposits. Article 25(10) of the MiFID II requires ESMA to develop, by January 3, 2016, guidelines for the assessment of (i) bonds, other forms of securitized debt, and money market instruments incorporating a structure that makes it difficult for the client to understand the risk involved; and (ii) structured deposits incorporating a structure that makes it difficult for the client to understand the risk of return or the cost of exiting the product before term. The consultation paper (ESMA/2015/610) sets out draft guidelines on related issues that are important for the correct classification of debt instruments (bonds, securitized debt and money market instruments) as either "complex" or "non-complex," specifically the concept of an embedded derivative for debt instruments. ESMA has published the responses it received on the consultation.
- In April 2015, ESMA published a consultation paper (ESMA/2015/753) on draft guidelines for the assessment of knowledge and competence in respect of Articles 24 and 25 of MiFID II. Article 25(9) of the MiFID II requires ESMA to develop guidelines specifying criteria for the assessment of knowledge and competence of natural persons in investment firms providing investment advice or information on financial instruments, investment services or ancillary services to clients, on behalf of the investment firms, to fulfil those firms' obligations under Article 24 and Article 25 of MiFID II. ESMA considers that compliance with the knowledge and competence requirements under MiFID II requires individuals to acquire an "appropriate qualification" and gain "appropriate experience" to provide investment advice or information to clients. The draft guidelines set out the areas of knowledge and experience against which individuals should be assessed for these purposes. ESMA expects to publish a final version of the guidelines in the fourth quarter of 2015.
- In June 2015, ESMA published its final report (ESMA/2015/1006) on draft ITS and RTS relating to the authorization, passporting and registration of third country firms and the cooperation between competent authorities under MiFID II.
- In August 2015, ESMA published a consultation paper (ESMA/2015/1301) on the remaining draft ITS under MiFID II. The consultation paper covers:

- Suspension and removal of financial instruments from trading on a trading venue (this includes the timing and format of publications and communications foreseen by MiFID II in case a suspension or removal of an instrument occurs);
- Notification and provision of information for data reporting services providers (**DRSPs**) (this looks at both the application for authorization by DRSP applicants, as well as the notification of members of the management body of a DRSP and of any changes to its membership); and
- Weekly aggregated position reports for commodity derivatives, emission allowances and derivatives thereof (this is intended to deliver transparency and support monitoring of the new position limits regime).

  ESMA intends to send the final report to the European Commission for endorsement by January 3, 2016. The final report covers the majority of the draft ITS and RTS on investor protection topics that ESMA is expected to develop.

In the United Kingdom, the HM Treasury published a consultation paper in March 2015 on transposing MiFID II into national law, while the FCA has issued a discussion paper seeking views on a range of implementation issues, mainly focusing on retail conduct of business rules in the MiFID II.

Market Abuse Directive II

The Market Abuse Directive II (**MAD II**) was published in the Official Journal of the European Union on June 12, 2014. It came into force on July 2, 2014. While certain provisions set out in Article 39(2) of MAD II have applied as of July 2, 2014, most of the provisions under MAD II will apply as of July 3, 2016. In addition, to the extent provisions in MAD II refer to "organised trading facilities" (**OTFs**) (such as swap execution facilities or broker crossing systems), small and medium-sized enterprises growth markets, emission allowances or auctioned products based on emission allowances, those provisions will not apply to any of these items until January 3, 2017, the same date on which the MiFID II and the MiFIR will begin to apply.

Also on June 12, 2014, the Directive for Criminal Sanctions for Market Abuse (Market Abuse Directive) (**CSMAD**) was published in the Official Journal. CSMAD came into force on July 2, 2014, and EU member states, with the exception of the United Kingdom and Denmark (both of which have opted out), must transpose its provisions into national law by July 3, 2016.

The principal aim of MAD II and CSMAD is to enhance market integrity and investor protection. The new market abuse regime will, among other things, incorporate the following changes and enhancements to the existing regime:

- New minimum rules on criminal offences and criminal sanctions for serious market abuse cases;
- An extended scope covering new markets (such as OTFs), additional financial instruments (such as emission allowances and related auctioned products) and trading strategies (such as algorithmic trading and high frequency trading);
- An expanded definition of "inside information" and an extension in the application of the market manipulation offence, including to cover attempted market manipulation;
- Improved cooperation arrangements between law enforcement and judicial authorities across the EU; and

- Enhanced investigative and administrative sanctioning powers for regulatory authorities.

MAD II requires the European Commission and ESMA to develop (and, in the European Commission's case, adopt) delegated acts, binding technical standards (both RTS and ITS) and guidelines in key areas. On September 28, 2015, ESMA published a final report containing draft RTS and ITS on the Market Abuse Regulation (Regulation 596/2014) (ESMA/2015/1455). The final report included draft requirements on market participants conducting market soundings, requirements to report suspicious orders and transactions, rules for public disclosure of insider information and the delay of such publication, specific arrangements on how to present investment recommendations and specific formats for establishing insider lists and the notification and disclosure of managers' transactions. ESMA has sent the final report to the European Commission, which has three months to decide whether to endorse the draft RTS and ITS. Following endorsement by the European Commission, the Council of the EU and the European Parliament will have a period in which they can raise any objections.

Fourth Money Laundering Directive

On June 25, 2015, the Fourth Money Laundering Directive (**MLD4**) came into effect and replaced the Third Money Laundering Directive (**MLD3**), the existing EU AML and counter-terrorist financing (**CTF**) regime. MLD4 is required to be transposed by EU member states by June 26, 2017.

MLD4 seeks to protect the financial system through the prevention, detection and investigation of money laundering and terrorist financing. It is also aimed at ensuring that the EU framework is aligned with the Financial Action Task Force's (**FATF**) February 2012 AML and CTF recommendations (the recognized international standards). In particular, MLD4 enhances the risk-based approach to AML and CTF and increases focus on the effectiveness of AML and CTF systems. In some cases, MLD4 goes beyond the FATF's recommendations (including in relation to scope, beneficial ownership information and sanctions). MLD4 applies to a range of businesses, from banks and other financial institutions to auditors and accountants. It will also apply to any other kinds of businesses involved in making or receiving cash payments for goods worth at least €10,000 (approximately $11,000), regardless of whether payment is made in a single transaction or via a series of linked transactions.

While MLD4 sets a high level of common standards, like MLD3, it is a minimum harmonizing directive. This means that EU member states may go further than the minimum provisions in MLD4 if they choose to do so. In the explanatory memorandum to MLD4, the European Commission explained that MLD4 is deliberately less detailed so as to allow member states, national regulators and firms to target their resources more effectively and apply preventative measures suited to the risks of particular sectors or activities.

Below is a summary of the main changes introduced by MLD4:

- Under the new regime, the most severe financial penalties that could be levied for non-compliance will be fines of up to at least €5 million (approximately $5.4 million) or 10% of a business' annual turnover.
- The new regime will bring into force new customer due diligence checking requirements, together with new obligations to report suspicious transactions and maintain records of payments. Businesses subject to the rules will also have to install internal controls to combat money laundering and terrorist financing activities under the framework.

- EU member states must set up registers to record the ultimate beneficial owners of businesses. The registers will be accessible to authorities within each country, "obliged entities" (such as banks doing due diligence into customers) and others who can demonstrate a "legitimate interest" in gaining access to the information.

On October 21, 2015, the joint committee of the three European Supervisory Authorities launched a public consultation on two AML and CTF guidelines based on the mandates contained in MLD4. The consultations are expected to end on January 22, 2016. A public hearing on the draft guidelines will be held in London on December 15, 2015.

Bank of England Letter

On August 11, 2015, the Governor of the Bank of England, Mark Carney, in his capacity as the Chairman of the Financial Policy Committee, wrote to the Chancellor of the Exchequer, George Osborne announcing his intention to launch a review of the non-bank financial system, including hedge fund investment advisers.

In his letter, Mr. Carney wrote that he was increasingly happy that banks were now a relatively stable part of the financial system and did not pose the risks to the wider economy that had caused damage in the global financial crisis. Instead, Mr. Carney is looking at other parts of the financial system that are less heavily regulated, to see if risky activity has migrated from banks to hedge funds. In particular, Mr. Carney wrote: "The [Financial Policy] Committee will review a number of activities in the non-bank financial system over the next year, to consider potential systemic risks posed by: the investment activities of open-ended investment funds and hedge funds; securities financing transactions; the non-traditional, non-insurance and investment activities of insurance companies; and derivative transactions [...] These reviews will complement the Committee's annual stocktake of risks outside the core banking system. If the Committee identifies risks or structural vulnerabilities that cannot be addressed under the current regulatory framework, it will consider making recommendations to HM Treasury relating to the boundaries between and within regulated activities and products."

In conjunction with this review, the Bank of England held an open forum in November 2015 that brought together all stakeholders in fixed income, currency and commodities markets including policymakers, financial market participants and users, academics, media representatives and wider society. The forum focused on the prospects for market functioning, where regulations might overlap or conflict and whether enough has been done to build successful markets.

U.K. Disguised Investment Management Fee Rules

With effect from April 6, 2015, new rules have come into force in the United Kingdom, which will re-characterize certain amounts or value arising to investment professionals resident or working in the United Kingdom as U.K.-source trading income. Such re-characterized trading income will be subject to U.K. income tax at potentially higher rates than would otherwise have been the case. These rules apply to any fund structure that includes at least one partnership or limited liability partnership.

The purpose behind the new rules is to prevent investment professionals from being able to obtain capital gains tax treatment on proceeds from a fund which would otherwise be taxed as income. These rules target structures which allow investment professionals to obtain interests in the general partner's share (**GPS**) and/or interests relating to waived GPS or management fee (*e.g.*, deemed contributions). The

legislation is drafted so as to re-characterize all payments to investment professionals as trading income, unless it falls within an exemption.

The two main exemptions are for payments of carried interest and payments of co-investment returns. Each of these two terms is defined under the legislation, and the intention is to allow investment professionals to benefit from capital gains tax treatment in relation to capital proceeds which were either (i) at significant risk of not arising; or (ii) related to an actual return on an investment in the fund by such individuals.

These rules will also apply to non-U.K. resident investment professionals to the extent they carry out investment management or advisory services in the United Kingdom and where they receive disguised investment management fees as a result of the provision of such services. While it is likely that treaty relief will be available in relation to such payments, individual advice should be sought on a case-by-case basis.

Please see our March 30, 2015 client alert for more information.

Changes to the Taxation of Carried Interest in the United Kingdom

With effect from July 8, 2015, U.K. resident investment management executives will pay capital gains tax on all their carried interest returns (as such term is defined under the Disguised Investment Management Fee rules) from investment funds. The current rate of capital gains tax is 28% for all higher and additional rate taxpayers, although the overall rate applicable to carried interest returns under these new rules may in many cases be higher, since items of income such as interest and dividends remain liable to income tax. In addition, those executives who are not domiciled in the United Kingdom (**non-doms**) will no longer be able to benefit from the remittance basis of taxation in relation to their carried interest returns to the extent that they perform the relevant investment management services inside the United Kingdom. Please see our July 16, 2015 client alert for more information.

Since the release of the new rules in the July Finance Bill, HM Revenue & Customs has published guidance on how the new rules will be operated. This is somewhat helpful and indicates that the test for how much of a person's carried interest returns will be attributed to U.K. services will be more of a holistic test that looks at all the facts and circumstances, rather than strictly at the number of days spent in each territory. That said, the example in the guidance looks at a very clear-cut case, and so all non-dom U.K. resident investment management professionals should individually consider how they may be affected by these new provisions.

China Regulatory Updates

New Regulations on Mutual Recognition of Funds Between Mainland China and Hong Kong

On May 22, 2015, the China Securities Regulatory Commission (**CSRC**) and the Hong Kong Securities and Futures Commission (**SFC**) signed the Memorandum of Regulatory Cooperation Concerning Mutual Recognition of Funds between Mainland China and Hong Kong (**Memorandum**). As another breakthrough in the liberalization of Mainland China's financial market, the Memorandum provides a scheme of mutual recognition of funds (**MRF**) between Mainland China and Hong Kong, allowing eligible Mainland China and Hong Kong funds to be distributed in the other market. The initial quota for the MRF is set at RMB300 billion (approximately $48 billion) each way for funds flow between Mainland China and Hong Kong.

