

Proskauer»

2017 Proskauer

Annual Review and Outlook

for Hedge Funds, Private Equity Funds and
Other Private Funds



2017 Proskauer Annual Review and Outlook for Hedge Funds, Private Equity Funds and Other Private Funds

The following annual review and outlook (**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 2018.

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, Niamh A. Curry, Anthony M. Drenzek and Christopher W. Ryder, with contributions from Mike Album, John P. Barry, Connie N. Bertram, Martin J. Bienenstock, Allan S. Bloom, Ira G. Bogner, Benjamin J. Catalano, Lloyd B. Chinn, John E. Failla, Chantel L. Febus, Robert E. Gaut, Vincent Indelicato, Edward A. Kwalwasser, Henry J. Leibowitz, Jeremy C. Leifer, Jeffrey W. Levitan, Ying Li, Kristen J. Mathews, Timothy W. Mungovan, Jeffrey D. Neuburger, Joshua M. Newville, Amanda H. Nussbaum, Stephen Pevsner, Robert Plaze, Jonathan E. Richman, Kathy H. Rocklen, Catherine Sear, Mike Sirkin, Jay D. Waxenberg, Fabio A. Yamada, Frank Zarb, Nathan R. Lander, Adam W. Scoll, John Verwey, Susan L. Wiener, Edward J. Canter, William D. Dalsen, Amy G. Drais, Yonatan L. Grossman-Boder, Brian A. Hooven, Lijuan Hou, Mani Kakkar, Smriti Kodandapani, Nathan R. Lander, Charles Lee, Marissa A. Mastroianni, Mariya (Masha) Nazginova, Tiffany Quach, Louis Rambo, Saulo Salles de Padua, Luzia Santos, Brett Schwab, Divya Taneja, Pengtao (Mac) Teng, Oleg Zakatov, Max D. Brashear, Elizabeth G. Coscia and Jonathan P. Mollod.

Table of Contents

SEC Examination Priorities and Trends	1
SEC Enforcement Developments	2
SEC Outlines Guiding Principles and Enforcement Priorities	2
2017 Enforcement Trends	2
Initial Coin Offerings May Be Securities	3
Performance Marketing and Advertising	3
Valuation	3
Continued Focus on Fee/Expense and Conflict Disclosures	4
Trade Allocation	5
MNPI/Insider Trading	5
Form ADV Misstatements	5
Other Enforcement Highlights	6
SEC Administrative Proceeding Updates	6
SEC Whistleblower Updates	7
Continued Scrutiny of Separation Agreements	7
Awards to Culpable Whistleblowers	8
CFTC Amends Whistleblowing Rules	9
Financial CHOICE Act of 2017	9
Anticipated Supreme Court Ruling	9
SEC Rule Making Developments & Other Guidance	10
Private Funds Litigation	10
Devaluation of Technology Unicorns	10
Distributed Ledger Technology	11
Cybersecurity	11
Valuation Practices and Performance Marketing	11
Professional Liability Insurance	11
CFTC Updates	12
CFTC Position Limits	12
Final Rule on Aggregation Requirements	12
Proposed Regulation AT	12
Enforcement Actions	12
FINRA/Broker-Dealer Updates	13
Regulation of ICOs	13
The SEC's Report on the DAO Tokens as Securities	13

The Significance of Tokens as Securities	14
Implications for ICO Stakeholders.....	14
The Road Ahead	15
The SEC's Adopts T+2 Settlement	15
State Legislative Efforts Impose Fiduciary Duties and Related Requirements on Broker-Dealers	15
FINRA Expansion of Pay-to-Play Regulation to Capital Acquisition Brokers....	16
State Regulatory Updates	17
Form D	17
Blue Sky Filings.....	17
Insider Trading Updates	18
Friends and Benefits	18
Newman	18
Salman	19
Martoma	20
Where Are We Now?.....	21
Materiality	22
SEC's Use of Advanced Data Analytics	23
The SEC Gets Hacked.....	23
Legislation on Insider Trading? Perhaps?.....	24
Final Note	25
FCPA Updates	25
SEC and DOJ FCPA Enforcement Activity	25
Key Risks for Private Funds.....	26
Anti-Money Laundering Updates.....	26
FinCEN Final Rule on Beneficial Ownership.....	26
FinCEN Proposed AML Rules for Registered Investment Advisers.....	27
SEC Charges Broker-Dealer for Failing to File Suspicious Activity Reports.....	27
Cybersecurity Updates	28
SEC Establishes New Enforcement Initiative Directed at Cyber-Based Threats	28
SEC Risk Alerts Warn Investment Advisers and Broker-Dealers about Ransomware and Recommend Cybersecurity Best Practices.....	28
FINRA Takes Disciplinary Action Against Firms for Failing to Protect Records from Alteration	28
Growing Trend of State Financial Regulators Addressing Cybersecurity Risks	29
New York.....	29
Vermont.....	29
Colorado.....	30

Big Data, Web Scraping and Other Issues in Data Science for Fund Managers...	30
Introduction to Big Data and Web Scraping	30
Breach of Contract	31
Computer Fraud and Abuse Act.....	32
Securities Laws	32
Copyright Infringement.....	33
Additional Issues	33
Fund Manager Best Practices	34
Blockchain Updates.....	35
Blockchain Generally.....	35
Blockchain State Law Developments	36
Initial Coin Offerings	36
BEA Filing Updates	37
U.S. Tax Updates	37
Comprehensive Tax Reform	37
Selected General Provisions	38
Tax-Exempt Organizations	41
Tax Treatment of Partnership Audits.....	41
Gain on Sale by Non-U.S. Partner of Interest in ECI-Generating Partnership..	42
Section 754 Election – No Signature Required	42
871(m) Regulations	43
Section 385 Regulations	43
BEPS and Country by Country Reporting	44
United States.....	44
ERISA Updates	45
Employment Law Updates	47
Invalidation of the 2016 Federal Overtime Rule.....	47
Newly Enacted State Paid Family Leave Laws	47
DOL Wage and Hour Division Resumes Issuing Opinion Letters	49
Newly Enacted Restrictions on Employer Inquiries into Salary History	49
New York City.....	49
Philadelphia.....	51
San Francisco	51
New York City Freelancer Law.....	52
Supreme Court to Review Class Action Waivers in Arbitration Agreements	52
Executive Compensation Updates	53
Insurance Updates	55

Enhancing Coverage for Government Investigations.....	55
Protecting against Cyber Risks	55
Focus on Protecting Key Individuals	56
Focus on Costs of Correction Coverage	56
Increased Attention to Portfolio Company Risk and Insurance.....	56
Looking Ahead to 2018	56
Activist Investing Updates	57
Section 16 Cases	57
Background	57
Recent Court Decisions.....	57
Brokaw Act	60
Estate Planning Updates.....	61
Lifetime Estate, Gift and GST Tax Exemptions.....	61
Gift Tax Annual Exclusion	62
2017 Gift Tax Returns	62
IRA Required Minimum Distributions Deadline	62
New Tax Legislation	63
Estate, Gift and GST Taxes	63
Reorganization and Chapter 11 Developments	63
Supreme Court Strikes Down Use of “Structured Dismissal” in Chapter 11 to Circumvent Absolute Priority Rule.....	63
The <i>Jevic</i> Decision	64
Structured Dismissals Going Forward.....	65
Reorganizing Around the Trust Indenture Act.....	65
The <i>Marblegate</i> Decision	65
Creative Out-of-Court Restructurings.....	67
Making Creditors Whole	67
The <i>Ultra Petroleum</i> Decision	67
Alternative Arrangements.....	68
European Union Regulatory Updates	68
Brexit Update.....	68
Expected Loss of the Financial Services Cross-Border “Passport”	68
EU Anti-Money Laundering Update.....	69
Changes to the UK Persons with Significant Control Regime.....	69
AIFMD Update.....	69
Packaged Retail and Insurance-Based Investment Products Regulation Update.....	70
Requirements for the KID.....	71
GDPR Update	71

What Does the GDPR Do?	72
Who Does the GDPR Apply To?	72
Why Does the GDPR Matter?	72
What would bring Non-EU Fund Managers within the Scope of the GDPR? ...	72
What are the Next Steps Fund Managers Should be Taking to Prepare for the GDPR?	72
MiFID II Update	73
UK Tax Updates	74
OECD Base Erosion and Profit Shifting and the UK's Response	74
Action 2 – Neutralising the Effects of Hybrid Mismatches.....	75
Action 4 – Limiting Base Erosion Involving Interest Deductions and Other Financial Payments	76
Action 6 – Preventing the Granting of Treaty Benefits in Inappropriate Circumstances.....	77
Action 7 – Preventing the Artificial Avoidance of Permanent Establishment Status	78
Actions 8-10 – Transfer Pricing – Aligning Transfer Pricing Outcomes with Value Creation.....	79
Article 13 – Transfer Pricing Documentation and Country by Country Reporting.....	79
China Regulatory Updates	80
New AMAC Regulations on the Registration and Conduct of Private Fund Managers	80
Restriction on Foreign Ownership of Private Securities Investment Fund Management Companies Lifted	80
Certain AMAC Self-Regulatory Rules can be Expected to be put in a Higher Level of Law	81
Hong Kong Regulatory Updates.....	81
Bond Connect Launched.....	81
SEC and Hong Kong SFC Sign New Memorandum of Understanding.....	81
Consultation Paper on Expansion of Categories of Professional Investors	82
Requirement to Include Suitability Clause in Client Agreements	82
Augmented Responsibility Regime for Senior Management of Licensed Corporations (Managers-in-Charge of Core Functions).....	83
Expansion of the Short Position Reporting Regime	84
Open-Ended Fund Companies.....	84
Enhancements to the Open Position Limit Regime.....	85
SFC Statement on ICOs.....	86
Changes to Disclosure of Interests Regime	86
Electronic Filing	86

New Forms and Event Codes	87
No Filing with Listco	87
Latin America Regulatory Updates.....	87
Introduction to the Legal Framework of Brazilian Funds.....	87
New Regulatory Framework for Brazilian Funds.....	88
Brazilian Tax Authorities Increased Scrutiny over FIP Ownership Structures ..	91
Annual Compliance Review and Filing Requirements	91
Offering Document Updates.....	91
Compliance Policies and Procedures Review and Employee Training.....	91
Rule 506(d) Bad Actor Due Diligence	92
Broker-Dealer Registration Issues	92
Business Continuity and Disaster Recovery Plans	93
Anti-Money Laundering Policies.....	93
Annual and Other Periodic Filing Requirements	93
Form ADV.....	94
Umbrella Registration for Multiple Related Advisers.....	94
Additional Reporting Requirements for Separately Managed Accounts	95
Additional Information Regarding Investment Advisers	95
Clarifying and Technical Amendments to Form ADV.....	96
Amendments to Performance Reporting Record-Keeping Rules.....	97
Compliance Dates	97
Form PF	98
Form D and Blue Sky Filings.....	99
Form 13F.....	100
Schedules 13D and 13G	100
Forms 3, 4 and 5	101
Form 13H	101
CFTC Annual Reaffirmations and Periodic Reports.....	102
TIC Form B.....	104
TIC Form S.....	105
TIC Form SLT.....	105
BE-13	106
Annual U.S. Tax Elections and Filings	106
Other Annual Requirements and Considerations.....	109

2017 Developments and Outlook for 2018

SEC Examination Priorities and Trends

Examinations of investment advisers by the U.S. Securities and Exchange Commission's (**SEC**) Office of Compliance Inspections and Examinations (**OCIE**) continue at a rapid pace, ranging from the largest to the smallest advisers, and with an apparent continued emphasis on advisers who previously have not been examined. The focus seems to have shifted somewhat away from private equity fund managers and now seems more balanced among managers of hedge, private equity and other private funds.

The most typical exam format for private fund advisers seems to be one week on site, after two weeks' advance notice and a longer (often two to three hours) introductory conference telephone call in which representatives of a number of different groups within the SEC's staff may participate. Follow up written questions can continue for weeks or months after completion of the *onsite* portion of the exam, although the examiners do seem to try to conclude exams within six months as required by internal OCIE guidelines.

Not all examinations are the same, and practices can and do vary from one SEC office to another and from examiner to examiner. We have experienced directly, and heard reports of, surprise examinations without any advance notice, especially out of the SEC's Boston regional office. We have also seen a number of "remote" examinations recently that began exclusively offsite with a conference call and document request, where the examiners indicated that they would determine at a later date whether or not there would be an onsite portion of the exam.

There also have been reports recently of sweep examinations focused on private credit (*e.g.*, direct lending activities and liquidity and valuation issues), initial public offerings (**IPOs**) and electronic messaging (including questions as to the types of platforms and devices used, written and "unwritten" policies, monitoring and record keeping practices, records of exceptions and violations, internal audits and risk assessments).

The topics covered in exams do not seem to have changed significantly. A recent release by OCIE cited the most common areas of deficiencies identified in examinations as: the compliance rule (compliance manuals not tailored to adviser's business; failure to conduct annual compliance reviews; and failure to follow existing procedures); regulatory filings (incorrect or late Form ADV, Form PF and Form D filings); the custody rule (**Custody Rule**) under the Investment Advisers Act of 1940 (**Advisers Act**) (technical mistakes and failure to identify covered accounts); code of ethics (late or missing reports by access persons); and books and records.

OCIE also recently released a very informative advisory describing common deficiencies noted in exams relating to advertisements and marketing materials. The most common deficiencies included reporting gross versus net performance results; using hypothetical or back-tested performance results without explaining how the returns were derived or failing to include other material information; incorrectly claiming compliance with voluntary performance standards like the Global Investment Performance Standards (**GIPS**); cherry-picking (*i.e.*, including only profitable stock selections or recommendations without meeting conditions set forth in prior SEC guidance); using composites without correctly defining or disclosing which accounts were included in the composite; and using accolades (referred to by OCIE as its "touting" initiative) obtained by submitting false or misleading information, or that used stale ranking or

evaluation information or that failed to disclose key facts, such as that the adviser paid a fee to participate and be ranked.

Other matters that we have seen raised frequently in exams include: fees and expenses (calculation, allocation and adequacy of disclosure); insider trading (monitoring contacts between employees and insiders; managing access to nonpublic information; use of consultants; restricted lists); conflicts of interest (parallel trading; trade allocations; cross trades; side letters and other relationships); use of social media; personal trading by employees; pay-to-play practices; valuations; and whistleblower issues (improper language in employment or severance agreements).

Our conclusion, supported by recent comments from SEC staffers, is that OCIE's examination practices and priorities have not changed materially with the new administration.

SEC Enforcement Developments

SEC Outlines Guiding Principles and Enforcement Priorities

The newly appointed SEC Chairman Jay Clayton has outlined high-level guiding principles for the agency in his [September 2017 testimony](#) before Congress and in a [July speech](#) to the Economic Club of New York. In general, these remarks focused on (i) ensuring protections for retail investors, (ii) positioning the SEC as a regulator which is able to evolve on pace with industry, and (iii) taking a more measured and effects-focused approach to rulemaking. In addition, Chair Clayton has [stated](#) that he opposes any wholesale changes to the SEC's fundamental regulatory and enforcement approach.

Clayton reiterated the SEC's traditional three part mission: (1) to protect investors; (2) to maintain fair, orderly and efficient markets; and (3) to facilitate capital formation. Interestingly, he has repeatedly stated that the "analysis starts and ends with the long-term interests of the Main Street investor." With this end in mind, it appears that the focus relative to private funds will be on areas where retail investors (including pension funds and retirement plans) have access to nonpublic offerings.

For enforcement priorities, Clayton stated that the SEC would focus on areas where main street investors are "most exposed" and listed the following: retail investor fraud; misconduct by brokers and investment advisers; insider trading; market manipulation; accounting fraud; and cybersecurity. Clayton has stated that individual accountability is the most effective deterrent. We can expect to see continued coordination between the SEC and the Department of Justice (**DOJ**), and continued focus on the conduct of individual actors.

2017 Enforcement Trends

In March 2017, senior SEC staff [outlined](#) their priorities for private funds. In particular, they noted the following areas of focus:

- **Valuation:** This is a perennial priority for the SEC staff. Even in matters where the SEC does not challenge valuations *per se*, the staff tends to focus on structural issues around valuation, such as failure to follow firm policies and procedures, or breakdowns in controls.
- **Undisclosed Fees:** The SEC's Asset Management Unit (**AMU**) is highly focused on failures to adequately disclose fees or compensation that directly or indirectly benefit an adviser. This focus is nothing new – fee and expense allocations are [classic examples](#) of a potential conflict of interest between an adviser and a fund.
- **Trade Allocation:** Enforcement will look at trade allocation practices with respect to private funds as well as retail client advisers, especially situations where favorable trades are allocated to accounts

where an adviser receives higher fees – so-called “cherry-picking” – or allocated in a manner inconsistent with guidelines disclosed to clients.

- **Gatekeepers:** When the SEC identifies a significant issue with an adviser or a fund, the AMU will evaluate whether the gatekeepers, such as auditors, custodians or administrators, failed to perform their duties.
- **Insider Trading:** The SEC staff continues to focus on identifying suspicious trades, including those that may be the result of unauthorized computer hacking. SEC staff members repeatedly have noted their use of data analytics to track patterns of suspicious trading.

For more information, please see our posts [SEC Chairman Identifies Guiding Principles](#) and [SEC Speaks: 2017 Enforcement and Exam Trends for Private Funds](#), on Proskauer’s Capital Commitment Blog and our later discussion of [Big Data, Web Scraping and Other Issues in Data Science for Fund Managers](#).

Initial Coin Offerings May Be Securities

On July 25, 2017, the SEC issued an [investigative report](#) cautioning market participants that offers and sales of digital assets by “virtual” organizations are subject to the requirements of the federal securities laws. For example, initial coin offerings (ICOs) or tokens based on distributed ledger or blockchain technology may qualify as securities if they otherwise meet the traditional *Howey* test for investment contracts. The SEC is determined to stake a claim to this category using the application of traditional securities laws.

Please see our [August 24, 2017](#) post on Proskauer’s [Capital Commitment Blog](#) and our [full client alert \(SEC Speaks on Initial Coin Offerings\)](#) for more information.

Performance Marketing and Advertising

In September of this year, the SEC published a [Risk Alert](#) highlighting the most common deficiencies seen in investment advisers’ marketing materials based on recent examinations and initiatives. The top six deficiencies were: (i) misleading performance results; (ii) misleading one-on-one presentations; (iii) misleading claims of compliance with voluntary performance standards; (iv) cherry-picked profitable stock selections; (v) misleading selection of investment recommendations; and (vi) lack of adequate compliance policies and procedures.

Disclosure of prior performance has and will come under the regulatory microscope. For example, a misstep in a fund’s initial performance figures – such as presenting performance gross of fees – will invite SEC scrutiny of disclosures to investors. In 2016, the SEC sanctioned a number of advisory firms for repeating misleading third-party performance claims and also enhanced the record keeping obligations for performance advertising. Challenges concerning valuation practices will likely bring challenges concerning performance marketing and advertising.

Please see our [September 25, 2017](#) post on Proskauer’s [Capital Commitment Blog](#) for more information.

Valuation

The SEC typically notes that valuation is one of its priorities for private fund exams and enforcement. In our experience, however, the SEC will focus on issues “around” valuation practices, including: (i) breakdowns in controls/policies/procedures; (ii) violations of generally accepted accounting principles (GAAP); and (iii) disclosures to investors and auditors.

SEC Continues to Pursue its Aberrational Performance Inquiry: Over the past few years, the SEC has continued to pursue its “Aberrational Performance Inquiry” initiatives that use proprietary risk analytics to identify hedge funds with suspicious returns. That [inquiry](#) continued to produce results in 2017, with the SEC charging an adviser and its principal with disseminating false information to prospective clients and investors to induce their investments. Specifically, the SEC alleges that the principal misstated the adviser’s assets under management, the firm’s ownership and use of a proprietary quantitative trading strategy, and embellished returns purportedly generated by that strategy.

The Domino Effect of Overstating Value: On July 19, 2017, the SEC entered a settled order with an investment adviser and two of its principals, asserting that they overstated the value of two private funds they advised and improperly valued a loan where it was probable that the full value would not be collected. As a result of those violations, the SEC [asserted](#) that the funds’ financial statements were not prepared in accordance with GAAP. As a result of the GAAP violation, the SEC further alleged that the adviser violated the Custody Rule.

Please see our [May 17, 2017](#) and [June 20, 2017](#) posts on Proskauer’s [Capital Commitment Blog](#) for more information on valuation policies and procedures.

Continued Focus on Fee/Expense and Conflict Disclosures

Misallocated “Broken Deal” Expenses: The SEC staff will continue to focus on these categories of fees. In September 2017, the SEC entered a [settled order](#) imposing sanctions against a private equity fund adviser for charging client funds for out-of-pocket fees, costs and expenses incurred in developing, negotiating, and structuring prospective portfolio investments for co-investors that were not ultimately made (so-called “broken deal” expenses). While the limited partnership agreements (LPAs) disclosed the funds would pay their own expenses, none disclosed paying broken deal expenses for co-investors. To resolve the matter, the adviser agreed to pay \$1.9 million in disgorgement and interest, and a \$1.5 million penalty.

Failure to Disclose Conflicts of Interest: In July 2017, the SEC entered a [settled order](#) with an investment adviser and two of its principals for failure to disclose that the fund they managed made significant investments in a second investment fund they created that loaned money back to the adviser to increase its business. The adviser and principals did not disclose the investments until a year and a half after they were made despite the apparent conflict. Additionally, the adviser hired an auditor not subject to Public Company Accounting Oversight Board (PCAOB) inspection and the financial statements were not timely distributed, in violation of the Custody Rule. The firm and its principals agreed to civil penalties and to retain an independent consultant to review its compliance policies and procedures.

Using Fund Assets to Pay Adviser Fees and Expenses: On September 11, 2017, the SEC entered a [settled order](#) against a private equity fund adviser and its principal for using client fund assets to cover adviser expenses, including to pay rent, compensate the investment team, and cover costs associated with its regulatory obligations. The adviser and principal also improperly charged fees for services provided by affiliates to a portfolio company. Additionally, the SEC alleged that the principal failed to disclose his failure to make timely capital contributions as required by the funds’ LPAs. To resolve the matter, the adviser and principal agreed to an order imposing a \$300,000 civil penalty.

Unauthorized and Undisclosed Fee Advances: In February 2017, the SEC entered a [settled order](#) with an investment adviser and its managing member for taking unauthorized and undisclosed fees through a related entity. The relevant limited partnership agreements required advisory-committee

approval for any transactions with affiliated entities. After unsuccessfully requesting additional compensation from the advisory committee, the managing member allegedly directed £16.25 million to be transferred from the funds' accounts to the adviser's account on the grounds that those fees were "earned" through work that an affiliate of the general partner had performed on behalf of the funds. To resolve the matter, the SEC barred the managing member from association with any broker, dealer or adviser and from serving on the board of any adviser, and imposed an additional \$1.25 million penalty.

Trade Allocation

The SEC has used data analytics to uncover and identify investment advisers suspected of improper trade allocation practices or "cherry-picking" schemes. The SEC brought a number of recent cases alleging that advisers allocated profitable trades for their personal accounts to the detriment of their clients' accounts, including [one](#) earlier this year in which an investment adviser was sentenced to two years in prison. The [charges](#) arose from the SEC's Division of Economic and Risk Analysis initiative to combat cherry-picking, which used data analysis to uncover the schemes (*In the Matter of Jeremy A. Licht*, [Release No. 34-81584](#); and *In the Matter of Howarth Financial Services, LLC*, [Release No. 34-81585](#), September 12, 2017).

MNPI/Insider Trading

The SEC has continued to pursue a relatively typical number of insider trading cases this year, aided by data analytics capabilities. For example, an individual's pattern of trades in advance of corporate mergers may suggest access to material nonpublic information (**MNPI**). Once a suspicious pattern is identified, other information (phone records, chats, social networks, etc.) can be leveraged to identify relationships between traders or to identify a common source of inside information.

For example, on August 16, 2017, the SEC [announced](#) that it used data analysis to uncover a wide-reaching insider-trading scheme involving seven individuals – even though the traders allegedly used shell companies, code words and encrypted messaging to evade detection. Specifically, the SEC claimed that it was able to detect improbably successful trading across different securities over time, and thereby discovered the scheme.

Aside from pursuing individual traders, the SEC also has brought cases against fund managers alleging that they had inadequate policies and procedures to prevent insider trading. For example, the SEC obtained disgorgement of trading profits in a settlement where the SEC alleged that an adviser employed outside research firms but only performed an initial review of those firms' policies and procedures. The SEC asserted that the program effectively left employees to police themselves, which was inadequate in a situation where alleged "red flags" existed. The SEC expects investment advisers to tailor their policies and procedures to the specific risks presented by their businesses.

Please see our [June 7, 2017](#) post on Proskauer's [Capital Commitment Blog](#) for more information.

Form ADV Misstatements

A trio of recent cases demonstrates that the SEC is still digging through Forms ADV and looking for potential misstatements:

- The SEC [pursued](#) an investment adviser based on misstatements in its Form ADV. The Form ADV stated that block trades would be allocated to client accounts using a rotational method roughly allocating equal access participation. Instead, the adviser allegedly allocated day trades with a profit of \$300 or less only to a single client account, while distributing other trades

consistently among the other accounts. The settled order alleges violations of Advisers Act Sections 206(2) and 207.

- The SEC settled an enforcement action against Source Financial Advisors and its founder in mid-2017, [alleging](#) that she misrepresented her credentials on her firm's Form ADV brochure supplements. The SEC alleged that she inaccurately stated her education and credentials. Respondents agreed to correct the statements (and to advise each client accordingly), and to pay a \$25,000 penalty.
- The SEC filed its first ever [action](#) against the Chief Compliance Officer (**CCO**) of an exempt reporting adviser on January 19, 2017. The SEC alleged that the CCO made untrue statements in multiple Forms ADV that she prepared, signed, and filed on behalf of the adviser. Among other sanctions, the CCO was suspended from association with any investment adviser for a period of nine months and was fined \$15,000. The SEC apparently will continue to charge CCOs, including CCOs of exempt reporting advisers, for violations related solely to their compliance function in certain circumstances. The SEC's case underscores the expansive approach the SEC historically has taken toward CCO liability and confirms that CCOs should take steps to confirm that the responses to Form ADV are accurate.

Other Enforcement Highlights

Custody Rule Violations: The SEC continues to pursue violations of the Custody Rule. As [noted](#) above, one adviser was found to have violated the rule where it hired an auditor not subject to PCAOB inspection and the financial statements were not timely distributed. In another case, the SEC [alleged](#) that an adviser violated the Custody Rule where it had custody of fund assets but did not subject them to an annual audit or obtain a surprise examination. Finally, as [noted](#) above, the SEC may "add-on" a Custody Rule violation that was caused by other violations, such as overstating the value of a loan or asset, thus rendering the financial statements inconsistent with GAAP.

Activists – SEC Settlement Relating to Section 13 of the Exchange Act. In February, the SEC reached a [settlement](#) with an activist fund and related individuals over allegations that they failed to disclose adequately information during campaigns in order to exert influence over public companies. The alleged violations included (i) failing to file a Schedule 13D to supersede a prior Schedule 13G, (ii) omitting important Schedule 13G information about the investors' plan with respect to the issuer, and (iii) failing to disclose joint action on Schedule 13D by a group of investors. Although such cases have been less common since the slew of similar enforcement actions in 2015, this is a reminder that the SEC still is interested in disclosures relating to filers' intentions in holding target company securities and their obligations to amend promptly filings for changes in their plans or proposals.

SEC Administrative Proceeding Updates

Respondents Prevail in Challenges against Fraud Allegations. While the vast majority of enforcement actions are resolved through a negotiated settlement, respondents recently have had some success challenging the SEC's claims in administrative proceedings:

- On September 27, 2017, an administrative law judge (**ALJ**) [dismissed](#) fraud charges against Patriarch Partners and its principal following a three-week administrative trial in November 2016. The SEC had alleged that the respondents defrauded investors by misrepresenting the security for loans to certain portfolio companies and sought the return of more than \$200 million in fees that the manager collected for managing clients' money. The ALJ disagreed.
- A former Standard & Poor's executive notched a win on August 29, 2017, when an in-house judge for the SEC [found](#) that she did not *intentionally* conceal changes to her company's mortgage-debt ratings methodology, as the SEC had alleged. Instead, the ALJ found that she

had *negligently* failed to ensure that the changes were disclosed. While the SEC sought a fraud finding, the ALJ disagreed, finding that there was no evidence that the executive's motivations were impure, and imposed a minor \$7,500 penalty.

- In another win, a hedge fund manager earned a [dismissal](#) of all charges on August 16, 2017. Eden Arc Capital Management and its principal challenged the SEC's claims that they had made statements violating §10(b) of the Securities Exchange Act of 1934 (**Exchange Act**) and §17(a) of the Securities Act of 1933 (**Securities Act**) to bond issuers regarding the beneficial ownership of the bonds. The ALJ disagreed with the SEC, stating that the novel investment strategy was profitable to investors, was based on a then-allowable contractual loophole, and (most importantly) was disclosed to investors.
- **Eleventh Circuit Reduces and Remands Civil Penalty.** On June 30, 2017, the Eleventh Circuit knocked at least \$75,000 off of an \$820,000 civil penalty after [ruling](#) that a newsletter, which the SEC had found to be misleading, was actually sufficiently clear. The remaining fines were remanded for further consideration.

SEC Whistleblower Updates

The law governing whistleblowing continued to evolve during 2017. Jane Norberg continues to serve in her role as the Chief of the SEC's Office of the Whistleblower under the new administration. The Office of the Whistleblower intakes and reviews whistleblower tips, evaluates whistleblower award claims, and makes recommendations on whether claimants have satisfied eligibility requirements to receive an award. While the SEC continued its pursuit of Exchange Act Rule 21F-17 violations throughout the beginning of fiscal year 2017, no enforcement action has been announced since the Trump inauguration. Looking forward, the most significant anticipated development is the Supreme Court's resolution of a Circuit split over whether Dodd-Frank's whistleblower anti-retaliation protections extend to employees who internally report violations but fail to alert the SEC.

Continued Scrutiny of Separation Agreements

After announcing in 2015 its first settlement of an enforcement action under the SEC's Rule 21F-17, which prohibits any person from taking "any action to impede an individual from communicating directly with SEC staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement with respect to such communications," the SEC brought additional enforcement actions in fiscal year 2016 for violations of this rule, as reported in last year's Annual Review. At the outset of fiscal year 2017, the SEC continued to bring enforcement actions under the SEC's Rule 21F-17.

On December 19, 2016, the SEC announced that a Virginia-based technology company settled charges involving its severance agreements that allegedly impeded at least one former employee from communicating information to the SEC. Without admitting or denying the findings, the company agreed to pay a penalty of \$180,000. According to the SEC [order](#), from August 12, 2011 to May 21, 2015, the company routinely entered into severance agreements that contained a broad non-disparagement clause forbidding former employees from engaging with the SEC and other regulators "in any communication that disparages, denigrates, maligns or impugns" the company. Former employees could be compelled to forfeit all but \$100 of their severance pay for breaching the clause. After the SEC began its investigation, the company voluntarily revised its severance agreements and added language affirmatively advising former employees of their right to contact regulators with concerns about potential legal or regulatory violations. In addition to revising the agreements and paying the above-referenced penalty, the company agreed to make "reasonable efforts" to contact all former employees who signed

severance agreements from August 12, 2011 to May 21, 2015, and inform them that they are not prohibited from communicating any concerns about potential violations of law or regulation to the SEC.