To implement the Memorandum at Mainland China's end, the CSRC has issued the Interim Provisions on Mutually Recognized Hong Kong Funds (**Interim Provisions**), which took effect on July 1, 2015. The Interim Provisions set out the eligibility requirements, application procedures and operational requirements for a Hong Kong fund seeking distribution in the Mainland China market through recognition by the CRSC under the MRF.

Below is an overview of some of the noteworthy provisions of the Interim Provisions:

Eligibility Requirements. At the current stage, only qualified publicly-offered Hong Kong funds may be recognized by the CSRC under the MRF to be offered publicly to Mainland Chinese investors (**Recognized HK Fund**). To qualify as a Recognized HK Fund, the fund and its investment adviser must, among other things, satisfy the below conditions:

- The fund is (i) established and operates in Hong Kong in accordance with Hong Kong law; and (ii) is approved by the SFC to be publicly offered and is regulated by the SFC;
- The fund's investment adviser (i) is registered and operates in Hong Kong; (ii) holds a Hong Kong asset management license; (iii) has not delegated its investment management function to an institution in another country or region; and (iv) has not been subject to any material penalty by the SFC in the past three years or since its establishment;
- The fund has a custody arrangement, and its trustee and custodian must meet the qualification requirements imposed by SFC;
- The fund is a general equity fund, mixed fund, bonds fund or unlisted index fund (including physical index-tracking exchange-traded funds);
- The fund has been established for more than one year and has a minimum fund size of no less than RMB200 million (approximately $32 million) (or its equivalent in another currency); and
- The fund must not primarily invest in Mainland China, and the value of units in the fund sold to Mainland Chinese investors should not be more than 50% of the value of the fund's total assets.

Registration Procedures. To become a Recognized HK fund, a Hong Kong fund meeting the above conditions must go through certain registration procedures with the CSRC. Registration documentation includes: (i) an application letter; (ii) the trust deed or articles of the fund; (iii) the prospectus and product disclosure statement summary of the fund; (iv) the most recent audited annual report of the fund; (v) the agency agreement with a Mainland China agent; (vi) certification documents in respect of the qualification of the fund, its investment adviser, trustee, custodian and Mainland China agent; (vii) a legal opinion issued by a qualified law firm; and (viii) other documents that may be requested by the CSRC.

Mainland China-based Agent. Under existing PRC laws and regulations, offshore fund managers are generally prohibited from conducting business in Mainland China. The Interim Provisions thus require the investment adviser of a Recognized HK Fund to appoint a Mainland China-based agent (**Mainland China Agent**), whose role is to facilitate the registration and distribution of the Recognized HK Fund in Mainland China. The Mainland China Agent must be a CSRC-regulated manager or custodian of publicly offered funds.

Information Disclosure. While the offering document of a Recognized HK Fund can follow the same form as that used in Hong Kong, it is required by the Interim Provisions to be supplemented with the following disclosures for the benefits of Mainland Chinese investors: (i) risk factors and statements specific

to the mutual recognition of the fund under the MRF; (ii) the types, timing and means of fund disclosures to Mainland Chinese investors; (iii) the rights and obligations of investors, including the procedures and rules of investor meetings, the grounds and procedures for termination of fund documents and dispute resolution method; (iv) information on the services provided to fund interest holders; and (v) any other information that may include material differences compared with that available to Hong Kong investors or that may have a material impact on Mainland Chinese investors.

Shenzhen QDIE Pilot Program

On December 8, 2014, the Shenzhen Municipal Government issued the Interim Measures on the Pilot Program of Overseas Investment by Qualified Domestic Investment Enterprises in Shenzhen (**Interim Measures**), which provide a pilot program (**QDIE Pilot Program**) allowing qualified fund management companies and financial institutions to form and manage Chinese onshore investment vehicles for making overseas investments. The full text of the Interim Measures is not publicly available and has only been circulated to a small group of program participants. Compared to similar pilot programs launched in other cities, Shenzhen's QDIE Pilot Program is reported to allow a broader scope of permissible investment, including common and preferred shares, money market instruments, fixed-income securities, funds (such as hedge funds and private equity funds), financial derivatives, debt, real estate, physical assets and other underlying assets approved by the program's administrator. It is reported that the initial foreign exchange quota granted by the State Administration of Foreign Exchange for Shenzhen QDIE Pilot Program is $1 billion.

Hong Kong Regulatory Updates

Standardization of Regulatory Obligations of Licensed Operators of Alternative Liquidity Pools for the Benefit of Users

On May 15, 2015, the SFC published its consultation conclusions concerning the regulation of alternative liquidity pools (**ALPs**) (also commonly known as "dark pools"), which are operated in Hong Kong by broker-dealer operators licensed to carry on the business of providing automated trading services (**ATS**). While licensed ATS operators have traditionally been subject to licensing conditions on a case-by-case basis, the SFC will refine and standardize the regulatory obligations imposed on all ALP operators licensed in Hong Kong by amending the Code of Conduct for Persons Licensed by or Registered with the SFC with effect from December 1, 2015.

Below is an overview of the principal points of interest to investment advisers who may be, or plan to be, users of ALPs in Hong Kong:

Information for Users. A licensed or registered person operating an ALP should prepare guidelines (**ALP Guidelines**) to provide guidance to the users of the ALP on its operations to ensure that users are fully informed as to the manner in which the ALP operates. Moreover, prior to routing any order to an ALP on behalf of a client for the first time, a licensed or registered person should ensure that the ALP Guidelines have been brought to the attention of the person placing or originating the order.

An ALP operator should prepare and publish on its website comprehensive and accurate ALP Guidelines concerning its ALP, including, among other things, details relating to:

- Trading and operational matters;
- User restrictions;

- Opt-out arrangement;
- User priority, order routing and execution methodology;
- Transaction pricing;
- Order cancellation;
- Internal control procedures that have been put in place to ensure the fair and orderly functioning of the ALP and address potential conflict of interest issues;
- Potential risks associated with transactions conducted in the ALP in respect of which the ALP's users should reasonably be made aware;
- Transaction of proprietary orders in the ALP;
- Whether the orders of different users of the ALP may be aggregated; and
- Identity of each member of its staff (by title and department) who is permitted access to trading information concerning orders placed into, and transactions conducted in, the ALP and, in each case, the reason(s) why such access is necessary.

Opting out of an ALP. A licensed or registered person operating an ALP should permit a user to opt out of matching or crossing its order in its ALP.

Transaction Reporting. An ALP operator should have appropriate arrangements in place to ensure that (i) information concerning transactions conducted on its ALP is appropriately reported or made available to its users; and (ii) regular transaction analyses are made available to the ALP's users concerning the transactions that are conducted on their behalf in the ALP.

Phased Introduction of Regime for the OTC Derivatives Market

In our 2014 Annual Review, we reported that the regulators were planning a phased introduction of the different parts of a new over-the-counter (**OTC**) regime for mandatory reporting, clearing and trading obligations for certain types of OTC derivatives (**OTCD**). We also reported that the new regime would not impact an offshore hedge fund structured as a partnership, but the reporting and other obligations would extend to any onshore investment adviser of a hedge fund that is licensed to carry on Type 9 regulated activity (asset management on behalf of third parties) under Hong Kong's licensing regime.

In the subsequent consultations, industry feedback was that there would be reporting difficulties for investment advisers and the funds they manage, as they typically rely heavily on their counterparties (usually dealers) to report their trades to a trade repository. The regulators accepted that as investment advisers and funds would not be accustomed to, nor have in place the necessary system set-up for, reporting transactions themselves, more time would be needed to address these points. So as not to delay the implementation of mandatory reporting for the main group of players in the market, the rules for this first phase of implementation, which came into effect on July 10, 2015, do not include requirements for Type 9 licensed corporations to report transactions entered into by them in that capacity. The rules introduced mandatory reporting for certain interest rate swaps (**IRS**) and non-deliverable forwards in Hong Kong (phase 2 reporting). The regulators have stated that they will take into consideration the industry comments received when it further fine-tunes these proposals for implementation at a later stage. Thus, we can expect a further consultation on this area in the near future, and at some point the extension of the Rules to Type 9 licensed corporations.

Looking ahead, the regulators have stated that their next goal is to introduce (i) a first phase of mandatory clearing (phase 1 clearing), focusing on certain standardized IRS transactions entered into between the major dealers; and (ii) a second phase of mandatory reporting (phase 2 reporting), which will expand the mandatory reporting regime so that it covers all OTCD products and requires the reporting of a wider range of information and particulars about the transaction to be reported.

Shenzhen-Hong Kong Stock Connect

In our 2014 Annual Review, we also reported that the Shanghai-Hong Kong Stock Connect had commenced on November 17, 2014. The next phase of integration of the markets across the border will be connecting the Hong Kong Stock Exchange with the Shenzhen Stock Exchange. The composition of stocks of the Shenzhen Stock Exchange is different from that of the Shanghai Stock Exchange, with the former traditionally being seen as the market for tech companies. While Shenzhen has approximately 50% more companies listed on its boards than Shanghai, its market capitalization is approximately 50% that of Shanghai's. The launch of this scheme is regarded as a key step towards the inclusion of China's "A-shares" in global benchmark indices (such as the MSCI Emerging Markets Index). The Chinese government had indicated that the scheme would be launched in the second half of 2015, but there is now speculation that owing to the slump in Chinese shares, its launch may be delayed until 2016.

Annual Compliance Review and Filing Requirements

Offering Document Updates

As part of their ongoing compliance reviews, investment advisers should regularly assess their private fund offering materials and determine if updates are required or appropriate. Among other things, an investment adviser should consider if there have been any material changes in the investment adviser's or the private fund's business (including, among other things, investment objectives and strategies, risks, conflicts of interest and service provider arrangements) and/or any relevant regulatory changes (including, among other things, changes in tax and ERISA) since the most recent documents update. Before amending a private fund's offering documents, an investment adviser should evaluate if any investor, advisory board and/or director consent and/or other actions or items would be necessary or appropriate for approving the amendments. The adviser should also consider whether the revised offering documents would need to be filed with or approved by any regulatory authority.

Compliance Policies and Procedures Review and Employee Training

The Advisers Act requires investment advisers to review their compliance policies and procedures annually. This annual review should include, among other things, an assessment of any compliance issues (including, in particular, any known defects from prior years or noted in any SEC examinations), as well as any relevant regulatory changes or guidance and any other changes in the investment adviser's business that may require or otherwise call for changes to the investment adviser's compliance policies and procedures. Investment advisers should document any such reviews in writing.

Investment advisers should adopt and implement employee training policies to educate firm personnel on the investment adviser's compliance programs and procedures, including, among other things, programs and procedures relating to conflicts of interest, insider trading and anti-money laundering. Training should be provided to firm personnel periodically so that they are familiar with the investment adviser's obligations and policies.

In addition to topics already highlighted elsewhere in this Annual Review (including, without limitation, Custody Rule compliance, cybersecurity preparedness and social media use), below are certain other topics that investment advisers should consider in their compliance review:

Rule 506(d) Bad Actor Due Diligence

Under Rule 506(d) of Regulation D, a private fund will be precluded from conducting a private offering under Rule 506 if the private fund or any of its covered persons are subject to a disqualifying event occurring on or after September 23, 2013. In addition, the private fund must disclose any pre-September 23, 2013 disqualifying events to prospective investors within a reasonable time before they invest. To comply with Rule 506(d), investment advisers to private funds should implement a program to determine on an ongoing basis whether any covered person is subject to any pre-September 23, 2013 disqualifying events (which again must be disclosed to prospective investors), and any post-September 23, 2013 disqualifying events (which again would disqualify the private fund from relying on Rule 506). Due diligence measures may include, among other things, conducting checks on public databases, requiring covered persons to complete periodic questionnaires or certifications and requiring covered persons to

notify the investment adviser and the private fund of any disqualifying events and any facts that may lead to a disqualifying event.[10] Frequency of due diligence checks will depend on the nature of the private fund's and the investment adviser's business, but should be conducted at least annually.