On January 17, 2017, the SEC announced that a New York-based asset management firm settled charges that it violated Rule 21F-17 by requiring outgoing employees to waive whistleblower award eligibility in connection with severance agreements. Without admitting or denying the findings, the firm agreed to pay a penalty of \$340,000 and revise its agreements. According to the SEC [order](#), from October 2011 until March 2016, the firm had used the waiver provision stating that outgoing employees “waive any right to recovery of incentives for reporting of misconduct” in order to receive their monetary separation payments from the firm. In addition to agreeing to pay the above-referenced penalty, the firm agreed to revise its severance agreements and take a number of remedial actions, including the implementation of mandatory yearly training to summarize employee rights under the SEC’s whistleblower program. The firm also agreed to make “reasonable efforts” to contact all former employees who signed severance agreements from October 14, 2011 through March 31, 2016, and inform them that they are not prohibited from seeking and obtaining whistleblower awards from the SEC.

On January 19, 2017, the SEC announced that a Seattle-based financial services company settled charges that it engaged in improper accounting and also took steps to impede potential whistleblowers, including requiring outgoing employees to sign severance agreements waiving potential whistleblower awards. Without admitting or denying the findings, the company agreed to pay \$500,000 and revise its agreements. According to the SEC [order](#), on at least two occasions in April 2016, the company implemented the above-mentioned waiver provision. In addition to agreeing to pay the above-referenced penalty, the firm agreed to revise its severance agreements to include the following language:

Employee understands that nothing contained in this Agreement limits Employee’s ability to file a charge or complaint with any federal, state or local governmental agency or commission (**Government Agencies**). Employee further understands that this Agreement does not limit Employee’s ability to communicate with any Government Agencies or otherwise participate in any investigation or proceeding that may be commenced by any Government Agency including providing documents or other information without notice to the Company. This Agreement does not limit the Employee’s right to receive an award for information provided to any Government Agencies.

The company also agreed to make “reasonable efforts” to contact all former employees who signed severance agreements in April 2016 and inform them that they are not prohibited from reporting information to the SEC or from seeking and obtaining whistleblower awards from the SEC.

Awards to Culpable Whistleblowers

On July 27, 2017, the SEC announced that it was paying a \$1.7 million bounty award to a whistleblower, even though the whistleblower: (1) had some culpability in the underlying fraud; (2) unreasonably delayed reporting the fraud; and (3) failed to comply with a Dodd-Frank rule governing the submission of whistleblower complaints.

In its [order](#), the SEC stated that in determining an appropriate award percentage, it balanced the fact that the whistleblower alerted it to a serious multiyear fraud that would have otherwise been difficult to detect against the whistleblower’s unreasonable delay in reporting the fraud and culpability in the fraud itself. The SEC noted that the whistleblower’s unreasonable delay was somewhat mitigated because he first alerted the SEC to the fraud before the whistleblower program and the protections that accompany it were established by Dodd-Frank. The SEC also stated that it did not consider at all the whistleblower’s

failure to comply with the submission process, because he was working actively with the SEC before the enactment of Dodd-Frank and, once the act was passed, provided the information in the format the SEC requested.

The SEC also noted that the whistleblower “bears some, albeit limited, culpability.” While Dodd-Frank prevents the SEC from awarding bounties to whistleblowers who are criminally convicted for conduct that is the same as, or related to, the conduct that is the subject of the information they provide, the SEC currently is able to grant awards to whistleblowers who are involved in the wrongdoing but are not criminally charged.

Please see our [August 1, 2017](#) post on Proskauer’s Whistleblower Defense Blog for more information.

CFTC Amends Whistleblowing Rules

On May 22, 2017, the U.S. Commodity Futures Trading Commission (**CFTC**) unanimously amended its whistleblower rules to strengthen the anti-retaliation protections and enhance the awards claims review process. The amendments added a new Section 23 to the existing Commodity Exchange Act (**CEA**) regulations, titled “Commodity Whistleblower Incentives and Protection.” 7 U.S.C. § 26. While the framework of the whistleblowing rules was largely unchanged, the amendments allow the CFTC or a whistleblower to bring an action against an employer for retaliation, even if the whistleblower does not qualify for an award. In addition, employers are now prohibited from impeding a potential whistleblower from “communicating directly with the CFTC’s staff about a possible violation of the CEA, including by enforcing, or threatening to enforce, a confidentiality agreement or pre-dispute arbitration agreement with respect to such communications.”

In issuing these regulations, the CFTC also aimed to streamline and add transparency to the whistleblower awards claim process. There is now a Claims Review Staff, replacing the Whistleblower Award Determination Panel, to determine whether an award claim should be granted or denied. After a preliminary determination, a whistleblower is now able to view the record and contest the determination prior to the final determination. The amendments note that this enhanced review process is “similar to that established under the SEC’s own whistleblower rules.”

Please see our [May 25, 2017](#) post on Proskauer’s Whistleblower Defense Blog for more information.

Financial CHOICE Act of 2017

On June 8, 2017, the U.S. House of Representatives (the **House**) passed the Financial CHOICE Act of 2017 (the **CHOICE Act**). The CHOICE Act would prohibit culpable whistleblowers from receiving any monetary award under Dodd-Frank’s whistleblower bounty program. More specifically, Section 828 of the CHOICE Act would prohibit the SEC from issuing an award “to any whistleblower who is responsible for, or complicit in, the violation of the securities laws for which the whistleblower provided information to the SEC.” It provides that “a person is responsible for, or complicit in, a violation of the securities laws if, with the intent to promote or assist the violation, the person—(A) procures, induces, or causes another person to commit the offense; (B) aids or abets another person in committing the offense; or (C) having a duty to prevent the violation, fails to make an effort the person is required to make.” The prospects for passage of the CHOICE Act are unclear.

Anticipated Supreme Court Ruling

On June 26, 2017, the Supreme Court agreed to consider the question of whether employees who only complain internally are covered by the Dodd-Frank anti-retaliation provision, resolving a circuit split on the

issue. Currently, the Fifth Circuit is at odds with the Second and Ninth Circuits on the issue. In *Asadi v. G.E. Energy*, the Fifth Circuit held that the “plain language and structure” of the statute requires that one must complain to the SEC in order to qualify as a “whistleblower.” In *Berman v. Neo@Ogilvy*, the Second Circuit disagreed, deferring to the SEC’s regulations, which provide otherwise. The Ninth Circuit held that the statute “unambiguously” protects employees who report internally in *Somers v. Digital Realty*. The Supreme Court’s decision on this issue will determine the nature and scope of Dodd-Frank whistleblower claims filed in the future.

SEC Rule Making Developments & Other Guidance

Following the 2016 U.S. federal election, the SEC and CFTC have not announced or introduced any significant rule making initiatives in areas that would affect significantly private fund advisers. To the converse, many federal agencies have appeared to proceed in accordance with a series of executive orders issued by President Trump, which include a January 20, 2017 memorandum instituting a freeze on new agency rule making, and an executive order dated January 30, 2017 requiring that for every one new regulation issued, at least two prior regulations must be identified for elimination. While the January 30, 2017 executive order applies only to federal executive-branch agencies, and excludes the SEC, CFTC and other independent U.S. federal regulatory agencies, it generally is expected that the excluded regulatory bodies will endeavor to follow the executive order in spirit.

It would appear based upon public comments from SEC Chairman Jay Clayton that the primary areas of the agency’s initial regulatory focus likely will include ensuring protections for retail investors and facilitating enhanced access to the public capital markets for issuers currently relying on private sources of funding.

On May 3, 2017, the CFTC voted to seek public input on simplifying and modernizing the CFTC’s rules. CFTC then-Acting Chairman J. Christopher Giancarlo initially announced Project KISS, which stands for “Keep It Simple, Stupid,” in March as an agency-wide internal review of CFTC rules, regulations and practices to identify those areas that can be simplified to make them less burdensome and less costly. Concluding on September 30, 2017, the CFTC had accepted comments in connection with Project KISS in the four specific areas of registration, reporting, clearing, and execution, as well as a fifth omnibus miscellaneous category. It remains to be seen what actions the CFTC ultimately will take on the comments it has received.

Private Funds Litigation

Private investment funds are likely to face increased litigation risk in 2018 due to transparency and compliance initiatives of investors and other market developments. Here are several areas that should be on the top of every private fund adviser’s list and how to assess and manage the associated risks.

Devaluation of Technology Unicorns

As predicted in our 2016 Annual Review, tech unicorns have attracted increased scrutiny and litigation during the past year (with Theranos and Uber being prominent examples). Rising valuations for unicorns can lead to inflated expectations for market participants, especially those of employees expecting a payout and investors expecting returns. Some types of disputes that can arise from unicorn failures include: (i) employee claims (as in the case of former unicorn Good Technology) alleging breach of fiduciary duty by the directors arising from a perceived inadequate sale or an unwarranted dissolution ahead of a public offering; (ii) SEC scrutiny, particularly concerning valuation-based inquiries pre-IPO; (iii)

claims arising from an acquisition, such as fraudulent inducement or breach of contract claims arising from an improper valuation; and (iv) limited partner/general partner disputes, such as suits alleging breach of fiduciary duty to investors or potential conflicts between an adviser and funds.

Distributed Ledger Technology

The use of “blockchain” technology to raise capital through ICOs, or investments in or via virtual currency such as Bitcoin or Ethereum, continues to attract regulatory scrutiny. This year, the SEC [took the position](#) that ICOs may be securities, and their offer and sale in the form of virtual coins or tokens may be subject to the federal securities laws. Going forward, organizations considering ICOs should consider crafting ICO tokens to avoid securities laws, conducting offerings outside the United States, structuring the ICO as a private placement, or ultimately pursuing a securities offering registration with the SEC.

Cybersecurity

Investment firms continue to be targets of cyber-attacks, such as “spear phishing” email scams designed to lure investment advisers to reveal their email credentials. Among other things, phishers attempt to use those credentials to redirect wire transfers to the phisher’s account. The SEC has stated that firms are expected to anticipate potential cybersecurity events and have clear written policies and procedures in place for the protection of private client information, and also have robust reactionary measures prepared should a breach occur. Accordingly, Proskauer can assist advisers in proactively evaluating their exposure to cybersecurity threats from an operational perspective at both the firm and portfolio company level, and, if necessary, retain experts to assist.

Valuation Practices and Performance Marketing

Any significant devaluation of unicorns is likely to amplify the scrutiny of valuation practices, particularly of funds with significant exposure to unicorns. Fund investors almost certainly will focus on sponsors’ adherence to their own valuation policies, as well as any potential discrepancies in valuations between private funds and mutual funds. Other areas of focus may include the quality of a sponsor’s valuation policy and whether it tracks the FASB Accounting Standards Codification for Fair Value Measurement (Topic 820).

Professional Liability Insurance

In the face of increased litigation risk, Proskauer can assist sponsors with reexamining their professional liability insurance programs in light of the scope of available indemnification rights, not just at the fund level but also from portfolio companies where affiliates of the fund sponsor may serve as equity holders and directors. A typical “off the shelf” general partner liability policy may be deficient in a number of important areas. Coverage review should include an assessment of whether the customary “insured versus insured” exclusion excludes claims by fund investors against the general partner or sponsor entities, and the relative priority between policies with respect to indemnification rights.

It is clear that the litigation climate for private fund sponsors is rapidly changing. However, sponsors who take early and proactive steps to manage their risk will be well positioned to weather the storm.

CFTC Updates

CFTC Position Limits

The CFTC has proposed new rules under Part 150 of the CFTC regulations establishing limits on speculative positions in 25 physical commodity futures contracts. Under existing rules, commodities exchanges retain the authority to adopt limits that are more restrictive than those set by the CFTC, and to set position limits on other futures contracts that are not currently subject to position limits set by the CFTC.

Final Rule on Aggregation Requirements

The CFTC adopted final rules under Part 150 governing when related accounts must be aggregated for purposes of applying the position limits under Part 150. The new rules became effective on February 14, 2017, although the CFTC recently granted temporary relief from some of the provisions of the new rules as described below.

Under the new rules, a person generally must aggregate all positions in accounts for which that person, either by agreement, power of attorney or otherwise, directly or indirectly, either (i) controls trading or (ii) holds a 10 percent or greater ownership or equity interest in the positions held and trading done by another person.

There are various exemptions to the aggregation requirement that are potentially applicable to managers of private funds. In particular, there is a self-executing exemption for passive owners and fund investors, such as limited partners and shareholders of a fund, who own less than 10 percent of a pool. There is also a non-self-executing exemption for certain passive investors who own greater than 10 percent of a fund or other entity, but the exemption requires a notice filing with the CFTC. In response to industry requests for relief, the CFTC recently extended the deadline for filing the exemption notices required under the new rule until August 12, 2019.

Proposed Regulation AT

On November 4, 2016, the CFTC proposed additional changes to pending proposed Regulation AT. Regulation AT, if adopted, would require various market participants who use algorithmic trading systems (**ATS**) and who qualify as an “AT Person,” including a commodity pool operator (**CPO**) or commodity trading advisor (**CTA**), to adopt various risk controls and other requirements. The rule also would require certain proprietary traders who use ATS and currently are not registered to register with the CFTC.

The amendments clarify when the CFTC would be authorized, without the need of a subpoena, to gain access to the source code used by managers in automated futures trading. The amendments also propose minimum volume-based quantitative tests for registration, so that CFTC registration would only be required for someone trading 20,000 contracts or more per day, on average, over a six-month period for a firm’s own account, the accounts of its customers, or both.

Enforcement Actions

The CFTC has continued to use the expanded antifraud enforcement authority granted to it under the Dodd-Frank Act to pursue a number of cases involving alleged market manipulation and spoofing activity by market participants.

FINRA/Broker-Dealer Updates

Regulation of ICOs

This has been the year of the ICO. (Please also see our preceding [discussion](#) of blockchain technology in the Private Funds Litigation section, and also our later [discussion](#) of blockchain updates.) More than \$1.7 billion was raised globally in ICOs in the first three quarters of the year. The explosion coincided with a dramatic rise in the value of digital currencies such as Bitcoin (**BTC**) and Ether (**ETH**).¹ The SEC and other regulators have just begun to scrutinize these offerings.

In a typical ICO, a company building or providing a blockchain-based product or service offers proprietary digital assets (commonly known as **tokens**) in exchange for digital currency. Many of these companies simply provided prospective investors with a business plan² and issued tokens directly to purchasers in lieu of a registered offering or private placement under federal securities laws.

One ICO, by a platform called The DAO, undertook to build a “decentralized autonomous organization”³ to profit in various initiatives. Over the span of about a month in May 2016, The DAO’s ICO raised about 12 million ETH, which at the time was equivalent to approximately \$150 million in value.

The SEC’s Report on the DAO Tokens as Securities

On July 25, 2017, the SEC released a [report](#) of investigation on the application of the federal securities laws to The DAO’s ICO. The SEC, without taking any enforcement action, stated that the ICO was an offering of “securities” under the Securities Act because The DAO tokens represented an interest in an “investment contract.”

Whether an investment contract exists must be resolved on a case-by-case basis according to the economic realities of the transaction. For more than 75 years, this analysis has proceeded under a multifactor analysis first laid out by the Supreme Court in *SEC v. W.J. Howey Co.*, known as the *Howey* test.

Under the *Howey* test, an investment contract is defined as: (i) an investment of money, (ii) in a common or pooled enterprise, (iii) with a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others. To find an investment contract exists, all three prongs must be satisfied.