Broker-Dealer Registration Issues

A number of activities commonly conducted by private fund advisers may raise potential broker registration issues under the Exchange Act. The definition of a "broker" under the Exchange Act is quite broad and includes any person "engaged in the business of arranging securities transactions for the account of others." In general, any person engaged in such activities is required to be registered as a broker under the Exchange Act unless a specific exemption applies.

For private fund advisers, types of activities that may trigger broker-dealer registration requirements include, for example:

- Capital-raising activities, particularly in circumstances (i) where employees of the investment adviser may be compensated based on how successful they are in selling interests in the investment adviser's private funds (*i.e.*, "transaction-based" compensation); or (ii) where an employee's sole or primary function is to sell interests in the private funds; and
- Receipt of transaction fees relating to one or more of a private fund's portfolio companies for services that could be characterized as investment banking or other broker activities, including investment banking-type services in connection with the acquisition, disposition or recapitalization of the portfolio companies (such as negotiating transactions, identifying and soliciting purchasers and sellers of a portfolio company's securities or structuring transactions).

The determination of whether an investment adviser or its employees are engaged in broker activities can be highly fact-specific. Investment advisers should periodically review their business activities to assess whether any broker-dealer registration requirements are implicated. In addition, investment advisers should be aware that questions related to these issues may be raised in SEC examinations.

Identity Theft Red Flags Policies

Under the identity theft red flags rules jointly issued by the SEC and CFTC in 2013, certain SEC- and CFTC-regulated entities are required to adopt written identity theft programs designed to detect, prevent and mitigate identity theft. The red flags rules apply to certain "financial institutions" (including registered investment advisers) and "creditors" that offer or maintain "covered accounts."[11] The identity theft program must include at minimum the following elements:

- Identification of relevant "red flags" that may be indicators of potential identity theft;
- Detection of the relevant red flags;
- Appropriate responses to any red flags that are detected; and
- Periodic review and updates to the identity theft program.

---

[10] If a disqualifying event is discovered, an investment adviser that is required to file Form ADV may be required to amend its Form ADV (see below).

[11] In general, "financial institutions" include an entity that holds a transaction account belonging to an individual, whereby the individual may make payments or transfers of money from the account to third parties (or direct the entity to make such payments or transfers); "creditors" include an entity that advances or loans money to consumers; and "covered accounts" include an 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, or any other account that poses a reasonably foreseeable risk to consumers of identity theft.

Investment advisers should review their business practices to determine whether they might fall within the definition of a "financial institution" or "creditor" (for more details on the red flag rules, please see our May 31, 2013 client alert). Although the red flags rules typically will not apply to investment advisers to private funds, it is nevertheless advisable for all investment advisers to consider adopting an identity theft red flags policy and to periodically review the risk of identity theft with respect to investors in the private funds they advise.

Business Continuity and Disaster Recovery Plans

Under the Advisers Act, investment advisers have a fiduciary obligation to take steps to protect clients' interests from being placed at risk as a result of the investment adviser's inability to provide advisory services after a natural disaster or other emergencies. Following the widespread market disruption caused by Hurricane Sandy, the SEC surveyed the business continuity and disaster recovery plans of investment advisers in the affected region and issued a risk alert on August 27, 2013 identifying some general trends and weaknesses observed in its survey. The risk alert highlighted certain key areas of consideration that investment advisers should evaluate when devising their business continuity plans, including:

- Widespread disruption considerations;
- Alternative locations considerations;
- Vendor relationships considerations;
- Telecommunications services and technology considerations;
- Communication plans considerations;
- Regulatory compliance considerations; and
- Reviewing and testing considerations.

Investment advisers may consider using the SEC's risk alert as a template for assessing the adequacy of their business continuity plans. We note, however, that the risk alert's list of considerations is not intended to be exhaustive and investment advisers should design their business continuity and disaster recovery plans in light of the facts and circumstances surrounding their business and operations.

Anti-Money Laundering Policies

Investment advisers should review their AML policies and procedures at least annually and update such policies and procedures to account for changes in requirements imposed by the trade and economic sanction programs administered by the Treasury Department's Office of Foreign Asset Control and any applicable non-U.S. requirements. Investment advisers should also provide training to personnel to ensure they are familiar with the investment adviser's AML obligations and practices. Investment advisers should also periodically check with their private fund administrators, if applicable, to ensure that the administrators are properly following their AML policies and are conducting sufficient investor due diligence. We note that FinCEN has also proposed AML rules applicable to registered investment advisers.

Annual and Other Periodic Filing Requirements

Below is a summary of certain key filing requirements applicable to investment advisers to private funds. We note that this list of filings discussed below is not intended to be exhaustive. In addition to the requirements discussed in this Annual Review, investment advisers should examine the nature of their

business and operations and determine whether any other filings or actions will be required pursuant to applicable federal, state and non-U.S. laws and regulations.

Form ADV

Registered investment advisers must file an updated Form ADV Part 1 and Part 2A with the SEC within 90 days after the investment adviser's fiscal year-end (by **March 30, 2016** for investment advisers with a December 31 fiscal year-end). Registered investment advisers must deliver the updated Form ADV Part 2A, or a summary of the changes made, to clients within 120 days following the investment adviser's fiscal year-end (by **April 29, 2016** for investment advisers with a December 31 fiscal year-end). Although underlying investors of private funds managed by the investment advisers are not "clients" of the investment advisers under the Advisers Act, it is generally considered best practice to deliver the updated Form ADV Part 2A to these underlying investors on an annual basis.

In addition to the annual amendments, Form ADV Part 1 must be promptly amended where certain types of information reported, such as the disciplinary history of the investment adviser and/or its personnel, becomes inaccurate or, in certain cases, materially inaccurate. Form ADV Part 2A and Part 2B must be amended promptly whenever information reported becomes materially inaccurate. If the change relates to a disciplinary event, then the updated Form ADV Part 2A and/or Part 2B, as applicable, also must be delivered to clients. While Form ADV Part 2B is not required to be filed with the SEC, investment advisers must maintain copies in their records.

"Exempt reporting advisers" are subject to similar reporting requirements with respect to sections in Form ADV Part 1 that apply to them. If the exempt reporting adviser is exempt from SEC registration under the "private fund adviser" exemption, the exempt reporting adviser must register with the SEC once it reports in its amended Form ADV that its regulatory assets under management (**RAUM**) attributable to private funds have reached $150 million (or, in the case of an adviser based outside of the United States, if the RAUM attributable to private fund assets managed at a place of business in the United States have reached $150 million). The exempt reporting adviser must apply for registration within 90 days of filing the amendment. If the exempt reporting adviser is exempt from SEC registration under the "venture capital fund adviser" exemption, the exempt reporting adviser must register with the SEC *prior* to the time it may no longer rely on such exemption.

Certain states impose "notice filing" requirements, requiring investment advisers to file their Form ADV with the relevant state securities authorities. Investment advisers may also be subject to additional state requirements where, for example, the investment adviser has a place of business in the state and/or has over five non-exempt clients in that state. Investment advisers may also be subject to certain "blue sky" requirements, as discussed below. An investment adviser should review its business on a periodic basis to determine whether any additional state requirements have been triggered.

Form PF

A registered investment adviser that advises one or more private funds and has at least $150 million in RAUM attributable to private funds is required to file Form PF with the SEC to report certain information regarding the private funds under its management. The frequency of the reporting obligation and the amount of information that must be reported on Form PF will vary depending on the size of the investment adviser and the type of private funds managed by it.

In general, a registered investment adviser that has at least $150 million in RAUM attributable to private funds is required to file Form PF within 120 days after the end of the investment adviser's fiscal year (by **April 29, 2016** for investment advisers with a December 31 fiscal year-end). However, the reporting requirements for investment advisers with larger RAUMs will be more frequent and/or more extensive. In particular:

- **Large Hedge Fund Advisers**. An investment adviser with at least $1.5 billion in RAUM attributable to hedge funds as of any month-end during the preceding fiscal quarter is subject to more comprehensive quarterly reporting requirements with respect to hedge funds under its management. In addition, the Large Hedge Fund Adviser is required to provide fund-specific information with respect to any "qualifying hedge funds" (*i.e.*, hedge funds with more than $500 million in net asset value). A Large Hedge Fund Adviser must file Form PF within 60 days of each quarter-end (by **February 29, 2016** for the quarter ending December 31, 2015).
- **Large Liquidity Fund Advisers**. An investment adviser with at least $1.0 billion in RAUM attributable to private liquidity funds and registered money market funds as of any month-end during the preceding fiscal quarter will be subject to more comprehensive quarterly reporting requirements with respect to private liquidity funds under its management. Large Liquidity Fund Advisers must file Form PF within 15 days of each quarter-end (by **January 15, 2016** for the quarter ending December 31, 2015).
- **Large Private Equity Fund Advisers**. An investment adviser with at least $2.0 billion in RAUM attributable to private equity funds as of the end of the most recent fiscal year will be subject to more comprehensive annual reporting requirements with respect to private equity funds under its management. Large Private Equity Fund Advisers must file Form PF within 120 days of fiscal year-end (by **April 29, 2016** for investment advisers with a December 31 fiscal year-end).

For purposes of determining whether an investment adviser meets any of the large adviser classifications above, the investment adviser may disregard a private fund's equity investments in other private funds.

Exempt reporting advisers are not required to file Form PF.

Form D and Blue Sky Filings

Form D. A private fund conducting an offering under Rule 506 must file a Form D with the SEC on its filer management system, EDGAR, within 15 days of the initial sale of securities in such offering (*i.e.*, the date on which the first investor is irrevocably contractually committed to invest). For any ongoing offering for which a Form D was filed after March 16, 2009, Form D must be amended annually on or before the first anniversary of the last notice filed. Form D must also be amended as soon as practicable to correct a material mistake of fact or error or to reflect a change in the information provided in the previously filed notice. For certain specified types of changes in information, however, such as a change in the amount of securities sold in the offering or the number of investors who have invested in the offering, the private fund is not required to amend Form D until the next annual filing (if any) is due (but may choose to do so at any time).

Blue Sky Filings. Compliance with Rule 506 is very important for compliance with state securities or "blue sky" laws, since, under Section 18 of the Securities Act, the states are pre-empted from regulating offerings that comply with Rule 506. Without such compliance, unless an applicable self-executing state

exemption is available, a state where an investor purchases the issuer's securities can require a pre-sale filing and regulate the required disclosure and other aspects of the offering.

Provided that an offering is made in compliance with Rule 506, the blue sky laws of many states currently require that a hard copy of Form D be filed with the relevant state authority within 15 days following the initial sale of securities in that state, along with the state's required filing fee. In addition, some states' blue sky laws require that copies of amended SEC filings also be filed with the state. A handful of states require annual renewal filings and, in a couple of cases, the payment of annual renewal fees for ongoing offerings. Please note that the states now have a central electronic filing system for Rule 506 offerings, which is currently required to be used for filings in a few states, and possibly will be mandatory for all or most states in the not-too-distant future.

Private funds should be aware of requirements that may be triggered when sales of securities are made to investors in states where sales have not been made in the past, and sales in states in which a Form D has not yet been filed. The penalties for failing to make timely filings can be significant. Some states may require payment of a fine, or even demand that an issuer offer rescission to each investor in a state, or the administrator may issue a consent order.

Although Section 18 of the Securities Act states that covered securities, such as securities offered pursuant to Rule 506 of Regulation D, are not subject to state regulation, an increasing number of states have nevertheless used their authority under broker-dealer and investment adviser regulation and anti-fraud statutes to review and comment on Form Ds filed in connection with Rule 506 offerings. Questions regarding whether a related party listed under item 3 of the Form D is required to be registered as an investment adviser in the state are not unusual. Some states have also requested to see copies of the offering materials to be provided.

Form 13F

An investment adviser is required to file a Form 13F with the SEC if it exercises investment discretion over $100 million or more in Section 13(f) securities as of the last trading day of any month in any calendar year. In general, Section 13(f) securities include U.S. listed equity securities, certain equity options and warrants, shares of closed-end investment companies and certain convertible debt securities. The SEC publishes an official list of Section 13(f) securities at the end of every quarter.

An investment adviser must file a Form 13F for the last quarter of the calendar year during which the reporting threshold is met. In addition, it must file a Form 13F for the first three quarters in the subsequent calendar year, even if its holding level has dropped below $100 million. In each case, Form 13F will be due within 45 days of quarter-end.

For investment advisers that exceeded the reporting threshold for the first time in 2015, the first Form 13F filing deadline in 2016 will be **February 16, 2016** (for the quarter ending December 31, 2015).

Schedules 13D and 13G

A person that has direct or indirect beneficial ownership of more than 5% of a class of outstanding voting equity securities of a U.S. public company is required to file Schedule 13D, or Schedule 13G, if eligible, with the SEC. "Beneficial ownership" is defined to include the direct or indirect power to (i) vote the securities; or (ii) exercise investment authority over the securities, including the right to acquire the securities within 60 days (such as through the exercise of an option or a convertible security). Under this

definition, “beneficial owners” may include a private fund, its investment adviser and certain controlling persons and/or parent companies of the investment adviser.

Schedule 13D. Schedule 13D must be filed within 10 days after crossing the 5% threshold and must be amended promptly following (i) a material increase or decrease in the filer’s holding; or (ii) a material change in the Schedule 13D. An increase or decrease is deemed “material” if it equals at least 1% of the outstanding securities and may, depending on the facts and circumstances, be deemed “material” even if it is less than 1%.

Schedule 13G. A beneficial owner otherwise required to file Schedule 13D may file Schedule 13G if it acquired the securities in the ordinary course of its business and not with the purpose or effect of changing or influencing the control of the issuer.

- If the beneficial owner falls within any of the specified categories of “Qualified Institutional Investors” (**QII**), which includes SEC-registered investment advisers, it must file Schedule 13G within 45 days after the end of a calendar year if its holding crossed the 5% threshold during the year and is at least 5% as of year-end (by **February 16, 2016** for 2015). Schedule 13G must be amended within 10 days of a month-end if the holding exceeds 10% of the class of equity securities as of such month-end and if it thereafter increases or decreases by more than 5% of the class of equity securities.
- A beneficial owner that does not qualify as a QII may still use Schedule 13G as a “passive investor,” so long as its holding is below 20% of the class of securities. A passive investor must file Schedule 13G within 10 days of crossing the 5% threshold. Schedule 13G must be amended promptly once the holding exceeds 10% of the class of equity securities and if it thereafter increases or decreases by more than 5% of the class of equity securities.

Schedule 13G is also available to a beneficial owner that crossed the 5% threshold as of calendar year-end but is exempt from filing a Schedule 13D due to exemptions under Section 13(d) of the Exchange Act or otherwise. This may include, for example, a beneficial owner that met the 5% threshold at the time the issuer went public and continues to meet the 5% threshold at the end of the relevant calendar year-end. Each such exempt filer is required to file a Schedule 13G within 45 days after the end of a calendar year (by **February 16, 2016** for 2015).

QII, passive investor and exempt investor filers must amend Schedule 13G within 45 days of each calendar year-end to report any changes in the information previously reported, provided that no amendment will be required if the only change relates to the filer’s percentage holding and is solely due to a change in the underlying aggregate number of outstanding shares in the class. The filing deadline for 2015 amendments will be **February 16, 2016**.

Forms 3, 4 and 5

Form 3. A person, including an investment adviser and/or an employee or representative acting on its behalf, is required to file Form 3 with the SEC within 10 days of (i) acquiring beneficial ownership of more than 10% of a class of equity securities of a U.S. public company (including, among other things, puts, calls, options, warrants, convertible securities or other rights or obligations to buy or sell securities exercisable within 60 days); and/or (ii) becoming an officer or director of a U.S. public company. “Beneficial ownership” is defined in the same way as in the Schedule 13D and 13G context. With respect to an issuer undergoing an IPO, the initial Form 3 filing is due on the effective date of the registration.

Form 4. If a director, officer or 10% beneficial owner effects a transaction which changes the beneficial ownership of securities previously reported on Form 3, such director, officer or beneficial owner must file a Form 4 with the SEC within 2 business days of the transaction.

Form 5. Form 5 must be filed with the SEC within 45 days following the issuer's fiscal year to report any exempt or other insider transactions not previously reported on Form 4 (by **February 16, 2016** if the issuer has a fiscal year-end of December 31).

Form 13H

Large traders of Regulation NMS securities (generally defined to be exchange listed securities, including options) are required to file Form 13H with the SEC. A "large trader" is any person that exercises investment discretion over transactions in Regulation NMS securities that equal or exceed (i) two million shares or $20 million during any day; or (ii) 20 million shares or $200 million during any month. Large traders must file Form 13H with the SEC when the thresholds above are met. The initial Form 13H filing must be made "promptly" after reaching the threshold (generally within 10 days). Thereafter, an annual 13H filing must be submitted within 45 days of the end of the calendar year (by **February 16, 2016** for 2015). Amendments to Form 13H must be filed promptly following the end of a calendar quarter if any information on the Form 13H becomes inaccurate.

CFTC Annual Reaffirmations and Periodic Reports

CPO and CTA Exemption Reaffirmations. Each CPO exempt from CPO registration under CFTC Rule 4.5, 4.13(a)(1), 4.13(a)(2), 4.13(a)(3) or 4.13(a)(5) and each CTA exempt from CTA registration under CFTC Rule 4.14(a)(8) must submit an annual affirmation of its exemption with the NFA within 60 days of calendar year-end (by **February 29, 2016** for 2015).

Annual Reports and Account Statement Requirements. Each registered CPO, including a CPO relying on CFTC Rule 4.7, must file financial statements of each commodity pool it operates with the NFA within 90 days after each such commodity pool's fiscal year-end (by **March 30, 2016**, if the fiscal year ends on December 31).

In addition, each registered CPO must distribute monthly account statements to participants of the commodity pool within 30 days of month-end for commodity pools with a net asset value greater than $500,000. For commodity pools with a net asset value of $500,000 or less, or operated under CFTC Rule 4.7, the CPO is instead required to distribute quarterly account statements to pool participants within 30 days of the quarter-end.

CFTC Form CPO-PQR and NFA Form PQR. Each registered CPO is required to report certain information to the CFTC on CFTC Form CPO-PQR, the CFTC equivalent of Form PF. CFTC Form CPO-PQR contains three sections: Schedule A, Schedule B and Schedule C. The frequency that a CPO must file CFTC Form CPO-PQR and the sections that it must complete will depend on the CPO's amount of assets under management (**AUM**) and its SEC reporting obligations (if a dual registrant).

Each registered CPO that is an NFA member is also required to file NFA Form PQR quarterly with the NFA. NFA Form PQR consists of certain questions from Schedule A and Schedule B of CFTC Form CPO-PQR.

Both CFTC Form CPO-PQR and NFA Form PQR are filed on the NFA's EasyFile system. As NFA Form PQR is incorporated into CFTC Form CPO-PQR, there are no separate filings for the CFTC and the NFA. A CPO will

satisfy its NFA Form PQR reporting obligations to the extent it is already responding to the same items on its CFTC Form CPO-PQR for that reporting period.

In addition, CPOs that are registered as investment advisers with the SEC may satisfy certain of their CFTC Form CPO-PQR filing obligations by filing Form PF with the SEC.

Filing Requirements				
CPO Size	**First Quarter**	**Second Quarter**	**Third Quarter**	**Fourth Quarter**
Large CPO (CPO with AUM of at least $1.5 billion)	CFTC Form CPO-PQR Schedules A, B and C (within 60 days of quarter-end)	CFTC Form CPO-PQR Schedules A, B and C (within 60 days of quarter-end)	CFTC Form CPO-PQR Schedules A, B and C (within 60 days of quarter-end)	CFTC Form CPO-PQR Schedules A, B and C (within 60 days of quarter-end)
Mid-Sized CPO (CPO with AUM of at least $150 million but less than $1.5 billion)	NFA Form PQR (within 60 days of quarter-end)	NFA Form PQR (within 60 days of quarter-end)	NFA Form PQR (within 60 days of quarter-end)	CFTC Form CPO-PQR Schedules A and B (within 90 days of year-end)
Small CPO (CPO with AUM of less than $150 million)	NFA Form PQR (within 60 days of quarter-end)	NFA Form PQR (within 60 days of quarter-end)	NFA Form PQR (within 60 days of quarter-end)	CFTC Form CPO-PQR Schedule A and NFA Form PQR (within 90 days of year-end)
Dual-Registered CPO (CPO that is an SEC-registered investment adviser and files Form PF with the SEC)	NFA Form PQR (within 60 days of quarter-end)	NFA Form PQR (within 60 days of quarter-end)	NFA Form PQR (within 60 days of quarter-end)	CFTC Form CPO-PQR Schedule A and NFA Form PQR (within 60 or 90 days of quarter-end, depending on AUM)

The upcoming filing deadlines for the period ending on December 31, 2015 will be **February 29, 2016** for Large CPOs and **March 30, 2016** for Mid-Sized and Small CPOs.

CFTC Form CTA-PR and NFA Form PR. All registered CTAs, regardless of size and dual registration, must file CFTC Form CTA-PR annually within 45 days of the end of the fiscal year. CFTC Form CTA-PR covers certain identifying information about the CTA as well as performance information. In addition, each CTA that is an NFA member must file NFA Form CTA-PR within 45 days of each quarter-end. As the same form is used for CFTC Form CTA-PR and NFA Form PR, a CTA will satisfy its NFA Form PR obligation for the

quarter ending on December 31 by filing its annual CFTC Form CTA-PR. Both CFTC Form CTA-PR and NFA Form PR are filed on the NFA's EasyFile system.

The deadline for the period ending December 31, 2015 will be **February 16, 2016**.

The CFTC has published a series of FAQs on CFTC Form CPO-PQR and CTA-PR.

TIC Form B

A U.S. investment manager (on behalf of itself and any U.S. or non-U.S. funds that it manages) and U.S. resident funds managed by a non-U.S. resident investment manager are required to report cross-border claims, liabilities and short-term securities holdings on TIC B Forms with the Federal Reserve Bank of New York, in each case if the reporting person is owed "reportable claims" or owes "reportable liabilities" in excess of certain monetary thresholds, as discussed below.

The TIC B Forms require reporting of current obligations (including loans, regardless of their maturity) and short-term securities:

- That are owed by a U.S. resident entity to a non-U.S. resident, or by a non-U.S. resident entity to a U.S. resident;
- That are not held by a U.S. custodian or sub-custodian; and
- That are in excess of the relevant reporting thresholds (determined on an aggregated basis for the top-tier U.S. entity in an affiliated group, and separately for all of the funds that they manage).

TIC B Forms consist of a series of monthly and quarterly forms. Monthly TIC B filings (Forms BC, BL-1, and BL-2) are due no later than 15 days following the end of a month, and the quarterly TIC B filings (Forms BQ-1, BQ-2 (Part 1), BQ-2 (Part 2) and BQ-3) are due no later than 20 days following the end of a quarter. Any financial institutions with "reportable claims" or "reportable liabilities" (as described below) exceeding the monetary thresholds and required to file for a reporting period are also required to file for all subsequent reporting periods in that year (regardless of whether the thresholds are exceeded in the subsequent periods). The reporting threshold for each TIC B Form (except Form BQ-3) is $50 million total ($25 million in any one foreign country). The reporting threshold for Form BQ-3 is $4 billion total (no country limit). A reporter is only required to file the applicable TIC B Forms for which its reportable claims and/or liabilities exceeds the relevant threshold.

"Reportable claims" generally include all claims not held by a U.S. resident custodian or sub-custodian, including deposit balances due from banks, negotiable certificates of deposit of any maturity, brokerage balances, customer overdrawn accounts, loans and loan participations, resale agreements and similar financing agreements, short-term (original maturity of one year or less) negotiable and non-negotiable securities, money-market instruments, reinsurance recoverables and accrued interest receivables.

"Reportable liabilities" generally include all liabilities not held by a U.S. resident custodian or sub-custodian, including non-negotiable deposits of any maturity, brokerage balances, overdrawn deposit accounts, loans of any maturity, short-term (original maturity of one year or less) non-negotiable securities, repurchase agreements and similar financing agreements, insurance technical reserves and accrued interest payables.

"Reportable claims" and "reportable liabilities" do not include long-term securities (including equities and any long-term notes, bonds and debentures), derivatives, credit commitments, contingent liabilities, and securities borrowing or lending agreements in which one security is borrowed or lent in return for

another. For purposes of the TIC B Forms, a feeder fund's investment into a master fund is considered a non-reportable long-term security and is not a reportable claim.