The SEC’s report applied the test to the underlying characteristics of The DAO organization and its ICO. The report concluded that the ICO involved an investment of money based on the principle, well-established in case law, that an investment may take the form of goods and services or some other exchange of value in lieu of money. Thus, the securities laws may still apply despite the fact that

1 BTC started off the year trading below \$1,000 and reached a high of over \$5,000. ETH started off the year below \$10 and reached a high of nearly \$400. Holders of these currencies may view ICOs as an opportunity to diversify their digital asset portfolios as well as capture the gains in the value of the digital currencies without needing to sell them on an exchange.

2 In many instances, the companies conducted an ICO before even a prototype or a proof-of-concept had been developed.

3 Using smart contracts and code built on the Ethereum blockchain, The DAO promised to automate organizational governance and decision-making in the pooling and allocation of capital to promising projects, as well as in the distribution or reallocation of profits. Members of The DAO held voting power in these decisions proportional to the number of The DAO tokens they owned. Highly skilled individuals selected by Slock.it to act as “curators” worked outside the decentralized system to vet proposed projects and determine whether and in what order they would be put up for vote.

investors purchased the tokens using ETH rather than cash. It went on to say that purchasers of The DAO tokens invested in a common enterprise because the ETH was pooled and available to The DAO to fund projects. It concluded that the requisite expectation of profits by the efforts of others was present in the intention to share with holders of The DAO tokens benefits or returns from projects pursued by The DAO,⁴ which were dependent on the entrepreneurial and managerial efforts of The DAO's creators and curators.⁵

The Significance of Tokens as Securities

As securities, offers and sales of tokens must be registered with the SEC or qualify for an exemption in order to be offered or sold to U.S. persons or from within the United States. A person or entity selling the tokens may have to register as a broker-dealer or be an associated person of a registered broker-dealer. And an exchange platform that facilitates initial or secondary market transactions in such token securities may be required to register as a national securities exchange or an alternative trading system (an **ATS**).

Purchases of tokens in such unregistered offerings or sales by unregistered broker-dealers or conducted on an unregistered exchange may be subject to a right of rescission. State remedies may be available as well.

Implications for ICO Stakeholders

The DAO, which was known to have had around \$50 million stolen by hackers, is no longer operational. The real import of the SEC's report of investigation is what it means for other actual and would-be ICO issuers, digital currencies, exchanges and the tokens marketplace as a whole.

There are a couple of approaches available for blockchain developers thinking of doing an ICO with characteristics of a securities offering. First is to register the tokens with the SEC and issue them in a public offering (this is unlikely to appeal to those who seek the flexibility and ease of an ICO). Alternatively, the tokens can be offered in a private placement under Regulation D or another applicable registration exemption.⁶

For intermediaries in the initial offering or resale of tokens, SEC registration as a broker-dealer may be necessary. Registration as a futures commission merchant with the CFTC may be required if the intermediary's activities involve tokens that qualify as futures contracts, options on futures or swaps.

Electronic trading platforms or exchanges in the tokens—some of which already exist to facilitate the trading of cryptocurrencies—may have to be registered as an exchange or an ATS. This would require registration and approval by the SEC, the CFTC or other regulatory bodies.⁷

4 This investment value is distinguishable from use value. For example, one may have an expectation of profit in buying a house but the house is valuable as livable space independent of the fact that its value is expected to rise over time on the market.

5 The DAO's creators developed and maintained the technological platform, facilitated communications between its users, and promoted it to the public. The curators had the unilateral ability to select projects that would be put to vote for approval. The SEC found that the voting power of The DAO Token holders was comparatively limited, compared to the curators. On net, this led the SEC to find the final prong of the *Howey* test satisfied.

6 Protocol Labs Inc., which aims to develop a distributed data storage system, offered a private placement in August 2017.

7 Such a token exchange in compliance with SEC and the Financial Industry Regulatory Authority (FINRA) guidelines was announced by Overstock in late September. <https://www.bloomberg.com/news/articles/2017-09-27/overstock-unit-starting-anexchange-for-digital-coin-trading>

Potential investors in public companies purporting to make investments in or raise capital through unregistered ICOs should proceed cautiously. In 2017, the SEC [issued](#) several trading suspensions on the common stock of certain issuers who made claims regarding their investments in ICOs or touted coin/token related news.

The SEC did not state whether The DAO was an “investment company” under the Investment Company Act of 1940 (**ICA**), but a footnote in the report noted that ICO issuers and their investors should consider potential ICA obligations as well. Because, in part, The DAO never commenced its business operations funding projects, this report does not analyze the question whether anyone associated with The DAO was an “[i]nvestment adviser” under Section 202(a)(11) of the Advisers Act.

The Road Ahead

Initially, the SEC’s action on The DAO report has served to temper ICO activity somewhat. A decentralized application, Protostarr, opted to cease operations after receiving communications from the SEC and refunded all proceeds it had generated from an ICO.⁸ Ultimately, however, regulatory involvement could prove to expedite development of the ICO market and other blockchain-based mechanisms for alternative fund raising, creating a path towards greater legitimacy and more reliable offerings that would benefit existing market participants and attract more mainstream investors.

Please also see our preceding [discussion](#) of blockchain technology in the Private Funds Litigation section, and also our later [discussion](#) of blockchain updates.

The SEC’s Adopts T+2 Settlement

On March 22, 2017, the SEC adopted an amendment to Exchange Act Rule 15c6-1(a) to shorten by one business day the standard settlement cycle for most broker-dealer securities transactions. Previously, the standard settlement cycle for these transactions was three business days, known as T+3. The amended rule shortened the settlement cycle to two business days, T+2.

According to the SEC, the amended rule is designed to enhance efficiency, reduce risk, and ensure a coordinated and expeditious transition by market participants to a shortened standard settlement cycle. In the press release announcing the change, SEC then-Acting Chairman Michael Piwowar stated “[a]s technology improves, new products emerge, and trading volumes grow, it is increasingly obvious that the outdated T+3 settlement cycle is no longer serving the best interests of the American people. The SEC remains committed to ensuring that U.S. securities regulation is reflective of modern times, and in shortening the settlement cycle by one day we aim to increase efficiency and reduce risk for market participants.”

Broker-dealers were required to comply with the amended rule beginning on September 5, 2017.

State Legislative Efforts Impose Fiduciary Duties and Related Requirements on Broker-Dealers

Over the past year, several U.S. states have engaged in legislative initiatives to impose fiduciary duties on registered broker-dealers. Currently, legislation extending a fiduciary duty has been enacted in Nevada (effective July 1, 2017). Additional legislation has been introduced in New Jersey, New York and

⁸ Protostarr had sought to develop a platform for internet celebrities to receive funding from their fans.

Massachusetts which would require affirmative disclosure by broker-dealers of the absence of a fiduciary duty.

By way of background, and converse to the fiduciary duty judicially imposed on investment advisers by the U.S. Supreme Court in the *SEC v. Capital Gains Research Bureau, Inc.* decision, broker-dealers historically have provided services to their clients under the standard of “suitability.” To define the scope of the duty of suitability, FINRA Rule 2111 requires, in part, that a broker-dealer or associated person “have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the [firm] or associated person to ascertain the customer’s investment profile.”

In review of the judicial landscape, according to a research report issued by the Connecticut General Assembly’s Office of Legislative Research, courts in at least four states (California, Missouri, South Carolina and South Dakota) have explicitly imposed a fiduciary standard on broker-dealers. On the other hand, courts in 14 other states have expressly held that a fiduciary duty does not exist between a client and a broker-dealer (Arizona, Arkansas, Colorado, Hawaii, Massachusetts, Minnesota, Mississippi, Montana, New York, North Carolina, North Dakota, Oregon, Washington and Wisconsin). (Minnesota and Wisconsin laws provide that a broker does not owe a fiduciary duty to clients unless there is a special agreement between the parties.)

FINRA Expansion of Pay-to-Play Regulation to Capital Acquisition Brokers

On September 29, 2017, the SEC issued an order that will expand the scope of the pay-to-play obligations. The SEC approved a FINRA proposal to extend the self-regulatory organization’s Rules 2030 and 4580 (FINRA’s pay-to-play and associated record keeping rules) to a recently established category of FINRA-registered firms known as capital acquisition brokers (**CABs**).

CABs are firms that focus on a more limited set of activities than full-service broker-dealers. Generally, an entity qualifies as a CAB if it engages solely in specific capital raising or corporate advisory activities, including corporate restructurings and acting as a private fund placement agent. However, CABs are prohibited from maintaining customer funds and cannot trade customer securities. Firms that carry customer accounts, produce research or chaperone non-U.S. broker-dealers under Rule 15a-6 of the Exchange Act cannot register as CABs.

The SEC order subjects CABs to the pay-to-play restrictions and record keeping requirements already applicable to full-service broker-dealers under FINRA CAB Rules 203 and 458. The pay-to-play rule that applies to CABs is substantially similar to the pay-to-play rule that applies to investment advisers, with minor distinctions.

As a refresher, the SEC’s pay-to-play rule generally prohibits an adviser from providing compensated advisory services to state government or retirement plan investors for two years following an impermissible contribution – in other words, no fees or carried interests during the two-year “time out” period. The rule is triggered if the adviser or one of its “covered associates” makes a “contribution” to an “official” of a “government entity,” unless the “contribution” falls within one of the narrow exceptions to the rule. An adviser also could be subject to penalties if the adviser or one of its “covered associates” coordinates or solicits a “contribution” to an “official,” or “payment” to a state or local political party. The use of quotations here is intentional – each is a defined term within the rule that requires independent analysis by the adviser.

While the expansion of the FINRA pay-to-play rule is somewhat narrow, it serves as a useful reminder to private fund advisers to review their compliance policies, confirm that applicable record keeping requirements are being met, and double-down on ensuring that personnel are well-trained on the potential implications of their political activities. With the proper procedures in place, the potential for financial and reputational harm resulting from a violation of the pay-to-play rules can be minimized.

State Regulatory Updates

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 also must 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 preempted 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 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 currently is 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 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.

Insider Trading Updates

The last 12 months have seen important decisions from the Supreme Court and the Second Circuit on the nature of the “personal benefit” needed to create liability for insider trading. The Supreme Court’s ruling in *Salman v. United States* did not break new ground on this issue, but the Second Circuit’s latest foray into the area in *United States v. Martoma* might have expanded the law to some extent – although whether any such possible expansion has practical significance remains to be seen. Other notable rulings and developments have involved materiality considerations, the SEC’s use of advanced data analytics to detect insider trading, the hacking of the SEC’s EDGAR system, the emergence of digital coins as potential securities, and the apparent demise of efforts to adopt legislation to define insider trading. For more on how this relates to big data concerns, please see our discussions of [SEC v. Huang](#) and [SEC v. Dorozhko](#).

Friends and Benefits

As readers of this publication know, insider trading generally involves a purchase or sale of a security on the basis of material, nonpublic information that was obtained in breach of a fiduciary duty or a duty of trust or confidence owed to the shareholders of the issuer or to the source of the information.

Our prior reviews of insider-trading law explored the ongoing debate about the nature of the “personal benefit” needed to establish insider-trading liability. 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 a tippee’s liability. The Supreme Court held that tippee liability depends in part on tipper liability – and that a tipper cannot be liable for disclosing material, nonpublic information unless he or she breached a fiduciary (or fiduciary-like) duty by doing so. That breach of duty requires not only the disclosure of confidential information, but also the receipt of a *personal benefit* in exchange for the disclosure.

The personal-benefit requirement generally had been viewed as relatively easy to meet – until the Second Circuit tried to tighten it in *United States v. Newman*. *Newman* created a fair amount of controversy and caused the Ninth Circuit to disagree with it (at least to some extent) in *United States v. Salman*. The Supreme Court affirmed *Salman* in December 2016 and rejected at least one aspect of *Newman*. The Second Circuit now has backed off *Newman* and taken a different tack in *United States v. Martoma*, which some construe as diluting *Dirks*’s and *Salman*’s personal-benefit requirement.

Here is an overview of how we got to where we are today.

Newman

The Supreme Court in *Dirks* defined the “personal benefit” that constitutes an 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.”

Our prior reviews discussed the Second Circuit’s interpretation of this language in *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014). The Second Circuit there held that, under *Dirks*, “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.”

Salman

The *Newman* decision led to a possible circuit split with the Ninth Circuit in *United States v. Salman*, 792 F.3d 1087 (9th Cir. 2015), which held that insiders can engage in insider trading by disclosing material, nonpublic information with the intent to benefit a trading relative or friend even if the tippers do not receive a pecuniary gain or other *quid pro quo* type of benefit in exchange for the tips.

While *Newman* had involved an arguable friendship between the tippers and the tippees, *Salman* involved a family relationship: The tipper and the initial tippee were brothers. The tipper, who had worked for an investment bank, allegedly had provided confidential information to his brother about upcoming transactions involving the bank’s clients, and the tippee-brother then tipped Salman, whose sister had become engaged to and later married the tipper.

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 Ninth Circuit rejected Salman’s argument (based on *Newman*) that the tipper needed to have received “at least a potential gain of a pecuniary or similarly valuable nature.” Instead, the Ninth Circuit ruled 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 Supreme Court granted Salman’s certiorari petition (probably because of the tension with *Newman*) and affirmed the Ninth Circuit’s ruling in December 2016. *Salman v. United States*, 137 S. Ct. 420 (2016). The Court reiterated the rule that “a tippee is exposed to liability for trading on inside information only if the tippee participates in a breach of the tipper’s fiduciary duty.” “Whether the tipper breached [his or her] duty depends in large part on the purpose of the disclosure to the tippee.” The test for tipper liability under *Dirks* is “whether the [tipper] personally will benefit, directly or indirectly, from his disclosure.” The Court thus confirmed that “the disclosure of confidential information without personal benefit is not enough.”

As to the nature of the requisite personal benefit, the Court reemphasized *Dirks*’s holding that “a tipper breaches a fiduciary duty by making a gift of confidential information to ‘a trading relative,’ and that rule is sufficient to resolve the case at hand.” “[W]hen a tipper gives inside information to ‘a trading relative or friend,’ the jury can infer that the tipper meant to provide the equivalent of a cash gift.” The Court rejected *Salman*’s reliance on *Newman* and ruled that, “[t]o the extent the Second Circuit held that the tipper must also receive something of a ‘pecuniary or similarly valuable nature’ in exchange for a gift to family or friends, . . . we agree with the Ninth Circuit that this requirement is inconsistent with *Dirks*.”

Martoma

The Supreme Court's *Salman* decision recently led a divided panel of the Second Circuit to take a perhaps even more expansive approach to the personal-benefit requirement in *United States v. Martoma*, 2017 WL 3611518 (2d Cir. Aug. 23, 2017).

Martoma, a hedge-fund portfolio manager, had dealings with two doctors who had been involved in the clinical trial of a drug. The doctors had also entered into paid consulting arrangements with Martoma's employer under contracts through expert-networking agencies.

The Government alleged that at least one of the doctors had shared confidential safety data about the drug with Martoma, leading the hedge fund to buy securities of the two companies that owned rights to the drug. The Government also alleged that the doctor had given Martoma advance information of the drug trial's failure – and that the hedge fund had then sold off its positions in the two drug companies' stock before the news became public. Martoma was convicted of insider trading and conspiracy to commit securities fraud.

Martoma appealed, claiming that the Government had not proven that the doctor had received a legally sufficient personal benefit in exchange for providing the confidential information. Martoma recognized that *Salman* had undermined *Newman*'s holding that a cognizable personal benefit does not exist without a “potential gain of a pecuniary or similarly valuable nature” in exchange for a gift to family or friends. But he argued that *Salman* had not decided *how close* the relationship between a tipper and a tippee must be in order for the tipper to have breached his or her duty without receiving a concrete personal benefit such as the “potential gain of a pecuniary or similarly valuable nature” that *Newman* required. That issue had not arisen in *Salman* because the tipper and the tippee were brothers and thus had clearly shared a meaningfully close personal relationship. But Martoma contended that he and the doctor had not had a close personal relationship, so *Salman*'s gift-giving analogy was inapposite, and a personal benefit more direct and consequential than mere friendship was therefore required. He also claimed that, even though the doctor had been paid under the consulting arrangement with the hedge fund, the doctor had not been paid for disclosing the drug-efficacy data.