Representatives of the government agencies responsible for the TIC B Forms have indicated that any claims or liabilities held by a U.S. resident custodian or sub-custodian (such as a bank) or otherwise reportable by another U.S. financial institution (such as an administrative agent) should not be reported by investment managers or funds or used to calculate whether the threshold limits have been exceeded.

A U.S. resident investment manager reporting on behalf of itself and the entities in its organization should generally file Forms BC, BL-1, BQ-2 (Part 1) and/or BQ-3, as applicable. A U.S. resident investment manager should generally file consolidated reports on behalf of the funds it manages, including reportable claims and liabilities of non-U.S. resident funds, on Forms BL-2, BQ-1, BQ-2 (Part 2). Non-U.S. investment managers do not have a reporting obligation, but any U.S. resident fund they manage may be required to make a TIC B filing.

TIC Form S

A U.S. resident entity, including a U.S. investment adviser, is required to file TIC Form S with the Federal Reserve Bank of New York if its transactions (e.g., purchases, sales, redemptions and new issues) in long-term securities with foreign residents exceed $350 million in the aggregate during a month.[12] Long-term securities are securities without a stated maturity date (such as equities) or with an original term-to-maturity of over a year.

Reportable transactions include, among other things, purchases and sales of newly-issued securities, purchases and sales of existing securities from other investors, and transactions resulting from sinking fund redemptions, called or maturing securities. Long-term securities received or delivered to settle derivative contracts are also reportable as purchases or sales by foreign residents. For U.S. investment advisers, reportable transactions include, among other things:

- Purchases and sales they make for the accounts of their U.S. resident funds and other clients that are conducted directly with a foreign resident or placed through a foreign-resident broker, dealer or underwriter;
- Purchases and sales made for the accounts of their foreign-resident funds and other clients that are placed through U.S. resident brokers, dealers or underwriters, if the identity of the underlying account holder had not been fully disclosed to such brokers, dealers or underwriters;
- Redemptions from the accounts of their U.S. resident funds and other clients that are presented to a foreign-resident intermediary (e.g., foreign-paying agent, foreign-resident broker, foreign-resident dealer or foreign-resident issuer) without the use of a U.S. resident custodian; and
- Purchases and sales of interests in a foreign master fund by a U.S. resident feeder fund or in a U.S. resident master fund by a foreign feeder fund.

U.S. investment advisers meeting the reporting threshold in any given month must file TIC Form S no later than 15 days following month-end, and must continue to file TIC Form S monthly for the remainder of the calendar year, regardless of the level of transactions in the subsequent months.

[12] The reporting threshold for TIC Form S was previously $50 million but was increased to $350 million in June 2014 pursuant to revisions to TIC Form S.

TIC Form SLT

U.S. resident custodians (including U.S. resident banks), U.S. resident issuers (including U.S. private funds) and U.S. resident end-investors (including U.S. investment advisers, whether or not registered) are required to file TIC Form SLT with the Federal Reserve Bank of New York to report their cross-border ownership of reportable long-term securities, if the fair market value of their reportable holdings and issuances equals at least $1 billion as of the last business day of any month.

Most equity securities and debt securities with a maturity of greater than one year are considered reportable long-term securities for purposes of Form SLT. Certain types of securities are excluded, such as, among other things, short-term securities (original maturity of one year or less), bankers' acceptances and trade acceptances, derivative contracts (including forward contracts to deliver securities), loans and loan participation certificates, letters of credit, bank deposits and annuities.

U.S. investment advisers with aggregate holdings of reportable long-term securities with a fair market value of at least $1 billion by the investment adviser and its clients are likely to be subject to Form SLT reporting. An investment adviser that is subject to the reporting requirement will file one consolidated report for all U.S. resident parts of its organization and all U.S. resident entities that it advises. Funds organized under the laws of any U.S. state are included in the "U.S. resident" portion of a reporting investment adviser's organization, which will subject securities issued by non-U.S. master funds that are held by U.S. feeder funds and holdings of U.S. master fund securities by non-U.S. feeder funds to reporting.

For U.S. resident holdings of non-U.S. securities, the reporting party would be required to disclose:

- The residence of the non-U.S. issuer; and
- The fair market value and type of non-U.S. security.

For non-U.S. resident holdings of U.S. securities, the reporting party would be required to disclose:

- The non-U.S. holder's residence;
- The fair market value and type of U.S. security; and
- Whether the non-U.S. holder is a "foreign official institution" (including national governments, international and regional organizations and sovereign wealth funds).

Form SLT must be filed monthly by the 23rd day following the end of each month (by **January 25, 2016** for December 2015). If the $1 billion threshold is crossed as of the end of any month, the reporting person must file Form SLT for all remaining months in that calendar year regardless of the subsequent amount of its reportable holdings.

BE-13

A U.S. entity is required to make a BE-13 filing if a non-U.S. person acquires direct or indirect ownership or control of 10% or more of the voting securities of such U.S. entity. A U.S. entity that crosses the 10% reporting threshold must file a Form BE-13 if the cost of acquiring or establishing such interest exceeds $3 million. A different BE-13 form is required depending on the type of event that has occurred (e.g., formation, acquisition, merger or expansion). If the 10% reporting threshold is crossed but the cost of the transaction does not exceed $3 million, a U.S. entity must file a BE-13 Claim for Exemption. BE-13 reports are due within 45 days after a reportable transaction.

Annual U.S. Tax Elections and Filings

This section briefly summarizes certain U.S. tax filings and elections (and related deadlines) relevant to private funds, their investors and related persons. For key FATCA action items and deadlines, please see "FATCA Implementation" above.

Section 83(b) Elections. If an individual filed a Section 83(b) election with the IRS during 2015, that individual must attach a copy of the filed election to his or her U.S. federal income tax return for 2015. The deadline will be the due date (including any applicable extensions) of that individual's 2015 U.S. federal income tax return.

Form 8832 Filings. If an entity filed an IRS Form 8832 (an entity classification election) with respect to 2015, that entity must attach a copy of the Form 8832 with its U.S. federal income tax return. If that entity is not required to file a U.S. return, all direct or indirect owners of that entity generally must attach a copy with their U.S. federal income tax returns, if they are otherwise required to file U.S. returns. The deadline will be the due date (including any applicable extensions) of the filer's 2015 U.S. federal income tax return.

"Qualified Electing Fund" (QEF) Election. If a private fund has invested in a non-U.S. portfolio company that is (or may be) a "passive foreign investment company" (**PFIC**), the first U.S. person in the PFIC's ownership chain (e.g., the fund itself, if a U.S. fund, or each U.S. investor, if a non-U.S. fund) may wish to file a QEF election with respect to that PFIC. The QEF election must be filed with that U.S. person's U.S. federal income tax return for the first year in which the fund invested in the PFIC. The deadline for PFICs acquired in 2015 will be the due date (including any applicable extensions) of that U.S. person's 2015 U.S. federal income tax return.

"Electing Investment Partnership" (EIP) Election. Private funds that satisfy certain requirements may opt out of otherwise mandatory tax basis adjustments (including those that may result from transfers of interests in a fund) by filing an EIP election. The EIP election must be filed with the private fund's U.S. federal income tax return for the first year in which the election is intended to apply. For funds wishing to be treated as EIPs with respect to 2015 (and subsequent years), the deadline will be the due date (including any applicable extensions) of the private fund's 2015 U.S. federal income tax return.

Certain U.S. Tax Filings with respect to Non-U.S. Entities. U.S. private funds and their U.S. investors may be required to make certain filings with respect to non-U.S. entities owned by the private fund. These filings may include, without limitation:

- IRS Form 5471 (with respect to certain non-U.S. corporations, including "controlled foreign corporations," owned by the private fund);
- IRS Form 926 (with respect to certain contributions of property to a non-U.S. corporation);
- IRS Form 8621 (with respect to certain non-U.S. corporations that are PFICs; however, such reporting is generally not required of U.S. tax-exempt investors pursuant to regulations issued on December 30, 2013);
- IRS Form 8865 (with respect to certain non-U.S. partnerships);
- IRS Form 8858 (with respect to certain non-U.S. disregarded entities); and
- IRS Form 8938 (with respect to certain non-U.S. financial assets).

Generally, the deadline will be the due date (including any applicable extensions) of the U.S. person's 2015 U.S. federal income tax return.

Report of Foreign Bank and Financial Accounts (FBAR). With very limited exceptions, a U.S. person who has a financial interest in, or signatory authority over, one or more non-U.S. financial accounts must report those accounts annually to the Treasury Department, unless the aggregate value of all such accounts did not exceed $10,000 at any time during the year. Under current law, hedge funds and private equity funds generally are not considered "financial accounts." Nevertheless, such private funds and their investment advisers may be required to file FBARs if they have non-U.S. bank or other financial accounts. FBARs for the 2015 calendar year must be filed electronically (no paper filings allowed) by **June 30, 2016** using the E-Filing System maintained by the Department of the Treasury's Financial Crimes Enforcement Network (**FinCEN**). Filers must first register on the FinCEN site, so it is advisable to register well in advance of the June 30 filing deadline. Note that 2014 (and prior year) filings by officers and employees of certain entities who had signatory authority over, but no financial interest in, certain non-U.S. financial accounts is currently due **June 30, 2016**, but FinCEN may again extend this deadline.

Other Annual Requirements and Considerations

Audited Financial Statements Delivery

Rule 206(4)-2 of the Advisers Act (**Custody Rule**) requires registered investment advisers with custody of client assets to implement certain safeguards designed to protect client assets against the risk of loss, misuse or misappropriation. Among other things, it requires assets of an investment adviser's clients to be held by a qualified custodian and to be subject to surprise annual examinations by an independent public accountant that is registered with and subject to inspection by the Public Company Accounting Oversight Board (**PCAOB**). With respect to private fund clients, however, an investment adviser, rather than complying with the surprise audit requirement, may comply with the Custody Rule by relying on the Audit Provision under part (b)(4) of the Custody Rule. To rely on the Audit Provision, the investment adviser must have an independent public accountant that is registered with and subject to inspection by the PCAOB conduct an annual audit of each private fund client and deliver audited financial statements to all of its private fund investors. The audited financial statements must be delivered:

- Within 120 days of the private fund's fiscal year-end (by **April 29, 2016**, 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 28, 2016**, if the fiscal year ends on December 31).

The accountant conducting the annual audit must be registered with and subject to inspection by the PCAOB.

Privacy Policy Delivery

Investment advisers must deliver a privacy notice to clients (including fund investors) who are natural persons (including 401(k) and IRA investors) at least once every 12 months, even if the investment adviser's privacy policy has not changed. If there has been any change to the privacy policy that would permit nonpublic client information to be disclosed to non-affiliated third parties, and the new disclosure is not covered in the existing notice, the investment adviser must deliver an updated notice to clients and provide them a reasonable opportunity to opt out of the new disclosure.

Schedule K-1 Delivery

Under IRS rules, partnerships are required to deliver certain information on Schedule K-1 to their partners on or before the day on which the return for the relevant taxable year is required to be filed. As required by IRS rules issued in 2012, a partnership must obtain a partner's affirmative consent for the partnership to validly deliver Schedule K-1 to the partner electronically (*e.g.*, via email or by posting the Schedule K-1 on a web portal). For the consent to be valid, it must be obtained from a partner in the same electronic manner in which the partnership will deliver the Schedule K-1 to the partner. The applicable IRS rules also prescribe certain other requirements for electronic delivery of Schedule K-1s, including certain disclosures, which must be provided to partners regarding electronic delivery of Schedule K-1s. In addition to these IRS rules, states or other jurisdictions may impose security requirements for maintenance and transmission of sensitive personal information (such as individual social security numbers), which a partnership may need to comply with when delivering Schedule K-1s to its partners.

New Issues Investor Reaffirmations

If a private fund intends to invest in "new issues," the investment adviser will often obtain annual reaffirmations from the private fund's investors relating to each such investor's eligibility to participate in profits and losses from new issues. Reaffirmation may be obtained by sending out notices asking each investor to notify the investment adviser if the investor's new issues status has changed or by including a representation in the investor's subscription agreement whereby the investor agrees to notify the investment adviser of any subsequent change in its new issues status.