The Second Circuit – in a 2-to-1 decision – affirmed the conviction.

The majority first ruled that the evidence was sufficient to sustain Martoma's conviction on a simple pecuniary-benefit theory. The doctor had been paid for his consultations with Martoma. Even if the doctor had not billed the hedge fund specifically for the meeting at which he had conveyed the nonpublic information about the drug trial's failure, “the tipper's gain need not be *immediately* pecuniary.” “In the context of their ongoing relationship of *quid pro quo*, . . . where [the doctor] regularly disclosed confidential information in exchange for fees, a rational trier of fact could have found the essential elements of the crime [of insider trading] beyond a reasonable doubt under a pecuniary *quid pro quo* theory.”

The majority then turned to the nonpecuniary, gift-giving aspect of insider-trading liability and concluded that “the logic of *Salman* abrogated *Newman*'s ‘meaningfully close personal relationship’ requirement” for a non-financial [sic] or non-*quid pro quo* personal benefit. The court held that “an insider or tipper personally benefits from a disclosure of inside information whenever [1] the information was disclosed ‘with the expectation that [the recipient] would trade on it’ . . . and [2] the disclosure ‘resemble[s] trading by the insider followed by a gift of the profits to the recipient,’ . . . whether or not there was a ‘meaningfully close personal relationship’ between the tipper and the tippee.”

The majority derived its two-pronged standard from *Dirks*'s and *Salman*'s teaching that “the justification for construing gifts as involving a personal benefit is that [t]he tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient.” According to the majority, “nothing in . . . this logic supports a distinction between gifts to people with whom a tipper shares a ‘meaningfully close personal relationship’ . . . and gifts to those with whom a tipper does not share such a relationship. If the insider discloses inside information ‘with the expectation that [the recipient] would trade on it,’ . . . and the disclosure ‘resemble[s] trading by the insider followed by a gift of the profits to the recipient,’ . . . [the insider] personally benefits for the reasons described in *Dirks* and *Salman*.” The majority therefore “reject[ed], in light of *Salman*, the categorical rule that an insider can *never* personally benefit from disclosing inside information as a gift without a ‘meaningfully close personal relationship.’”

The dissent (by Judge Pooler) criticized the majority for rejecting *Newman* without convening the full court for an *en banc* review. But Judge Pooler also disagreed with what she viewed as a ruling that “an insider receives a personal benefit when the insider gives inside information as a ‘gift’ to *any* person. In holding that someone who gives a gift *always* receives a personal benefit from doing so, the majority strips the long-standing personal benefit rule of its limiting power.”

Martoma has asked the full court to review the panel’s decision *en banc*.

Where Are We Now?

The upshot of this three-year odyssey from *Newman* to *Salman* to *Martoma* is that we are more or less back where we started: with the 34-year-old *Dirks* decision. We can be fairly certain that, at least where relatives are involved (as in *Salman*), a tipper can breach his or her duty even if he or she does not receive a pecuniary, consequential, or *quid pro quo* type of personal benefit in exchange for the tip. We also can be fairly sure that the same rule holds for close friends. And if *Martoma* stands in the Second Circuit and is adopted elsewhere, a pecuniary or consequential benefit is not needed in *any* situation – regardless of the nature of the relationship between the tipper and the tippee – as long as the inside information “was disclosed ‘with the expectation that [the recipient] would trade on it’ . . . and the disclosure ‘resemble[s] trading by the insider followed by a gift of the profits to the recipient.’”

Martoma's approach arguably does read the relationship element out of *Dirks*'s and *Salman*'s discussions of “trading relatives or friends,” as the dissent argued. However, one must ask whether the Supreme Court really focused closely on that issue in those two cases. *Dirks* did not involve a gift to a friend or relative at all; an insider had tipped an investment adviser in the hope of disclosing a corporate fraud. And *Salman* involved a gift to a brother, so the Court did not need to consider whether friendship – or what degree of friendship – could also satisfy the personal-benefit requirement in the absence of a pecuniary or other “consequential” benefit.

In the real world, however, the Second Circuit’s two-pronged standard makes some sense. As the majority wrote in *Martoma* (in a quintessentially New York-centric analogy):

Imagine that a corporate insider, instead of giving a cash end-of-year gift to his doorman, gives a tip of inside information with instructions to trade on the information and consider the proceeds of the trade to be his end-of-year gift. In this example, there may not be a “meaningfully close personal relationship” between the tipper and tippee, yet this clearly is an illustration of prohibited insider trading, as the insider has given a tip of valuable information in lieu of a cash gift and has thus personally benefitted from the disclosure.

And in the real world, a person does not seem likely to tip inside information with the expectation that the recipient will trade on it if the tipper does not share some type of relationship with the tippee.

The Second Circuit's formulation rules out inadvertent disclosures and whistleblowing; it also rules out well-intended conversations between corporate insiders (such as PR/IR people) and analysts. In those situations, the insider generally does not share nonpublic information with the expectation that the recipient will trade on it, and the disclosure does not resemble trading by the insider followed by a gift of the profits to the recipient – as *Martoma* requires.

The sky thus did not fall down after *Salman*, or even after *Martoma*. In fact, those cases left intact some key defenses.

First, neither *Salman* nor *Martoma* undercut *Newman*'s principal holding that a tippee must *know or have reason to know* that the tipper received a legally cognizable personal benefit (whatever that benefit might be) in exchange for the tip. Particularly in cases involving remote tippees, this requirement could be decisive – as it was in *Newman*. Remote tippees at the end of a multi-person chain might have little, if any, idea of what happened at the initial tipper's level and might not know whether the tipper breached any duty in exchange for a personal benefit. This prong of *Newman* remains the law in the Second Circuit and is therefore likely to be the first line of defense for remote tippees. (The Supreme Court in *Salman*, however, did not need to address that aspect of *Newman* and therefore did not opine on it.)

Second, contrary to the hopes of the government and some *amici*, the Supreme Court did not use the *Salman* case as a vehicle to rewrite the law on insider trading. The Court did not retreat from the personal-benefit requirement, even though the government had urged the Court to adopt a broad distinction between disclosure for corporate purposes and disclosure for noncorporate purposes – and to hold that any disclosure for a non-corporate purpose satisfies *Dirks*. Nor did the Court jettison the personal-benefit requirement and adopt a broad parity-of-information principle, which would have prohibited trading on material, nonpublic information without further analysis of breaches of duty or personal benefits. (As we discussed in our 2016 review, the European Union has such a rule: The Market Abuse Regulation (the **MAR**) prohibits use of material, nonpublic information if the user knows or should have known that the material information is nonpublic. The MAR applies to securities admitted for trading on an EU market, even if those securities also are listed on a U.S. exchange and any alleged insider trading occurs on a U.S. exchange.)

Materiality

The Third Circuit issued a reminder (albeit a nonprecedential one) on the relatively low threshold needed to satisfy the materiality standard for nonpublic information. In an unpublished decision in *SEC v. Huang*, 2017 WL 1315664 (3d Cir. Apr. 10, 2017), the court upheld a jury verdict that the defendant had engaged in insider trading even though he had had access to only 2.4% of the relative universe of information.

The *Huang* case was an SEC enforcement action against a Capital One employee who had downloaded and analyzed data about retail purchases made with Capital One credit cards. The employee had used this information to predict the revenues of retailers whose customers had used Capital One credit cards, and he then traded the retailers' stocks before the retailers publicly announced their quarterly revenues.

The jury found that the employee had violated Capital One's confidentiality policies in using corporate information for his personal benefit and that he had therefore misappropriated Capital One's information

in breach of his duty to his employer. The Third Circuit affirmed the jury's verdict even though the employee had had access to information about only 2.4% of the retail companies' total sales.

The Third Circuit observed that, while "information about an insignificantly small percentage of revenue might not be material," 2.4% was not necessarily insignificant as a matter of law. Testimony at trial had shown how the employee had "used the nonpublic Capital One data (in tandem with publicly available information) to predict total revenue information with greater accuracy than analysts using only publicly available information. This testimony provided evidence upon which the jury properly could have found that the nonpublic Capital One data allowed [the employee] to predict the companies' total revenues before such information was public."

The *Huang* decision is yet another example of courts' reluctance to draw bright-line rules about materiality. Access to even seemingly small percentages of the available pool of data can create risks.

SEC's Use of Advanced Data Analytics

The SEC has pursued a number of insider-trading cases that sometimes have involved relatively small amounts of profits – even only \$40,000 to \$60,000. The SEC presumably wants to send a message that even low-profit insider trading is prohibited. But the cases also illustrate the SEC's use of data analytics to uncover new leads.

Much of the SEC's work on insider-trading matters has involved the Enforcement Division's Market Abuse Unit, which initiates its own investigations through data-mining and advanced detection. For example, analyses might flag multiple trades over a period of time, not just large, well-timed, one-off trades. Data might reveal a person's repeated trades in advance of corporate mergers, or seemingly unrelated trades that are similarly timed, produce similar profits, and/or involve investments in the same companies. These patterns can then be used to analyze phone records, chats, social networks and other data sources to identify relationships among traders or to focus on a source of inside information.

In March 2017, for example, the SEC brought an enforcement action captioned *SEC v. Hartung* against a person who allegedly had traded on inside information about a pending merger. According to the SEC's complaint, the defendant had learned about the potential deal from a relative who worked at the acquiring company. The SEC noted that its Analysis and Detection Center had developed the information about the case.

In another enforcement proceeding involving advance information about a merger (*SEC v. Fung*), the SEC's press release cited the Analysis and Detection Center's work "crunching trading data to identify suspicious trading patterns."

The SEC Gets Hacked

While the SEC likes to dig around in electronic data, other people do, too. On September 20, 2017, SEC Chairman Jay Clayton issued a "Statement on Cybersecurity," in which he noted that the SEC's EDGAR system had been hacked – and that the hackers might have traded on the information they obtained from the system. Chairman Clayton said that, in August 2017, "the SEC learned that an incident previously detected in 2016 may have provided the basis for illicit gain through trading."

The hack certainly sounds illegal and probably violated various laws. But did the hackers engage in insider trading if they traded on the information obtained through the hack? Perhaps yes, but perhaps not.

The Second Circuit provided an analytical framework for this type of situation in its 2009 decision in *SEC v. Dorozhko*, 574 F.3d 42 (2d Cir. 2009). Dorozhko had hacked into the computer system of an investor-relations firm that was hosting a public company's as-yet-unreleased earnings release, and he traded on the information. The SEC brought insider-trading charges against him, but the Second Circuit held that it could not determine, on the record before it, whether Dorozhko had engaged in insider trading.

The court held that, where someone like Dorozhko – or the SEC hacker – does not owe a fiduciary or fiduciary-like duty to the issuer or its shareholders, the question becomes whether the person misrepresented himself or herself to or otherwise deceived the source of the information (the investor-relations company, or the SEC itself, in the recent hacking situation). Whether insider trading occurred thus depends on how the hacker obtained the information. The Second Circuit explained:

In our view, misrepresenting one's identity in order to gain access to information that is otherwise off limits, and then stealing that information is plainly "deceptive" within the ordinary meaning of the word. It is unclear, however, that exploiting a weakness in an electronic code to gain unauthorized access is "deceptive," rather than being mere theft. Accordingly, depending on how the hacker gained access, it seems to us entirely possible that computer hacking could be, by definition, a "deceptive device or contrivance" that is prohibited by Section 10(b) [of the Exchange Act] and [SEC] Rule 10b-5.

So what happened with the SEC hack? Chairman Clayton said that "a software vulnerability in the test filing component of our EDGAR system, which was patched promptly after discovery, was exploited and resulted in access to nonpublic information."

The language seems to echo the second of the two scenarios described in *Dorozhko*: the one that involves "mere theft," but perhaps not insider trading. Chairman Clayton appears to have carefully chosen his words when he said that the hack "may have provided the basis for illicit gain through trading." He did not specifically say that the hacker might have engaged in "insider trading." We shall see.

Legislation on Insider Trading? Perhaps?

Our prior reviews noted that bills were pending in Congress to define insider trading and overrule the Second Circuit's *Newman* decision. Those bills did not go anywhere.

In fact, SEC Chairman Clayton stated in the first part of September 2017 that he saw no need for legislation to clarify insider-trading law. Speaking at NYU Law School, Chairman Clayton was reported to have said: "I think we do a pretty good job in this space as I compare it to other jurisdictions. . . . Some places that have a code-based insider-trading regime, my sense is [that] it doesn't work any better and in fact it's probably not as effective as our regime."

But what a difference a hack makes (maybe). On September 26, 2017, after the Equifax hack and the allegations of executives' stock sales, Chairman Clayton said that he would work with Congress to strengthen insider-trading rules. When asked by two Democratic members of the House to help with legislation ensuring that corporate executives do not profit from inside information, Chairman Clayton said: "We can definitely work on it."

Is some form of legislation now on the SEC's agenda? Stay tuned.

In any event, as we noted in our prior reviews, the government has brought some insider-trading prosecutions under the criminal statute prohibiting securities fraud (18 U.S.C. § 1348) and under the criminal wire-fraud statute (18 U.S.C. § 1343).

Final Note

If you find yourself trading on material nonpublic information (and we hope that you do not unless you thoroughly vet where the information came from, whether there were any breaches of agreement/fiduciary duty and/or deceptive behavior in the chain and whether the securities are also traded in the EU), try to avoid conducting internet searches for such topics as “how sec detect unusual trade” or “insider trading with international account.” See *SEC v. Yan*, No. 17-cv-05257 (S.D.N.Y. July 12, 2017) (complaint filed by SEC against defendant who allegedly had misappropriated material, nonpublic information from his attorney-wife about her firm’s clients and who had conducted Google searches about SEC’s insider-trading enforcement efforts).

FCPA Updates

SEC and DOJ FCPA Enforcement Activity

The number of Foreign Corrupt Practices Act (**FCPA**) related enforcement actions has dropped precipitously this year. While the SEC and DOJ brought a record-high 27 enforcement actions against corporations in 2016, they have only brought eight actions so far in 2017. The slow start is likely attributable to a number of factors, including leadership turnover at the SEC and DOJ and the rush to complete settlements before the new administration took office. Much of the enforcement pipeline appears to have been cleared out as a result.

Despite this, the SEC and DOJ have continued to indicate that FCPA enforcement remains a top priority. SEC Chairman Jay Clayton, who had [criticized](#) the FCPA while in private practice, recently [said](#) that he views “combatting corruption” as “an important governmental mission.” At the DOJ, Acting Assistant Attorney General Kenneth A. Blanco said in a [speech](#) this past April that the DOJ “remains committed to enforcing the FCPA and to prosecuting fraud and corruption more generally.” Attorney General Jeff Sessions has delivered the same message, [stating](#) that the DOJ “will continue to strongly enforce the FCPA and other anticorruption [sic] laws.”

The government’s continued commitment to FCPA enforcement also was driven home on September 21, 2017, when the [SEC](#) and [DOJ](#) announced that they had entered into a global foreign bribery resolution with a Swedish telecommunications company and its Uzbek subsidiary. As part of the resolution, the two companies agreed to pay a combined total penalty of more than \$965 million—the largest monetary sanction ever imposed in an FCPA case.

The government also does not appear to have given up its reported focus on the private fund industry. In our [2016 Annual Review](#), we discussed the settled SEC and DOJ enforcement action brought against a private fund manager—the first significant enforcement action targeting either a hedge fund or private equity fund. Earlier this year, the SEC charged two more of the private fund manager’s former executives with being the driving forces behind the bribery scheme. The charges against the former executives include violating the FCPA, aiding and abetting the manager’s violations, and violating Sections 206(1) and 206(2) of the Advisers Act.