ERISA/VCOC Annual Certifications and Compliance

Many private funds that accept investments from investors subject to ERISA are operated in such a manner so that the assets of such private funds do not constitute the "plan assets" of ERISA investors for purposes of ERISA. Typically, such a fund will either be operated as a "venture capital operating company" (**VCOC**) or so that "benefit plan investor" equity participation is not "significant" (i.e., under the ERISA 25% limit), and the sponsor of such a private fund often will contractually agree with its ERISA investors to deliver an annual certification as to the private fund's continued compliance with the VCOC requirements and/or the 25% benefit plan investor limit. Private funds that accept investments from ERISA investors should conduct the VCOC or 25% benefit plan investor limit analysis as applicable, whether or not they are required to annually certify compliance with respect thereto, and should be prepared to deliver any required or requested certifications in a timely manner.

Private funds that are designed to hold "plan assets" and that are actually holding "plan assets" of ERISA investors may need to provide the ERISA investors with certain information relating to any changes to the fees or expenses paid by the fund.

California Finance Lenders Law Requirements

The California Finance Lenders Law (**CFLL**) generally requires lenders (including private funds) "engaged in the business of a finance lender" in California to obtain a license, although there is an exemption for a person making no more than five loans per year, so long as the loans are incidental to the business of the person relying on the exemption (e.g., bridge loans to a portfolio company) and the person is not engaged in the business of making loans. The licensing process is cumbersome and time consuming, but willful violation of the law can result in civil and criminal penalties. A license holder is subject to certain inspection and reporting obligations. Please let us know if you have any questions about the potential applicability of the CFLL to your operations.

Lobbyist Registration

Under a California law that became effective January 1, 2011, "placement agents" hired or engaged to solicit California state plans (e.g., CalSTRS, CalPERS and the University of California pension system) are required to register as lobbyists. Under existing law, lobbyists are restricted in their ability to provide gifts and make campaign contributions and are prohibited from accepting fees contingent upon the success of their lobbying efforts. Under the 2011 law, certain employees of a fund sponsor may be subject to the lobbyist registration requirements and the gift and campaign contribution limits, and sponsors that retain placement agents may have filing and record keeping obligations as "lobbyist employers." If you are contemplating retention of a placement agent or any solicitation of CalSTRS, CalPERS or the University of California pension system, please contact a member of your Proskauer team for more information.

In addition, under New York City's Lobbying Law and based on regulatory guidance issued in 2010-2012, placement agents and/or employees of investment fund managers may be required to register with New York City in connection with the offering of fund interests to any of the New York City pension funds (including New York City Employees' Retirement System, the New York City Police Pension Fund, the New York Fire Department Pension Fund, the New York City Teachers' Retirement System, and the New York City Board of Education Retirement System). Although the Lobbying Law had been in effect for 20 years, it had not previously been interpreted to apply to the marketing activities of investment funds and their agents.

As a reminder, other state and local plans have their own regulations and policies on the use of placement agents (including disclosure or placement agent bans in some circumstances), and lobbyist registration may be relevant for marketing to other state or local plans.

Liability Insurance

Investment advisers should consider purchasing management liability insurance depending on their level of exposure and the extent to which their business and operations warrant such coverage. Given the heightened regulatory scrutiny of the private funds industry, investment advisers may benefit from protection against officer and director liability, fiduciary liability, error and omission liability and employment practice liability.

2016 Federal Filings and Other Document Delivery Calendar

Filing / Delivery	Who must file	Deadline
November 2015		
Form 13F	Investment advisers that exercise investment discretion over $100 million or more in Section 13(f) securities	November 16 (for the quarter ending September 30, 2015)
NFA Form PR	Registered CTAs	November 16 (for the quarter ending September 30, 2015)
TIC Form BC, BL-1 and BL-2	U.S. residents with reportable cross-border claims or liabilities in excess of $50 million (or $25 million with respect to an individual country)	November 16 (for October 2015)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding $350 million as of any month	November 16 (for October 2015)
TIC Form SLT	U.S. resident custodian, issuer or end-investor having cross-border ownership of reportable long-term securities exceeding $1 billion as of the last day of any calendar month	November 23 (for October 2015)
Form PF	Large Hedge Fund Advisers	November 30 (for the quarter ending September 30, 2015)
CFTC Form CPO-PQR	Large CPOs	November 30 (for the quarter ending September 30, 2015)
NFA Form CPO-PQR	All registered CPOs, except Large CPOs	November 30 (for the quarter ending September 30, 2015)
Delivery of Monthly Account Statements to Pool Participants	Registered CPOs (except for CPOs exempt under CFTC Reg. 4.7 or with respect to commodity pools with NAV below $500,000)	November 30 (for October 2015)

Filing / Delivery	Who must file	Deadline
December 2015		
TIC Form BC, BL-1 and BL-2	U.S. residents with reportable cross-border claims or liabilities in excess of $50 million (or $25 million with respect to an individual country)	December 15 (for November 2015)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding $350 million as of any month	December 15 (for November 2015)
TIC Form SLT	U.S. resident custodian, issuer or end-investor having cross-border ownership of reportable long-term securities exceeding $1 billion as of the last day of any calendar month	December 23 (for November 2015)
Delivery of Monthly Account Statements to Pool Participants	Registered CPOs (except for CPOs exempt under CFTC Reg. 4.7 or with respect to commodity pools with NAV below $500,000)	December 30 (for November 2015)
January 2016		
Form PF	Large Liquidity Fund Advisers	January 15 (for the quarter ending December 31, 2015)
TIC Form BC, BL-1 and BL-2	U.S. residents with reportable cross-border claims or liabilities in excess of $50 million (or $25 million with respect to an individual country)	January 15 (for December 2015)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding $350 million as of any month	January 15 (for December 2015)
TIC Form BQ-1, BQ-2 and BQ-3	U.S. residents with reportable cross-border claims or liabilities in excess of $50 million (or $25 million with respect to an individual country) (Form BQ-1 and BQ-2 Part 1), in excess of $50 million (no country limit) (Form BQ-2 Part 2), or in excess of $4 billion (no country limit) (Form BQ-3)	January 20 (for the quarter ending December 31, 2015)

Filing / Delivery	Who must file	Deadline
TIC Form SLT	U.S. resident custodian, issuer or end-investor having cross-border ownership of reportable long-term securities exceeding $1 billion as of the last day of any calendar month	January 25 (for December 2015)
February 2016		
Delivery of Quarterly Account Statements to Pool Participants	Registered CPOs exempt under CFTC Reg. 4.7 or with respect to commodity pools with NAV below $500,000	February 1 (for the quarter ending December 31, 2015)
Delivery of Monthly Account Statements to Pool Participants	Registered CPOs (except for CPOs exempt under CFTC Reg. 4.7 or with respect to commodity pools with NAV below $500,000)	February 1 (for December 2015)
Form 13F	Investment advisers that exercise investment discretion over $100 million or more in Section 13(f) securities	February 16 (for the quarter ending December 31, 2015)
Schedule 13G Annual Amendment	Beneficial owners of at least 5% of a class of outstanding equity securities of a U.S. public company eligible to file Schedule 13G (i.e., Qualified Institutional Investors and/or passive investors)	February 16 (for 2015)
Form 13H Annual Amendment	Large traders of Regulation NMS securities	February 16 (for 2015)
Form 5	Insiders required to report any exempt or other insider transactions not previously reported on Form 4	February 16 (if the issuer has a December 31 fiscal year-end)
CFTC Form CTA-PR	Registered CTAs	February 16 (for the quarter ending December 31, 2015)
TIC Form BC, BL-1 and BL-2	U.S. residents with reportable cross-border claims or liabilities in excess of $50 million (or $25 million with respect to an individual country)	February 16 (for January 2016)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding $350 million as of any month	February 16 (for January 2016)

Filing / Delivery	Who must file	Deadline
TIC Form SLT	U.S. resident custodian, issuer or end-investor having cross-border ownership of reportable long-term securities exceeding $1 billion as of the last day of any calendar month	February 23 (for January 2016)
Form PF	Large Hedge Fund Advisers	February 29 (for the quarter ending December 31, 2015)
CFTC Form CPO-PQR	Large CPOs	February 29 (for the quarter ending December 31, 2015)
CFTC Registration Exemption Reaffirmations	CPOs exempt from CPO registration under CFTC Rule 4.5, 4.13(a)(1), 4.13(a)(2), 4.13(a)(3) or 4.13(a)(5) and CTAs exempt from CTA registration under CFTC Rule 4.14(a)(8).	February 29 (for 2015)
March 2016		
Delivery of Monthly Account Statements to Pool Participants	Registered CPOs (except for CPOs exempt under CFTC Reg. 4.7 or with respect to commodity pools with NAV below $500,000)	March 1 (for January 2016)
TIC Form BC, BL-1 and BL-2	U.S. residents with reportable cross-border claims or liabilities in excess of $50 million (or $25 million with respect to an individual country)	March 15 (for February 2016)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding $350 million as of any month	March 15 (for February 2016)
TIC Form SLT	U.S. resident custodian, issuer or end-investor having cross-border ownership of reportable long-term securities exceeding $1 billion as of the last day of any calendar month	March 23 (for February 2016)
Form ADV Part 1 Annual Update	Registered investment advisers and exempt reporting advisers	March 30 (for an investment adviser with a December 31 fiscal year-end)

Filing / Delivery	Who must file	Deadline
Form ADV Part 2A Annual Update	Registered investment advisers	March 30 (for an investment adviser with a December 31 fiscal year-end)
CFTC Form CPO-PQR	All registered CPOs, except Large CPOs	March 30 (for 2015)
NFA Form CPO-PQR	Small CPOs	March 30 (for the quarter ending December 31, 2015)
Delivery of Monthly Account Statements to Pool Participants	Registered CPOs (except for CPOs exempt under CFTC Reg. 4.7 or with respect to commodity pools with NAV below $500,000)	March 30 (for February 2016)
NFA Commodity Pool Annual Financial Statements Filing	Registered CPOs	March 30 (for a pool with a December 31 fiscal year-end)
FATCA Information Report	Participating FFIs (except for FFIs in Model 1 IGA jurisdictions)	March 31
April 2016		
Form PF	Large Liquidity Fund Advisers	April 15 (for the quarter ending March 31, 2016)
TIC Form BC, BL-1 and BL-2	U.S. residents with reportable cross-border claims or liabilities in excess of $50 million (or $25 million with respect to an individual country)	April 15 (for March 2016)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding $350 million as of any month	April 15 (for March 2016)
TIC Form BQ-1, BQ-2 and BQ-3	U.S. residents with reportable cross-border claims or liabilities in excess of $50 million (or $25 million with respect to an individual country) (Form BQ-1 and BQ-2 Part 1), in excess of $50 million (no country limit) (Form BQ-2 Part 2), or in excess of $4 billion (no country limit) (Form BQ-3)	April 20 (for the quarter ending March 31, 2016)

Filing / Delivery	Who must file	Deadline
TIC Form SLT	U.S. resident custodian, issuer or end-investor having cross-border ownership of reportable long-term securities exceeding $1 billion as of the last day of any calendar month	April 25 (for March 2016)
Form PF	Registered investment advisers with at least $150 million in RAUM attributable to private funds, including Large Private Equity Fund Advisers	April 29 (for an investment adviser with a December 31 fiscal year-end)
Delivery of Updated Form ADV Part 2A to Clients	Registered investment advisers	April 29 (for an investment adviser with a December 31 fiscal year-end)
Delivery of Annual Audited Financial Statements to Clients	Registered investment advisers (except with respect to fund-of-funds)	April 29 (for private fund with a December 31 fiscal year-end)
May 2016		
Delivery of Quarterly Account Statements to Pool Participants	Registered CPOs exempt under CFTC Reg. 4.7 or with respect to commodity pools with NAV below $500,000	May 2 (for the quarter ending March 31, 2016)
Delivery of Monthly Account Statements to Pool Participants	Registered CPOs (except for CPOs exempt under CFTC Reg. 4.7 or with respect to commodity pools with NAV below $500,000)	May 2 (for March 2016)
Form 13F	Investment advisers that exercise investment discretion over $100 million or more in Section 13(f) securities	May 16 (for the quarter ending March 31, 2016)
NFA Form PR	All registered CTAs	May 16 (for the quarter ending March 31, 2016)
TIC Form BC, BL-1 and BL-2	U.S. residents with reportable cross-border claims or liabilities in excess of $50 million (or $25 million with respect to an individual country)	May 16 (for April 2016)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding $350 million as of any month	May 16 (for April 2016)