Key Risks for Private Funds

Hedge funds and private equity funds share many of the same anticorruption risks. The fundamental differences between their business models, however, make some risks more acute than others. One of the greatest anticorruption risks for all types of funds arises when securing capital from foreign officials and government entities, including sovereign wealth funds. Fund raising often is facilitated by local third-party agents who are familiar with the potential investing entities. Once a relationship is formed, local agents may be tasked with maintaining it. These interactions are a primary source of legal risk. A large number of FCPA enforcement actions in recent years have arisen from the use of third-party agents.

Private equity funds have additional anticorruption risks arising out of portfolio investments themselves, even when limited to the private sphere. Many private companies in emerging markets have weak anticorruption 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. Managerial control, board seats, voting rights and veto powers are some of the indicia of control that can confer additional 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 negative publicity risks. Any anticorruption investigation or enforcement action can severely impact a private equity fund.

In light of the ongoing focus on FCPA enforcement, now is a good time for advisers to private investment funds to assess their corruption risks, review their compliance programs, engage in targeted training of their officers and employees, and, if necessary, make tailored adjustments.

Anti-Money Laundering Updates

FinCEN Final Rule on Beneficial Ownership

The Financial Crimes Enforcement Network (**FinCEN**), a bureau of the U.S. Department of the Treasury (**Treasury Department**), issued a [final rule](#) under the Bank Secrecy Act (**BSA**) in 2016 that clarifies and expands the customer due diligence requirements for "covered financial institutions." Notably, the rule will require "covered financial institutions" to collect and verify personal information about the beneficial owners of "legal entity customers" opening new accounts—a significant new requirement, though one that will primarily affect exempt reporting advisers and foreign advisers that did not previously have to disclose this information. This rule is scheduled to go into effect in May 2018.

Covered financial institutions required to comply with the new rule include banks, broker-dealers, mutual funds, futures commission merchants, and introducing brokers in commodities. However, the additional customer due diligence requirements might ultimately be included in the proposed Anti-Money Laundering (**AML**) program requirements for registered investment advisers, which we discuss in greater detail below.

Legal entity customers subject to the beneficial ownership requirement include corporations, limited liability companies, and other entities created by filing a public document with a Secretary of State or similar office, as well as general partnerships and certain entities formed in foreign jurisdictions. However, the rule excludes certain customers already subject to another regulatory regime from its identification and verification requirements, including registered investment companies; registered investment advisers; pooled investment vehicles operated or advised by excluded financial institutions;

financial institutions regulated by a Federal functional regulator; entities listed on the NYSE, NYSE MKT, or NADAQ stock exchanges; domestic subsidiaries of listed entities; issuers required to file reports under Section 15 of the Exchange Act; any entity registered with the SEC under the Exchange Act; certain entities registered with the CFTC; and foreign financial institutions established in jurisdictions where the regulator of such institutions maintains beneficial ownership information. Pooled investment vehicles whose operators or advisers are not excluded from the beneficial ownership identification and verification requirements include non-U.S. managed hedge funds and private equity funds.

Under the rule, covered financial institutions generally will be required to identify and verify the identity of two types of beneficial owners: (1) individuals who own 25 percent or more of the equity interests of the legal entity customer; and (2) a single individual with “significant responsibility to control, manage, or direct” the legal entity customer. Under the second prong, financial institutions will only be required to collect beneficial ownership information regarding one individual with significant responsibility to control the company, not all. Thus, under the rule, covered financial institutions are not required to identify or verify the identity of mere investors in pooled investment vehicles.

FinCEN Proposed AML Rules for Registered Investment Advisers

Rules proposed by FinCEN in August 2015 which would require registered investment advisers to establish AML programs and report suspicious activity to FinCEN under the BSA are still under consideration. The [proposed rules](#) include investment advisers in the general definition of “financial institution,” which, among other things, will require them to file Currency Transaction Reports and comply with various record keeping requirements. The comment period on the proposed rule ended in November 2015.

On March 8, 2017, FinCEN [indicated](#) that the agency still plans to move forward with the proposal. In statements made to the trade publication *Financial Planning*, an agency spokesman said that FinCEN is currently in the process of reviewing public comments. “The next step is to draft a final rule and, beyond that, to work with OMB on how to proceed,” the agency spokesman said.

FinCEN has not provided any guidance regarding when a final rule might issue, and it is not clear whether investment advisers should expect it in the very near future or further down the line. In his comments to *Financial Planning* magazine, the FinCEN spokesman highlighted the complex nature of the proposed rule, adding that “[i]t’s not that unusual for complicated rule-makings to take significant time.” All registered investment advisers have robust AML as all of their service providers require it.

SEC Charges Broker-Dealer for Failing to File Suspicious Activity Reports

As AML requirements become more widespread, we may expect to see more enforcement proceedings similar to the settlement that the SEC [announced](#) in June 2017, charging Alpine Securities Corporation, a Utah-based brokerage firm, with securities law violations in connection with its failure to implement a meaningful BSA compliance program. Specifically, the SEC charged Alpine with violating Section 17(a) of the Exchange Act and Rule 17a-8 thereunder, which require broker-dealers to comply with the record keeping, retention and reporting obligations of the BSA and its implementing regulations. Although Alpine had a BSA compliance program on paper, the SEC alleged that Alpine repeatedly failed to file Suspicious Activity Reports (**SARs**) for suspicious transactions or, when it did file SARs, omitted material information about the suspected illicit activity. This enforcement action demonstrates that regulators may frown upon “check the box” compliance programs in this space.

Cybersecurity Updates

SEC Establishes New Enforcement Initiative Directed at Cyber-Based Threats

In September 2017, the SEC [announced](#) the establishment of the Cyber Unit, a new enforcement initiative targeting cyber-related misconduct. The types of misconduct that the Cyber Unit will address include:

- Hacking to obtain material nonpublic information;
- Violations involving distributed ledger technology and initial coin offerings;
- Cyber-related threats to trading platforms and other critical market infrastructure;
- Market manipulation schemes involving false information spread through electronic and social media;
- Misconduct perpetrated using the dark web; and
- Intrusions into retail brokerage accounts.

SEC Risk Alerts Warn Investment Advisers and Broker-Dealers about Ransomware and Recommend Cybersecurity Best Practices

On May 17, 2017, the SEC's Office of Compliance Inspections and Examinations (**OCIE**) released a [risk alert](#) strongly encouraging investment advisers and broker-dealers to review their cybersecurity programs in light of the global WannaCry ransomware cyberattack. Once the WannaCry ransomware infected a computer, it encrypted the computer's files, demanded ransom payments, and threatened to delete all data unless the ransom was paid. OCIE advised reviewing the alert regarding WannaCry released by the U.S. Department of Homeland Security's Computer Emergency Readiness Team and evaluating whether applicable patches are installed properly and timely. The May 2017 risk alert also described the following deficiencies OCIE observed in its recent cybersecurity examination of 75 SEC-registered firms: (1) failure to conduct cyber-risk assessments; (2) failure to conduct penetrations tests and vulnerability scans; and (3) shortcomings in system maintenance.

In its risk alert released on August 7, 2017, OCIE further elaborated on its cybersecurity examination of 75 SEC-registered firms and recommended the following best practices:

- Maintenance of an inventory of data, information and vendors;
- Detailed policies and procedures for penetration tests, security monitoring and system auditing, access rights and breach reporting;
- Maintenance of prescriptive schedules and processes for testing data integrity and vulnerabilities;
- Effective access controls and access monitoring;
- Mandatory employee training; and
- Engaging senior management in approval of policies and procedures.

FINRA Takes Disciplinary Action Against Firms for Failing to Protect Records from Alteration

In December 2016, FINRA [announced](#) that it fined 12 firms a total of \$14.4 million for failing to maintain records in a format called "write once, read many" (**WORM**) that prevents the alteration or destruction of records stored electronically. Federal securities laws and FINRA rules require that business-related electronic records be kept in WORM format to safeguard customer data and prevent alteration of the

records. Commenting on the disciplinary actions, FINRA's Chief of Enforcement Brad Bennett emphasized how regulators rely on maintenance of records in the WORM format to ensure the integrity of such records and examine for misconduct in the securities industry.

Growing Trend of State Financial Regulators Addressing Cybersecurity Risks

News of recent breaches and security incidents has illustrated how financial services firms and institutions face heightened cybersecurity risks. The Federal Bureau of Investigation [reported](#) that, between January 2015 and December 2016, there was a 2,370% increase in identified exposed losses attributed to sophisticated scams targeting businesses that regularly perform wire transfer payments. The risk of fraudulent wire transfers may have prompted the inclusion of “procedures for authenticating client instructions received via electronic communication” in both the Colorado and Vermont Regulations.

There has been a growing trend of state financial regulators imposing requirements on financial services firms and institutions in an effort to address cybersecurity risks. Here are a few examples:

New York

The New York Department of Financial Services' recently adopted cybersecurity regulation (the **New York Regulation**), which came into effect in March 2017, covers a different set of financial institutions (banks, insurance companies and certain financial services institutions) than the Colorado and Vermont Regulations. We believe that private funds and their managers are not covered by the New York Regulation and do not fall into any of the categories of institutions supervised by the New York Department of Financial Services. For more information on the New York Regulation, please see our [November 2016](#), [December 2016](#), [January 2017](#), [March 2017](#) and [April 2017](#) blog posts.

Vermont

The Vermont Department of Financial Regulation, Securities Division, adopted [cybersecurity rules](#) (the **Vermont Regulation**), effective May 1, 2017, that apply to “securities professionals.” The Vermont Regulation defines

- “securities professional” as “any person providing investment-related services in Vermont, including: broker-dealers, agents, investment advisers, investment adviser representatives (as defined by the Vermont Regulation), solicitors, and third-party portals,” and
- “investment-related” as “pertaining to securities, commodities, banking, insurance, or real estate (including, but not limited to, acting as or being associated with a broker-dealer, investment company, investment adviser, government securities broker or dealer, municipal securities dealer, bank, savings and loan association, entity or person required to be registered under the [federal CEA] or fiduciary).”

Under the Vermont Regulation, securities professionals are [required to](#):

- Establish and maintain written procedures “reasonably designed to ensure cybersecurity,” which is defined as “the protection of investor and firm information from compromise” through the use of electronic digital media. To the extent reasonably possible, such procedures must provide for:
 - an annual cybersecurity risk assessment;
 - the use of secure email, including use of encryption and digital signatures;
 - authentication practices for employee access to electronic communications, databases and media;
 - procedures for authenticating client instructions received via electronic communications; and

- disclosure to clients of the risks of using electronic communications;
- Include cybersecurity as part of its risk assessment;
- Maintain evidence of adequate insurance for the risk of cyber security [sic] [breach](#); and
- Provide identity restoration services at no cost to consumers “in the occurrence of breach in the cyber security [sic] of consumer nonpublic personal information.”

Colorado

The Colorado Department of Regulatory Agencies, Division of Securities, adopted cybersecurity [rules](#), effective July 15, 2017, applicable to broker-dealers and investment advisers regulated by the Colorado Division of Securities (the **Colorado Regulation**). The rules provide that such broker-dealers and investment advisers must:

- Establish and maintain written procedures “reasonably designed to ensure [cybersecurity](#),” which to the extent reasonably possible, must provide for:
 - an annual assessment of the potential risks and vulnerabilities to the confidentiality, integrity and availability of [Confidential Personal Information](#);
 - use of secure email for email containing Confidential Personal Information, including use of encryption and digital signatures;
 - authentication practices for employee access to electronic communications, databases and media;
 - procedures for authenticating client instructions received via electronic communication; and
 - disclosure to clients of the risks of using electronic communications; and
- Include cybersecurity as part of their annual risk assessments.

Big Data, Web Scraping and Other Issues in Data Science for Fund Managers

Fund managers have been capitalizing on methods to refine and analyze big data to assist investment decisions. (For example: e-commerce receipts and credit-card transaction data; sensors from Internet-connected machines or smart devices; and online data collected via “screen scraping” (or “web scraping” or “spidering”).) Yet alternative data does not come without risks. For example, data collected as a result of Web scraping may under certain circumstances be considered MNPI. If that data were collected in a manner considered deceptive, then trading on that information might implicate the antifraud provisions of the securities laws. As a result, it is very important to have tailored due diligence questionnaires and robust policies and procedures relating to big data. It also is very important to have agreements relating to big data negotiated by professionals who understand the risks and nuances.

Introduction to Big Data and Web Scraping

Automated data collection – also referred to as Web scraping, data scraping and spidering, among other names – is a practice that has been controversial since the early days of the commercialization of the Internet. The practice refers to the use of a “robot” (or “bot” or “spider”) to collect data from Web sites. Bots may target specific Web sites on a periodic basis or crawl through the Web more generally. Data collected through these means can be used for many different purposes, including by hedge fund managers to analyze prospective and existing investments.

Web site owners typically take certain measures to inform third parties about their preferences regarding scraping Web site data. Most commonly, a site's terms of service will contain language stating the site's policy regarding scraping; often, the terms generally prohibit automated database scraping activities. Also, a Web site's underlying code generally will communicate with search engine spiders and data scraping bots by placing a "robots.txt" file on its site that may signal that certain pages are off-limits to automated scraping, or a crawl delay to limit how many times a spider can access the site per minute.

When apprised of certain unwanted data-collection activities, Web site owners might institute certain technical measures, including IP address blocks, and might expressly revoke a third party's Web site access by sending a "cease and desist" letter to the entity behind unwanted scraping.

Disputes may arise when Web site owners seek to prevent third parties from, among other things:

- extracting content from the relevant site for the third party's commercial or competitive use;
- copying content protected by copyright;
- extracting content in contravention of the site's terms of service or technical measures; or
- disrupting the site's operations through scraping activities (e.g., causing a Web site outage through crawling excessively, spamming end users or causing the site owner to incur unwanted IT-related costs).

Despite the relative maturity of e-commerce, the legality of automated data collection is still unsettled. While there have been many cases that have examined scraping disputes under various state and federal statutes, the law is not uniform, and past decisions have been fact-specific in nature.

Breach of Contract

Most Web sites' terms of use, terms of service or end user license agreements (**EULA**) typically include language prohibiting automated data collection. Violation of the EULA by, for example, scraping information has been used successfully as the basis for breach of contract claims.

In some instances, site users are required to register and expressly agree to the site's terms before being permitted to access the principal areas of the site. In many cases, however, the EULA or site terms are accepted purportedly by a user simply by accessing the site. This type of electronic contracting is often referred to as a "browsewrap" agreement (e.g., a link to the terms of service is included at the bottom or top of each Web page but without any "click to accept" or "clickwrap" feature that is typical of many e-commerce transactions and social media registrations). While browsewrap agreements in consumer transactions generally have not been held to be enforceable, courts have evaluated the validity of these agreements based on whether the user had actual or constructive knowledge of a Web site's terms and conditions and whether the user manifested assent to those terms.

Whether the site terms are enforceable against a sophisticated commercial party (as opposed to a consumer) also may be relevant. Depending on the presentation, one may be able to argue that a particular Web site's terms are unenforceable, although as the U.S. Court of Appeals for the Second Circuit once ruled, such a contention can falter when a commercial entity that may not have been aware of the Web site terms the first time it scraped data was found to have been aware of the terms after multiple contacts with the site. The argument that one had no notice of the terms is naturally harder to make with respect to clickwrap or click to accept forms of EULA, which more consistently are found to be enforceable.

Computer Fraud and Abuse Act

Upon noticing unwanted scraping, a site owner may take technical and legal steps to discourage that activity. Data collectors who ignore these impediments and continue to scrape risk running afoul of certain federal laws. The Computer Fraud and Abuse Act (**CFAA**), while generally a criminal computer hacking statute, prohibits access to information from a computer, Web site, server or database that is “without authorization” or in a way that “exceeds authorized access.” The CFAA is nearly always asserted by site owners as the basis for relief against data collectors.