Filing / Delivery	Who must file	Deadline
TIC Form SLT	U.S. resident custodian, issuer or end-investor having cross-border ownership of reportable long-term securities exceeding $1 billion as of the last day of any calendar month	May 23 (for April 2016)
Form PF	Large Hedge Fund Advisers	May 31 (for the quarter ending March 31, 2016)
CFTC Form CPO-PQR	Large CPOs	May 31 (for the quarter ending March 31, 2016)
NFA Form CPO-PQR	All registered CPOs, except Large CPOs	May 31 (for the quarter ending March 31, 2016)
Delivery of Monthly Account Statements to Pool Participants	Registered CPOs (except for CPOs exempt under CFTC Reg. 4.7 or with respect to commodity pools with NAV below $500,000)	May 31 (for April 2016)
	June 2016	
TIC Form BC, BL-1 and BL-2	U.S. residents with reportable cross-border claims or liabilities in excess of $50 million (or $25 million with respect to an individual country)	June 15 (for May 2016)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding $350 million as of any month	June 15 (for May 2016)
TIC Form SLT	U.S. resident custodian, issuer or end-investor having cross-border ownership of reportable long-term securities exceeding $1 billion as of the last day of any calendar month	June 23 (for May 2016)
Delivery of Annual Audited Financial Statements to Clients	Registered investment advisers (with respect to fund-of-funds)	June 28 (for a fund-of-funds with a December 31 fiscal year-end)
Delivery of Monthly Account Statements to Pool Participants	Registered CPOs (except for CPOs exempt under CFTC Reg. 4.7 or with respect to commodity pools with NAV below $500,000)	June 30 (for May 2016)

Filing / Delivery	Who must file	Deadline
FBAR	Hedge funds and private equity funds, and their investment advisers, if they have non-U.S. bank or other financial accounts	June 30
	July 2016	
Form PF	Large Liquidity Fund Advisers	July 15 (for the quarter ending June 30, 2016)
TIC Form BC, BL-1 and BL-2	U.S. residents with reportable cross-border claims or liabilities in excess of $50 million (or $25 million with respect to an individual country)	July 15 (for June 2016)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding $350 million as of any month	July 15 (for June 2016)
TIC Form BQ-1, BQ-2 and BQ-3	U.S. residents with reportable cross-border claims or liabilities in excess of $50 million (or $25 million with respect to an individual country) (Form BQ-1 and BQ-2 Part 1), in excess of $50 million (no country limit) (Form BQ-2 Part 2), or in excess of $4 billion (no country limit) (Form BQ-3)	July 20 (for the quarter ending June 30, 2016)
TIC Form SLT	U.S. resident custodian, issuer or end-investor having cross-border ownership of reportable long-term securities exceeding $1 billion as of the last day of any calendar month	July 25 (for June 2016)
	August 2016	
Delivery of Quarterly Account Statements to Pool Participants	Registered CPOs exempt under CFTC Reg. 4.7 or with respect to commodity pools with NAV below $500,000	August 1 (for the quarter ending June 30, 2016)
Delivery of Monthly Account Statements to Pool Participants	Registered CPOs (except for CPOs exempt under CFTC Reg. 4.7 or with respect to commodity pools with NAV below $500,000)	August 1 (for June 2016)

Filing / Delivery	Who must file	Deadline
Form 13F	Investment advisers that exercise investment discretion over $100 million or more in Section 13(f) securities	August 15 (for the quarter ending June 30, 2016)
NFA Form PR	All registered CTAs	August 15 (for the quarter ending June 30, 2016)
TIC Form BC, BL-1 and BL-2	U.S. residents with reportable cross-border claims or liabilities in excess of $50 million (or $25 million with respect to an individual country)	August 15 (for July 2016)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding $350 million as of any month	August 15 (for July 2016)
TIC Form SLT	U.S. resident custodian, issuer or end-investor having cross-border ownership of reportable long-term securities exceeding $1 billion as of the last day of any calendar month	August 23 (for July 2016)
Form PF	Large Hedge Fund Advisers	August 29 (for the quarter ending June 30, 2016)
CFTC Form CPO-PQR	Large CPOs	August 29 (for the quarter ending June 30, 2016)
NFA Form CPO-PQR	All registered CPOs, except Large CPOs	August 29 (for the quarter ending June 30, 2016)
Delivery of Monthly Account Statements to Pool Participants	Registered CPOs (except for CPOs exempt under CFTC Reg. 4.7 or with respect to commodity pools with NAV below $500,000)	August 30 (for July 2016)
September 2016		
TIC Form BC, BL-1 and BL-2	U.S. residents with reportable cross-border claims or liabilities in excess of $50 million (or $25 million with respect to an individual country)	September 15 (for August 2016)

Filing / Delivery	Who must file	Deadline
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding $350 million as of any month	September 15 (for August 2016)
TIC Form SLT	U.S. resident custodian, issuer or end-investor having cross-border ownership of reportable long-term securities exceeding $1 billion as of the last day of any calendar month	September 23 (for August 2016)
Delivery of Monthly Account Statements to Pool Participants	Registered CPOs (except for CPOs exempt under CFTC Reg. 4.7 or with respect to commodity pools with NAV below $500,000)	September 30 (for August 2016)
FATCA Information Report	Participating FFIs in Model 1 IGA jurisdictions	September 30 (for 2015)
October 2016		
Form PF	Large Liquidity Fund Advisers	October 17 (for the quarter ending September 30, 2016)
TIC Form BC, BL-1 and BL-2	U.S. residents with reportable cross-border claims or liabilities in excess of $50 million (or $25 million with respect to an individual country)	October 17 (for September 2016)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding $350 million as of any month	October 17 (for September 2016)
TIC Form BQ-1, BQ-2 and BQ-3	U.S. residents with reportable cross-border claims or liabilities in excess of $50 million (or $25 million with respect to an individual country) (Form BQ-1 and BQ-2 Part 1), in excess of $50 million (no country limit) (Form BQ-2 Part 2), or in excess of $4 billion (no country limit) (Form BQ-3)	October 20 (for the quarter ending September 30, 2016)

Filing / Delivery	Who must file	Deadline
TIC Form SLT	U.S. resident custodian, issuer or end-investor having cross-border ownership of reportable long-term securities exceeding $1 billion as of the last day of any calendar month	October 24 (for September 2016)
Delivery of Quarterly Account Statements to Pool Participants	Registered CPOs exempt under CFTC Reg. 4.7 or with respect to commodity pools with NAV below $500,000	October 31 (for the quarter ending September 30, 2016)
Delivery of Monthly Account Statements to Pool Participants	Registered CPOs (except for CPOs exempt under CFTC Reg. 4.7 or with respect to commodity pools with NAV below $500,000)	October 31 (for September 2016)
November 2016		
Form 13F	Investment advisers that exercise investment discretion over $100 million or more in Section 13(f) securities	November 14 (for the quarter ending September 30, 2016)
NFA Form PR	All registered CTAs	November 14 (for the quarter ending September 30, 2016)
TIC Form BC, BL-1 and BL-2	U.S. residents with reportable cross-border claims or liabilities in excess of $50 million (or $25 million with respect to an individual country)	November 15 (for October 2016)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding $350 million as of any month	November 15 (for October 2016)
TIC Form SLT	U.S. resident custodian, issuer or end-investor having cross-border ownership of reportable long-term securities exceeding $1 billion as of the last day of any calendar month	November 23 (for October 2016)
Form PF	Large Hedge Fund Advisers	November 29 (for the quarter ending September 30, 2016)
CFTC Form CPO-PQR	Large CPOs	November 29 (for the quarter ending September 30, 2016)

Filing / Delivery	Who must file	Deadline
NFA Form CPO-PQR	All registered CPOs, except Large CPOs	November 29 (for the quarter ending September 30, 2016)
Delivery of Monthly Account Statements to Pool Participants	Registered CPOs (except for CPOs exempt under CFTC Reg. 4.7 or with respect to commodity pools with NAV below $500,000)	November 30 (for October 2016)
Other Floating Deadlines		
Form D	Private funds conducting an offering under Regulation D	Initial Filing: Within 15 days of the initial sale of securities Annual Amendment: Anniversary date of the previous Form D filing Interim Amendment: As soon as practicable after certain changes in information Note: Additional state blue sky filing requirements may apply.
Schedule 13D	Beneficial owners of at least 5% of a class of outstanding equity securities of a U.S. public company	Initial Filing: Within 10 days of crossing the 5% threshold Amendment: Promptly after any material change in beneficial ownership percentage

Filing / Delivery	Who must file	Deadline
Schedule 13G	Beneficial owners of at least 5% of a class of outstanding equity securities of a U.S. public company eligible to file Schedule 13G (i.e., Qualified Institutional Investors and/or passive investors)	Initial Filing: Generally, within 45 days of year-end (if a QII or exempt investor) or within 10 days of crossing the 5% threshold (if a passive investor) Annual Amendment: Within 45 days of year-end (see above) Interim Amendment: Within 10 days of month-end (if a QII) or promptly (if a passive investor) if holding exceeds 10% or if it thereafter increase or decrease by over 5%
Form 13H	Large traders of Regulation NMS securities	Initial Filing: Promptly (usually 10 days) after reaching reporting threshold Annual Amendment: Within 45 days of year-end (see above) Interim Amendment: Promptly after quarter-end if there is any change in information
Form 3	Beneficial owners of more than 10% of a class of equity securities of a U.S. public company, or officers or directors of a U.S. public company	Within 10 days of becoming a 10% beneficial owner, officer or director
Form 4	Beneficial owners of more than 10% of a class of equity securities of a U.S. public company or officers or directors of a U.S. public company that effect a transaction changing the beneficial ownership of securities previously reported on Form 3	Within 2 business days of the transaction

Filing / Delivery	Who must file	Deadline
Hart-Scott-Rodino Filings	Persons contemplating a business transaction which is not "solely for the purpose of investment" and relates to either: (i) the acquisition of voting securities valued in excess of $76.3 million (adjusted annually); or (ii) the acquisition of a majority of interests in certain unincorporated entities (such as certain partnerships or LLCs). The passive investor exemption is available only for holdings not exceeding 10% of an issuer's voting stock	Prior to completion of the proposed business transaction Note: Filers are generally subject to 30-day waiting period after submitting their HSR notice filing
Form BE-13 or BE-13 Claim for Exemption	U.S. entities in which a non-U.S. person acquires direct or indirect ownership or control of 10% or more of the voting securities of the entity If the cost of the transaction exceeds $3 million, then the U.S. entity should file Form BE-13 If the cost of the transaction does not exceed $3 million, then the U.S. entity should file a BE-13 Claim for Exemption	Within 45 days after a reportable transaction
New Issues Affirmations	Private funds that invest in new issues	Annually
Delivery of Privacy Policy Notice to Clients	Most investment advisers	Annually
Delivery of ERISA/VCOC Annual Certification to ERISA Investors	Private funds operating as a VCOC or pursuant to the 25% cap	Annually
Delivery of Schedule K-1	Private funds that are partnerships	Due date (including any applicable extension) of the partnership's U.S. federal income tax return
Section 83(b) Filing	Individuals that filed a Section 83(b) election with the IRS during 2015	Due date (including any applicable extensions) of the individual's 2015 U.S. federal income tax return

Filing / Delivery	Who must file	Deadline
Form 8832 Filing	Entities that filed an IRS Form 8832 with respect to 2015	Due date (including any applicable extension) of that entity's 2015 U.S. federal income tax return
QEF Election	In the case of a private fund that has invested in a non-U.S. portfolio company that is (or may be) a PFIC, the first U.S. person in the PFIC's ownership chain (e.g., the fund itself if a U.S. fund, or each U.S. investor if a non-U.S. fund)	Due date (including any applicable extensions) of that U.S. person's 2015 U.S. federal income tax return
EIP Election	Eligible private funds wishing to opt out of mandatory tax basis adjustments	Due date (including any applicable extensions) of that private fund's 2015 U.S. federal income tax return
Certain U.S. Tax Filings with respect to Non-U.S. Entities	Private funds and their U.S. investors may be required to make certain filings with respect to non-U.S. entities owned by the private fund, including, without limitation: • IRS Form 5471 • IRS Form 926 • IRS Form 8621 • IRS Form 8865 • IRS Form 8858 • IRS Form 8938	Generally, due date (including any applicable extensions) of the U.S. person's 2015 U.S. federal income tax return

Acknowledgements

This Annual Review is a service to our clients and friends. It is designed only to give general information on the developments actually covered. It is not intended to be a comprehensive summary of recent developments in the law, treat exhaustively the subjects covered, provide legal advice or render a legal opinion.