To bring a successful claim under the CFAA in a data-scraping case, site owners must, among other things, advance evidence that shows the scraper intentionally accessed the site “without authorization.” Considering that most Web sites are generally open to the public, a site owner will be required to show that the site revoked the third-party data scraper’s permission to access the site in question and that the scraper nevertheless continued to access it. Beyond terms of service that prohibit scraping, revocation or “de-authorization” typically takes the form of a cease and desist letter prohibiting further site access, along with technological impediments such as IP address blocks against a particular data scraper.

In August, a District Court in the Northern District of California held that the Computer Fraud and Abuse Act does not apply to the scraping of publicly available sites. This is a noteworthy case, as violations of the CFAA are usually alleged in screen scraping cases.

In recent years, courts have held that a site owner has communicated a complete revocation of access when it sends a cease and desist letter that forbids Web site access for any reason and then backs up that action with a technological barrier. Indeed, following recent court rulings, site owners are not merely relying on the enforceability of their site terms alone, but instead expressly revoking access to unwanted data scrapers. The U.S. Court of Appeals for the Ninth Circuit recently bolstered the importance of express revocation when it ruled that “a violation of the terms of use of a Web site [sic] – without more – cannot be the basis for liability under the CFAA.”

Securities Laws

The use of automated data collection for investment research purposes also may give rise to issues under securities laws. First, fund managers that obtain or receive data collected as a result of web scraping may come into possession of MNPI, or information that, when aggregated, could be considered MNPI. Risks arise if the information was provided in violation of a confidentiality obligation. Trading while in possession of such information could conceivably lead to liability under the “misappropriation theory” of insider trading, which holds that a person commits fraud in connection with a securities transaction – and thereby violates Section 10(b) of the Exchange Act and SEC Rule 10b-5 – when he, she or it misappropriates confidential information for securities-trading purposes in breach of a duty owed to the source of the information. The source need not be an insider of the issuer whose securities are being traded.

Second, if the data were collected in a manner considered “deceptive,” then there is a risk that trading on that information may be considered part of a fraudulent scheme in violation of the antifraud provisions under the securities laws. Behavior in violation of an “ever-present duty not to mislead” may violate these provisions even when the trader is under no duty to the source of the information. For example, if a manager or its agent circumvents security protocols; disguises or fails to reveal a scraper’s identity on a site (where required); or otherwise deceives a Web site into allowing access to the site, these might be

viewed as affirmative misrepresentations constituting a “deceptive device” under Section 10(b) and Rule 10b-5, which could form the basis for such a fraud claim.

Finally, even where data collectors fully comply with the terms of a site’s agreements and its security protocols, state attorneys general may raise concerns under state laws about practices that take “unfair advantage” of access to information and practices that are against public policy generally.

Copyright Infringement

In certain circumstances, automated data collection may infringe upon a site owner’s copyright or other intellectual property rights. Under the Copyright Act, copyright protection is embedded within original works that are fixed in any tangible medium, which can certainly include Web site content, images, or in some cases, portions of the underlying Web site code. Therefore, because web scraping tools generally index information on a targeted webpage, regardless of the type of information the tools are seeking to obtain, if that Web scraping leads to the reproduction of any copyrighted content, the activity may give rise to a claim for copyright infringement.

With respect to Web sites containing user-generated content, a data scraper may be unaware that some site owners previously may have obtained an exclusive license to, or actual assignment of copyright ownership in, the content posted by users. In those circumstances, the Web site operator would then have standing to bring a copyright claim against entities scraping and copying that content. However, compelling users to grant the site owner an exclusive license in the EULA is not a widespread approach, as sites generally do not garner exclusive copyright rights in user content for both practical and business reasons.

Additional Issues

Fund managers should be aware of certain additional issues that may arise from using automated data collection:

- Excessive automated data collection can interfere with the performance of a site. To the extent a site crashes, an end user experiences delays or a site’s operational capacity is otherwise burdened, the data collector may be deemed to have interfered with the site owner’s use of its tangible property. In these circumstances, site owners have brought trespass to chattels claims. Technological protocols such as robots.txt instructions regarding frequency and depth of scraping are intended to mitigate the risk of interfering with a site’s operational capacity.
- Similar to liability under the CFAA, circumvention of technological control measures, such as completely automated public Turing test to tell computers and humans apart (**CAPTCHA**) “I am not a robot” measures to block automated access, also can create the basis for liability under the Digital Millennium Copyright Act of 1998 (**DMCA**). The DMCA provides that “no person shall circumvent a technological measure that effectively controls access to a work protected under this title.”
- The Consumer Financial Protection Bureau (**CFPB**) recently called for comments on access to financial data via web scraping by fintech companies, including data providers. In its comment letter, the American Bankers Association (**ABA**) recommended that the CFPB ensure that data aggregators be held to the same data protection and notification standards as banks. Specifically, the ABA recommended that consumer data be subject to the protections of the Gramm-Leach-Bliley Act, which affords certain protections to “non-public [sic] personal information.”
- Collected data may contain personally identifiable information (**PII**). Generally, PII is data that is considered personal in nature and could be used to compromise the privacy of an individual. PII

includes sensitive and nonpublic financial, health or other data or attributes, such as addresses or financial account numbers. Data collectors should take care to anonymize data that comes from servers that contain PII. Even fund managers who purchase scrubbed data from third parties should check to ensure the information they receive is fully anonymized and, if not, take steps to remove all identifying information.

Fund Manager Best Practices

To minimize the risk of encountering any legal and compliance pitfalls, managers can follow certain best practices in collecting big data as part of their investment research either directly or through the use of a third-party data provider. Best practices include:

- **Abide by the Web site terms.** Although, in practice, it is impractical for a data collector to review the terms of every Web site that it accesses, it is important to remember that there can be some risk to engaging in such activities without conducting such a review, especially to the extent that a particular term of service prohibits automated data collection on a site.
- **Follow technological protocols, and refrain from circumventing impediments to automated data collection.** Some sites use, for example, the robots.txt protocol to specify: (1) which bots are allowed to access the site, if any; (2) which bots are blocked from the site; and (3) pages of the site that are available for access, including frequency of access. Compliance with the robots.txt protocol is voluntary, although customary in the industry, and has previously been considered by courts when considering a site's stance toward web crawlers. Other sites use impediments such as blocking the IP address of a specific data collector or other mechanisms to authenticate human users. Common techniques include CAPTCHA and image recognition tests.
- **Collect factual information; avoid expressive and proprietary content.** Bots used by managers should have the ability to avoid collecting any information with creative elements, including, in particular, images. They also should avoid manipulating creative elements of the site in the course of collecting any factual information. Keep in mind that, beyond what is expressly protected content, the site owner may consider other information to be proprietary and confidential, particularly in the context of a bot collecting that information as part of a larger data set.
- **Avoid collecting PII.** Anonymize data that comes from servers that contain PII. This includes making sure that data provided by a third party also has been appropriately scrubbed.
- **Evaluate any potential or existing relationships with third-party data providers.** Factors to consider in determining whether to engage the services of a third-party data provider include protection from legal claims, downstream communication of intellectual property and any potential loss of control over compliance practices. Additionally, it is important to conduct careful diligence of the vendor, including inquiring as to the source of the data and whether it has been appropriately anonymized; review the contract with the vendor and assess any potential areas of liability; and monitor the vendor's activities on an ongoing basis. Additional consideration should be given when a data collection project by a vendor is the type of activity it regularly performs for any customer or whether it is a "custom" job; this consideration may implicate whether a vendor is a company's agent and affect considerations of contributory or vicarious liability should a vendor be found liable for its data collection practices.
- **Leave a paper trail.** Whether reviewing the policies and procedures for in-house analysts or conducting formal due diligence of data aggregators who provide customized or non-exclusive services, compliance officers should have policies and procedures in place to monitor key risks associated with automated data collection.
- **Stay informed.** In addition to automated data collection, fund managers should be aware of a wider set of data science issues, including issues arising from, among others, use of satellite imagery, use of drones, location tracking from cell phones and privacy issues generally.

Blockchain Updates

2017 has been a big year for blockchain, the technology proclaimed as a future disruptor of the financial services sector and beyond. Financial companies, investors, technology startups, and a myriad of other industries have made investments in blockchain projects and have begun testing blockchain technology as a replacement for legacy systems for tracking or verifying transactions. The nature of blockchain technology – decentralized, immutable, verifiable and cryptographic – has led developers to consider how it might be used to store, transfer, and secure digital assets in the future. To get there, however, many legal and regulatory issues must be resolved. Ultimately, each industry adopting the blockchain will face its own unique set of concerns.

Blockchain Generally

The blockchain protocol, a form of a “distributed ledger system,” originally was designed as a peer-to-peer technology platform to process Bitcoin transactions and transfer the digital currency without the need for a trusted intermediary. The blockchain protocol as a platform is actually independent of the digital currency Bitcoin, and is therefore transferable to other applications in multiple industries. Naturally, because blockchain was conceived of as supporting a specific digital payment system, the initial and most obvious use of the blockchain outside of Bitcoin is “fintech” – technology-based payment and financial transaction systems. The goal of recent experimentation and development in fintech is to reduce inefficiencies in the existing payments, clearance and settlement systems. Conceivably, many of these functions could be conducted through a “smart contract” – a completely automated process, executed via a software application that runs on a blockchain. In pursuit of these goals, in the last several years, and continuing in 2017, many in the financial services area have made significant investments in research, development and pilot programs, in many cases through coalitions or in partnership with large technology companies as well as with blockchain-focused start up companies. Indeed, in 2017, the Office of the Comptroller of the Currency was exploring the possibility of granting special purpose bank charters to fintech companies that allow three core banking functions (receiving deposits, paying checks and lending) to streamline possible innovation in the area.

In a blockchain or distributed ledger network, individual transactions are grouped into “blocks.” As a block of transactions is verified, the block is distributed to all the participants in the network, often referred to as “nodes,” and logically and irrevocably is linked to the block before it, creating the “chain.” In this way, all of the nodes have a full and complete copy of every transaction ever conducted through that network. Unlike centralized ledger networks, the chain can be updated with a new transaction by any node on the network, with all nodes’ copies of the chain being identical. In short, the principal innovation is a method to send something of value digitally without a trusted intermediary or institution. Moreover, the blockchain allows for the automatic execution and settlement of business rules without human intervention through “smart contracts.” Smart contracts are software applications which run on the blockchain platform, and which automatically execute, verify, and enforce the performance of an agreed-upon transaction. In short, a smart contract can be used, for example, to facilitate paperless transactions with strangers across borders in a secure way.

There are public or “permissionless” blockchains (such as that underlying Bitcoin), where the right to be a node on the network and alter/verify the ledger by participating in the consensus mechanism is open to the public. For commercial entities developing fintech applications or participating as parties to a smart contract, the preferred implementation seems to be a private, or “permissioned,” blockchain, where the

right to participate in the network is restricted to pre-selected participants or institutions authorized to transact on the network. In both private and public blockchain implementations, no single entity or node controls the ledger—the network itself verifies transactions through a chosen “consensus mechanism” (whether it be “proof of work,” “proof of stake” or another method).

Blockchain State Law Developments

As developers consider more and more applications for blockchain, there are questions about the enforceability of blockchain-based transactions and related, self-executing “smart contracts,” including how existing state contract and business laws will have to be re-interpreted or amended to recognize blockchain records and transactions. Some states have begun to address some of these issues.

In March 2017, Arizona passed HB 2417 into law. The law clarified some of the enforceability issues associated with the use of blockchain and smart contracts under Arizona law, in particular with respect to transactions relating to the sale of goods, leases and documents of title governed, respectively, under UCC Articles 2, 2A and 7. On the heels of the Arizona law, Nevada passed its own blockchain legislation (SB 398) in June 2017. SB 398 gave legal recognition to blockchain transaction by including blockchain within the definition of electronic records, and prohibited local governments from levying taxes or licensing requirements on the use of blockchain. And most recently in July 2017, the Delaware governor signed SB 69 into law. SB 69 amended the Delaware General Corporation Law to authorize explicitly the use of distributed ledger technology in the administration of Delaware corporate records, including stock ledgers.

Initial Coin Offerings

In 2017, investors witnessed the rise of the ICO. ICOs represent a new method to raise capital outside of the traditional venture capital or equity offering paths. In a typical ICO, a blockchain-based product or service provider offers proprietary digital assets (**tokens**) – rather than traditional forms of debt or equity – in exchange for working capital, usually provided in the form of a cryptocurrency such as Bitcoin or Ether. Promoters generally inform purchasers that the capital raised from the sales will fund development of a digital platform, software, or other projects and that the virtual tokens or coins may be used to access the platform, use the software or otherwise participate in the project. Some promoters may suggest that buyers of the new cryptocurrencies or tokens expect a return on their investment or expect to participate in a share of the returns provided by the project.

The boom in ICOs (over \$1.7 billion has been raised in the first three quarters of 2017) has garnered the interest of regulators. In September 2017, the SEC charged an individual and two related companies with defrauding investors and sought various relief to prevent the defendants from engaging in illegal unregistered securities offerings and ongoing fraudulent conduct designed to deceive investors in connection with the sale of initial coin offerings. Such charges come on the heels of the SEC’s July 2017 [Investor Bulletin](#) on ICOs and a July [report](#) of an investigation regarding potential federal securities law violations involving a “virtual” investment organization, The DAO, and related entities that stated that [digital tokens may be securities](#) because they constituted an “investment contract” under the federal securities laws. On the international front, in September 2017, the People’s Bank of China announced a freeze on ICO fund raising on Chinese exchanges.

BEA Filing Updates

On July 27, 2017, the U.S. Department of Commerce Bureau of Economic Analysis (**BEA**) published a [proposed rule](#) to set forth the reporting requirements for the 2017 BE-12 Benchmark Survey of Foreign Direct Investment in the United States.⁹ The BE-12 survey is conducted every five years; the prior survey covered 2012. The benchmark survey covers the universe of foreign direct investment in the United States and is BEA's most detailed survey of such investment. Under the proposed rule, persons subject to the reporting requirements of Form BE-12 would be required to respond whether or not they are contacted by BEA. However, private funds will not have to report direct investments made by foreign persons unless such foreign persons own 10% or more of the voting interests in an operating company indirectly through the U.S. private fund.¹⁰

The proposed due date for Form BE-12 is May 31, 2018 (or by June 30, 2018 for reporters that use BEA's eFile system).

U.S. Tax Updates

Comprehensive Tax Reform

Please note that the following section on tax reform is current as of November 8, 2017, and may not reflect the present state of affairs given the evolving tax landscape in the United States.

On November 2, 2017, the Republicans in the House released their long-anticipated tax reform bill, entitled the "[Tax Cuts and Jobs Act](#)" (**Tax Act**). While there have been multiple statements that swift action is expected on this bill, the text of the bill is expected to be extensively revised in the legislative process and substantive amendments were already released on November 6, 2017 by the Chairman of the House Ways and Means Committee, Rep. Kevin Brady (R-Texas) (the **Brady amendments**). Further, the Republicans in the U.S. Senate are expected to introduce their own tax reform bill shortly, and that bill is anticipated to diverge from the House bill in many respects. In order for tax reform to be enacted, the House and Senate will have to pass a single piece of agreed legislation, which the President must in turn sign into law. Notwithstanding the very substantial effort that remains before the Congress to enact tax reform into law, the bill contains important details.

It is the stated goal of the Republicans in Congress, and the President, to enact tax reform before the end of the calendar year. However, it is not clear that, if that date of enactment were to slip into early 2018, any of the effective date provisions of the bill would be modified, and therefore time to plan around the effective date provisions may be very limited. As a result, taxpayers should consider whether to begin taking steps to plan for legislation that will in large part become effective on January 1, 2018.