This Annual Review was prepared by Robert G. Leonard, Michael F. Mavrides, Christopher M. Wells, Howard J. Beber, Sean J. Hill, Joyce Y. Ng and Tiffany Kwa, with contributions from Michael J. Album, Martin J. Bienenstock, Mark J. Biros, Allan S. Bloom, Ira G. Bogner, Benjamin J. Catalano, Lloyd B. Chinn, Robert E. Gaut, David T. Jones, Jeremy Leifer, Ying Li, Kristen J. Mathews, Peter McGowan, Timothy W. Mungovan, Amanda H. Nussbaum, Katharine H. Parker, Charles (Chip) Parsons, Geoffrey T. Raicht, Jonathan E. Richman, Kathy H. Rocklen, Anthony M. Drenzek, John R. Ingrassia, Adam W. Scoll, Susan L. Wiener, Daniella Abel, Gregory Branagan, Carolyn M. Dellatore, Amy G. Drais, Alice G. Dullaghan, Jessica P. Fisher, Pinchos (Pinny) Goldberg, Daniel W. Hatten, Amanda D. Hellenthal, Harris B. Hoffberg, Lijuan Hou, Elliot Katz, Smriti Kodandapani, Charles Lee, Danielle Dutervil Mubarak, Nicholas J. Mullen, Louis V. Sorgi, Krista Whitaker and Frank M. White.

Contacts

For additional information on matters discussed in this Annual Review, please contact any of the Proskauer attorneys listed below:

HEDGE FUNDS

Robert G. Leonard
212.969.3355
rleonard@proskauer.com

Michael F. Mavrides
212.969.3670
mmavrides@proskauer.com

Christopher M. Wells
212.969.3600
cwells@proskauer.com

Peter McGowan (London)
+44.20.7280.2066
pmcgowan@proskauer.com

PRIVATE INVESTMENT FUNDS

Howard J. Beber
617.526.9754
hbeber@proskauer.com

Stephanie W. Berdik
617.526.9441
sberdik@proskauer.com

Bruno Bertrand-Delfau (London)
+44.20.7280.2126
bbertrand-delfau@proskauer.com

Lynn Chan (Hong Kong)
+852.3410.8018
lchan@proskauer.com

Sarah K. Cherry
617.526.9769
scherry@proskauer.com

Niamh A. Curry
212.969.3474
ncurry@proskauer.com

Anthony M. Drenzek
617.526.9655
adrenzek@proskauer.com

Daniel P. Finkelman
617.526.9755
dfinkelman@proskauer.com

Sean J. Hill
617.526.9805
shill@proskauer.com

David T. Jones
617.526.9751
djones@proskauer.com

Ying Li (Hong Kong)
+852.3410.8088
yli@proskauer.com

Bruce L. Lieb
212.969.3320
blieb@proskauer.com

Stephen T. Mears
617.526.9775
smears@proskauer.com

Malcolm B. Nicholls III
617.526.9787
mnicholls@proskauer.com

Charles (Chip) Parsons
212.969.3254
cparsons@proskauer.com

Marc A. Persily
212.969.3403
mpersily@proskauer.com

Robin A. Painter
617.526.9790
rpainter@proskauer.com

Yong Ren (Beijing)
+86.10.8572.1899
yren@proskauer.com

Oliver Rochman (London)
+44.20.7280.2069
orochman@proskauer.com

Kate Simpson (London)
+44.20.7280.2068
ksimpson@proskauer.com

Michael R. Suppappola
617.526.9821
msuppappola@proskauer.com

David W. Tegeler
617.526.9795
dtegeler@proskauer.com

John Verwey (London)
+44.20.7280.2033
jverwey@proskauer.com

Nigel van Zyl (London)
+44.20.7280.2070
nvanzyl@proskauer.com

TAX

Richard M. Corn
212.969.3553
rcorn@proskauer.com

Michael Fernhoff
310.284.5671
mfernhoff@proskauer.com

Robert Gaut (London)
+44.20.7280.2064
rgaut@proskauer.com

Martin T. Hamilton
212.969.3964
mhamilton@proskauer.com

Scott S. Jones
617.526.9772
sjones@proskauer.com

Anne Kim
310.284.4575
akim@proskauer.com

Mary B. Kuusisto
617.526.9760
mkuusisto@proskauer.com

Arnold P. May
617.526.9757
amay@proskauer.com

Amanda H. Nussbaum
212.969.3642
anussbaum@proskauer.com

Jamiel E. Poindexter
617.526.9773
jpoindexter@proskauer.com

Catherine Sear (London)
+44.20.7280.2061
csear@proskauer.com

PRIVATE EQUITY AND HEDGE FUNDS LITIGATION

David Chu (Hong Kong)
+852.3410.8028
dchu@proskauer.com

Peter Duffy Doyle
212.969.3688
pdoyle@proskauer.com

Timothy W. Mungovan
617.526.9412
tmungovan@proskauer.com

Kevin J. Perra
212.969.3454
kperra@proskauer.com

SEC ENFORCEMENT

Robert J. Cleary
212.969.3340
rjcleary@proskauer.com

Ralph C. Ferrara
202.416.5820
rferrara@proskauer.com

Sigal P. Mandelker
212.969.3360
smandelker@proskauer.com

Jonathan E. Richman
212.969.3448
jerichman@proskauer.com

BROKER-DEALER

Benjamin J. Catalano
212.969.3980
bcatalano@proskauer.com

Charles E. Dropkin
212.969.3535
cdropkin@proskauer.com

Edward A. Kwalwasser
212.969.3515
ekwalwasser@proskauer.com

Kathy H. Rocklen
212.969.3755
krocklen@proskauer.com

CFTC/DERIVATIVES/SECURITIES LENDING/ REPOS

Charles E. Dropkin
212.969.3535
cdropkin@proskauer.com

Peter McGowan (London)
+44.20.7280.2066
pmcgowan@proskauer.com

Christopher M. Wells
212.969.3600
cwells@proskauer.com

MARKETS AND TRADING/REGULATION

Edward A. Kwalwasser
212.969.3515
ekwalwasser@proskauer.com

Frank Zarb
202.416.5870
fzarb@proskauer.com

ERISA

Ira G. Bogner
212.969.3947
ibogner@proskauer.com

Adam W. Scoll
617.526.9486
ascoll@proskauer.com

EXECUTIVE COMPENSATION

Michael J. Album
212.969.3650
malbum@proskauer.com

Daniel Ornstein (London)
+44.20.7280.2067
dornstein@proskauer.com

Michael S. Sirkin
212.969.3840
msirkin@proskauer.com

EMPLOYMENT

Allan S. Bloom
212.969.3880
abloom@proskauer.com

Katharine H. Parker
212.969.3009
kparker@proskauer.com

WHISTLEBLOWER

Connie N. Bertram
202.416.6810
cbertram@proskauer.com

Lloyd B. Chinn
212.969.3341
lchinn@proskauer.com

TRUSTS AND ESTATES

Henry J. Leibowitz
212.969.3602
hleibowitz@proskauer.com

David Pratt
561.995.4777
dpratt@proskauer.com

Jay D. Waxenberg
212.969.3606
jwaxenberg@proskauer.com

BANKRUPTCY AND RESTRUCTURING

Martin J. Bienenstock
212.969.4530
mbienenstock@proskauer.com

Jeff J. Marwil
312.962.3540
jmarwil@proskauer.com

Geoffrey Raicht
212.969.3165
graicht@proskauer.com

FCPA/OFAC/ANTI-MONEY LAUNDERING

Mark J. Biros
202.416.5804
mbiros@proskauer.com

CYBERSECURITY/ INTELLECTUAL PROPERTY AND TECHNOLOGY

Daryn A. Grossman
212.969.3665
dgrossman@proskauer.com

Kristen J. Mathews
212.969.3265
kmathews@proskauer.com

Jeffrey D. Neuburger
212.969.3075
jneuburger@proskauer.com

MULTI-TRANCHE FINANCE

William P. Brady
212.969.3299
wbrady@proskauer.com

Gary J. Creem
617.526.9637
gcreem@proskauer.com

Steven M. Ellis
617.526.9660
sellis@proskauer.com

CAPITAL MARKETS

Julie M. Allen
212.969.3155
jallen@proskauer.com

Peter Castellon (London)
+44.20.7280.2091
pcastellon@proskauer.com

Jeremy Leifer (Hong Kong)
+852.3410.8048
jleifer@proskauer.com

Frank Lopez
212.969.3492
flopez@proskauer.com

Fabio A. Yamada (Sao Paulo)
+55.11.3045.1250
fyamada@proskauer.com

MERGERS & ACQUISITIONS

Jonathan Benloulou
310.284.5698
jbenloulou@proskauer.com

Steven Davis (London)
+44.20.7280.2049
sdavis@proskauer.com

James P. Gerkis
212.969.3135
jgerkis@proskauer.com

Jeremy Leifer (Hong Kong)
+852.3410.8048
jleifer@proskauer.com

Ronald R. Papa
212.969.3325
rpapa@proskauer.com

Steven M. Peck
617.526.9890
speck@proskauer.com

Peter G. Samuels
212.969.3335
psamuels@proskauer.com

Monica J. Shilling
310.284.4544
mshilling@proskauer.com

Michael W. Woronoff
310.284.4550
mworonoff@proskauer.com

Beijing
Suite 5102, 51/F
Beijing Yintai Centre Tower C
2 Jianguomenwai Avenue
Chaoyang District
Beijing 100022, China
t: +86.10.8572.1800
f: +86.10.8572.1850

Boca Raton
2255 Glades Road
Suite 421 Atrium
Boca Raton, FL 33431-7360, USA
t: +1.561.241.7400
f: +1.561.241.7145

Boston
One International Place
Boston, MA 02110-2600, USA
t: +1.617.526.9600
f: +1.617.526.9899

Chicago
Three First National Plaza
70 West Madison, Suite 3800
Chicago, IL 60602-4342, USA
t: +1.312.962.3550
f: +1.312.962.3551

Hong Kong
Suites 1701-1705, 17/F
Two Exchange Square
8 Connaught Place
Central, Hong Kong
t: +852.3410.8000
f: +852.3410.8001

London
110 Bishopsgate
London EC2N 4AY, United Kingdom
t: +44.20.7280.2000
f: +44.20.7280.2001

Los Angeles
2049 Century Park East, 32nd Floor
Los Angeles, CA 90067-3206, USA
t: +1.310.557.2900
f: +1.310.557.2193

New Orleans
Poydras Center
650 Poydras Street
Suite 1800
New Orleans, LA 70130-6146, USA
t: +1.504.310.4088
f: +1.504.310.2022

New York
Eleven Times Square
New York, NY 10036-8299, USA
t: +1.212.969.3000
f: +1.212.969.2900

Newark
One Newark Center
Newark, NJ 07102-5211, USA
t: +1.973.274.3200
f: +1.973.274.3299

Paris
374 rue Saint-Honoré
75001 Paris, France
t: +33.1.53.05.60.00
f: +33.1.53.05.60.05

São Paulo
Rua Funchal, 418
26º andar
04551-060 São Paulo, SP, Brasil
t: +55.11.3045.1250
f: +55.11.3049.1259

Washington, D.C.
1001 Pennsylvania Avenue, NW
Suite 400 South
Washington, DC 20004-2533, USA
t: +1.202.416.6800
f: +1.202.416.6899

Proskauer

Proskauer.com