⁹ Foreign direct investment in the United States is defined as the ownership or control, directly or indirectly, by a foreign person of 10% or more of the voting securities of an incorporated U.S. business enterprise or an equivalent interest in an unincorporated U.S. business enterprise.

¹⁰Guidance from the BEA instructs reporters of investments in private funds that meet the definition of direct investment but display characteristics of portfolio investment (specifically, investors who do not intend to control or influence the management of an operating company) to report through the Treasury International Capital (TIC) reporting system, and not to report on the BEA's direct investment surveys.

Certain significant aspects of the bill and the Brady amendments are summarized below. However, this summary does not describe all of the proposals in the bill or the Brady amendments.

Selected General Provisions

Carried Interest: While the bill as originally proposed was silent on the topic of carried interest, the Brady amendments include a provision that would treat “carried interest” attributable to gains from the sale of capital assets held for less than three years as short-term capital gains. The provision would have no impact on “carried interest” attributable to qualified dividend income, nor would it recharacterize “carried interest” as “unrelated business taxable income” or “effectively connected income” (in each case, as such term is defined for U.S. federal income tax purposes).

20% Permanent Corporate Tax Rate: The bill proposes a permanent reduction of the corporate tax rate from 35% to 20% beginning in 2018.

25% Pass-through Rate: The bill provides a special 25% pass-through rate for “business income”, with certain rules that are designed to prevent applicability of the special rate to taxpayers who perform principally services. Net income from a passive business activity (as determined applying the “passive activity” rules in current section 469) would be fully eligible for the 25% rate. However, there are exceptions to the 25% rate for interest (other than interest income that is properly allocable to a trade or business), dividends, capital gains and other similar types of investment income. Owners receiving income from an active business would determine their business income by reference to their “capital percentage” of net business income (*i.e.*, the portion of their pass-through income attributable (or deemed attributable) to their ownership interest in the business rather than their labor contributed to the business).

Presumption That Income 70% Attributable to Labor: The bill generally allows owners to elect to apply a capital percentage of 30% to net business income from an active business to determine the amount of net business income eligible for the 25% rate. Thus, the bill presumes that 70% of pass-through business income is attributable to labor. The 30% election would effectively create a maximum blended rate of 35.22% ($[70\% \times 39.6\%] + 30\% \times 25\%$). Alternatively, the owners could apply a formula based on facts and circumstances to determine a capital percentage other than 30%. The formula would calculate the capital percentage by assuming an implied return on capital equal to the federal short term rate plus 7% multiplied by the capital investment of the business. An election to use this formula would be binding for five years.

Presumed Denial for Certain Service Providers: The bill establishes a 0% default capital percentage for lawyers, accountants, consultants, engineers, financial services professionals, and entertainers, as well as those engaged in investing, trading, or dealing in securities, partnership interests, or commodities. Therefore, these taxpayers would generally not be eligible for the 25% rate. However, the bill does permit these taxpayers to use the alternative capital percentage based on the business’s capital investments applying the formula described above.

If enacted as proposed, the bill would encourage some businesses to operate as flow-through entities so that their owners could benefit from the 25% rate (or even the 35.22% blended rate). It would also encourage employees to seek to become owners of their flow-through employers to benefit from the reduced rate and would encourage service providers to own their buildings and equipment so as to maximize their capital percentage under the formula.

25% Rate on Ordinary Dividends Paid by REITs: The bill provides that the 25% pass-through rate would apply to ordinary dividends paid by real estate investment trusts (**REITs**) (*i.e.*, all dividends not designated by the REIT as capital gain dividends or qualified dividend income).

Certain Changes to Self-Employment Tax: The bill would eliminate the “limited partner exception” to self-employment tax, such that any partner in an entity treated as a partnership for U.S. tax purposes could have net earnings from self-employment, regardless of the individual’s status as a limited partner of the partnership. The bill would also eliminate the exclusion from self-employment tax for rental income.

Limitation on Business Interest Deductions: Section 163(j) (providing for limitations on deductibility of interest payments in certain “earnings stripping” transactions) would be repealed and replaced with a provision to limit business interest deductions to 30% of adjusted taxable income, as specifically adjusted to approximate earnings before interest, tax, depreciation and amortization (**EBITDA**) for the tax year. “Investment interest” would be excluded, and businesses with adjusted gross receipts of \$25 million or less would be exempt. This could limit the benefits of using leveraged blockers in a fund’s investment structure (other than in the case of debt funds that would continue to be able to offset such investment interest paid against interest income received). Excluded interest deductions would be carried forward up to five years.

Limitation on Use of Net Operating Losses: Deductions for net operating losses (**NOLs**) would be limited to 90% of taxable income for any tax year. NOLs would be carried forward indefinitely to future tax years, rather than expiring after 20 years, as under current law. NOL carrybacks would generally be disallowed, with exceptions for certain disaster losses.

Current Tax on Deemed Repatriated Foreign Earnings: The bill imposes a one-time tax on the untaxed earnings of foreign subsidiaries of U.S. multinationals. The tax rate would be 12% on cash and 5% on illiquid investments. At the election of the U.S. shareholder, the tax liability would be payable over a period of up to eight years.

Territorial International Tax System With Special 10% Tax on High-Profit Foreign Subsidiaries: The bill would shift the current U.S. “worldwide” international tax system under which U.S. companies are taxable on worldwide income to a “territorial” system under which foreign active profits are generally exempt from tax. The mechanism would exempt the foreign-source portion of dividends paid by a foreign corporation to a U.S. corporate shareholder that owns 10% or more of the foreign corporation. No foreign tax credit or deduction would be permitted for any exempt dividend, and no deductions for expenses allocable to the exempt dividend would be taken into account for purposes of determining the U.S. corporate shareholder’s foreign-source income. The bill would impose a tax on 50% of a U.S. parent’s “foreign high returns” from its foreign subsidiaries.

Excise Tax on Payments by a Domestic Corporation to Certain Related Foreign Corporations: Under the bill, payments (other than interest) made by a U.S. corporation to a related foreign corporation in the same international financial reporting group that are either deductible, includible in costs of goods sold, or includible on the basis of a depreciable or amortizable asset would be subject to a 20% excise tax unless the related foreign corporation elects to treat the payment as income “effectively connected with the foreign corporation’s conduct of a trade or business within the United States” and attributable to its “permanent establishment” in the United States and, therefore, subject to U.S. corporate tax. The reference to “permanent establishment” – a treaty concept – appears intended to override any tax treaty protections otherwise available to an electing foreign corporation.

Treatment of Offshore Insurance Companies as PFICs: The bill would treat a foreign insurance company as a passive foreign investment company (PFIC) unless the foreign company would be taxed as an insurance company were it a U.S. corporation and if its loss and loss adjustment expenses, unearned premiums, and certain reserves constitute more than 25% of the foreign corporation's total assets (or 10% if the corporation is predominately engaged in an insurance business and the reason for falling below the 25% threshold is solely due to temporary circumstances).

Denial of Deduction for Entertainment Expenses: Under the bill, entertainment expenses would no longer be deductible, although business meals would remain deductible.

Individual Tax Rates: The bill retains the top rate of 39.6%, but increases the income level at which it applies. The other rates are 12% (up from 10%), 25% and 35%. The 12% rate would be phased out for individuals earning more than \$1,000,000 and married couples earning more than \$1,200,000. The method for adjusting the brackets for inflation would change, causing the brackets to increase at a slower rate than currently.

Denial of Deduction for State and Local Income Taxes; Limit on Deduction of State and Local Property Taxes up to \$10,000: The bill repeals the individual deduction for state and local income taxes and limits the deduction for state and local property taxes to \$10,000 for taxes that are not incurred in connection with a trade or business. State and local taxes incurred in connection with a trade or business would continue to be deductible. The denial of a federal deduction for state and local income taxes would have the greatest impact on individuals living in high-tax states, like New York, California and New Jersey.

Phase-Out of the Estate Tax: The bill would immediately double the estate tax exemption from \$5 million per person to \$10 million per person, and would repeal the estate tax and the generation-skipping transfer tax in 2024. The bill would retain the gift tax but would lower it to 35%, and would retain the \$10 million lifetime gift tax exclusion and the annual exclusion of \$14,000. The "step-up" in basis for heirs would also be retained.

Executive Compensation: The bill amends section 162(m), which imposes a \$1 million compensation deduction limitation, in the following significant ways. First, the bill eliminates the "performance-based" exemption that is relied upon by a majority of publicly-held corporations that pay their executive officers annual compensation exceeding \$1 million.

Second, additional executives would be subject to the deduction limitation. The definition of "covered employees" (*i.e.*, executives subject to the deduction limitation) is expanded to include the chief financial officer, and applies to any individual who served at any time during the taxable year as a chief executive officer or chief financial officer (rather than based on service on the last day of the taxable year). Also, an individual who becomes a covered employee for any taxable year beginning after December 31, 2016 would continue to be a covered employee in subsequent years.

Third, the bill would expand the number of corporations to which the deduction limitation applies to include any corporation required to file SEC reports under section 12 or 15(d) of the Exchange Act, including corporations that file solely due to the issuance of public debt.

Repeal of Section 409A and Section 457A; Changes to Taxation of Nonqualified Deferred Compensation: The bill would repeal sections 409A and 457A on a prospective basis. The bill proposes a new section 409B which, for services performed after 2017, would tax all compensation

deferred under a nonqualified deferred compensation plan as soon as there is no substantial risk of forfeiture with regard to the compensation.

Compensation would be considered to be subject to a substantial risk of forfeiture only if an individual's right to the compensation is conditioned upon the future performance of substantial services (covenants not to compete and payment conditions that relate to a purpose other than the future performance of services would not count as substantial risks of forfeiture).

Existing deferrals for services performed before 2018 would become subject to this new rule in 2026.

Deferral of Income Recognition for Certain Stock Options or Restricted Stock Units: The Brady amendments would also provide that certain employees who receive stock options or restricted stock units as compensation for the performance of services may elect to defer recognition of income, subject to certain conditions, generally until the date that is five years after the date such options or units vest, provided the corporation's stock is not publicly traded.

Tax-Exempt Organizations

State and Local Governmental Pension Plans Subject to Tax on Unrelated Business Taxable Income: Under the bill, state and local entities, such as pension plans, that are tax-exempt under both section 501(a) and section 115 as government entities, would be subject to tax on unrelated business taxable income.

Change to the Excise Tax Imposed on Investment Income of Private Foundations; Imposition of Excise Tax on Certain Private Colleges and Universities: The current 1% or 2% excise tax on private foundation net investment income would be fixed at 1.4%. Private tax-exempt colleges and universities with at least 500 students and assets with an aggregate fair market value of at least \$250,000 per student (originally \$100,000 under the bill as initially proposed, but increased per Rep. Brady's amendments, and excluding those assets used directly for purposes of educating students) would be subject to the same 1.4% excise tax on net investment income as private foundations.

Please see our [November 2, 2017](#) and [November 6, 2017](#) blog posts for more information.

Tax Treatment of Partnership Audits

Effective for audits of tax years that begin after December 31, 2017, the [Bipartisan Budget Act of 2015](#) (the **BBA**) significantly alters the U.S. tax rules applicable to audits of partnerships (including LLCs taxed as partnerships). The BBA creates 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). One change from these new audit rules is that the designated partnership representative who acts on behalf of the partnership and deals with the U.S. Internal Revenue Service (the **IRS**) no longer will need to be a member of the relevant partnership or limited liability company (**LLC**), although such partnership representative must have a "substantial presence" in the U.S. In addition, if the partnership representative is an entity, it must choose a designated individual to serve as the contact for the IRS.

On June 13, 2017, the IRS and the Treasury Department released proposed regulations that provide additional guidance on the new partnership-level audit rules. The proposed regulations include guidance on the scope of the new partnership audit regime; procedural rules on electing out of the regime; the requirement that a partner's treatment of items on its tax return must be consistent with the treatment of such items on the partnership's return; details regarding the partnership representative; and details

regarding the “imputed underpayment” (the amount by which the taxpayer is determined to have underpaid tax upon completion of the audit), including the “push out” election. The “push out” election would permit a partnership to avoid paying anything at the partnership level, as any liabilities would be “pushed out” to the partnership’s partners. While the proposed regulations provide clarity on many questions raised by the partnership-level audit rules, some key questions remain unanswered, including (i) whether partners are bound by the imputed underpayment if the “push out” election is made, (ii) whether the “push out” election will be permitted in the case of tiered partnership structures and (iii) the effect of the election on affected partners’ capital accounts and inside/outside tax bases.

Fund managers should review the operating agreements for their fund vehicles to ensure that such documents take into account these new audit rules, and should be aware that investors are asking increasingly for comfort on certain aspects of the new rules, either in fund documents or side letters. Among items to be addressed are the allocation of any partnership-level taxes among partners, including the allocation of prior-year tax liabilities among current partners, modifying “imputed underpayments” imposed on the partnership to account for partners’ tax status (such as tax-exempt or non-U.S.), and the appointment of a partnership representative.

Gain on Sale by Non-U.S. Partner of Interest in ECI-Generating Partnership

In [*Grecian Magnesite Mining v. Commissioner*](#), 149 T.C. No. 3, July 13, 2017, the Tax Court held that any gain from the redemption by a non-U.S. taxpayer of its direct or indirect interests in any “partnership engaged in a U.S. trade or business” (**U.S. Operating Flow-through Entity**), generally should not be subject to U.S. federal income tax as income effectively connected with the conduct of a U.S. trade or business (**ECI**) unless the proceeds are attributable to the disposition of U.S. real property interests. This conclusion is in opposition to the position taken by the IRS in Revenue Ruling 91-32, which holds that a non-U.S. partner’s gain on the sale or taxable exchange of its interest in a U.S. Operating Flow-through Entity is ECI and subject to U.S. federal income tax to the extent attributable to property of the entity that is used or held for use in the entity’s U.S. trade or business.

It is likely that the holding in this Tax Court decision will be challenged through judicial and/or legislative processes and, therefore, the appropriate treatment of such gain is not entirely clear. As a result of this lack of clarity, until the issue is resolved, partnerships should consider withholding tax on such gain allocable to non-U.S. partners. Also in light of the uncertainty surrounding this decision, taxpayers generally are not seeking refunds of tax on amounts that would not be treated as ECI under the Tax Court decision; however, this should be considered further if the decision stands after any challenges or if the statute of limitations for filing a refund claim is about to expire. This decision also expands the situations in which a non-U.S. blocker may be used to make certain investments in a tax-efficient manner. The IRS must decide by December 20, 2017 whether to appeal this holding through the judicial system, although there is another case pending before the Tax Court (*Telos CLO 2006-1, Ltd. v. Commissioner*, No. 6786-17, petitions filed 3/22/17), that raises the same question and has not been withdrawn.

Section 754 Election – No Signature Required

In a notice of proposed rule making issued on October 11, 2017 (the **NPRM**), the Treasury Department and the IRS proposed an amendment to existing regulations (the **Proposed 754 Regulations**) under Section 754 of the Internal Revenue Code of 1986 (the **Code**). The 754 Proposed Regulation eliminates the requirement under current regulations (the **Current 754 Regulations**) that an election under Section 754 of the Code (a **Section 754 election**) be signed in order to be effective.

The NPRM states that the Proposed 754 Regulations would apply to partnership taxable years ending on or after the date the Proposed 754 Regulations are published in final form. However, the NPRM's proposed applicability date provision provides that taxpayers may rely on the Proposed 754 Regulations for periods preceding the proposed applicability date.

Please see our [October 18, 2017](#) blog post for more information.

871(m) Regulations

On September 17, 2015, the IRS and the Treasury Department issued [final, temporary](#) and [proposed regulations](#) under Section 871(m) (collectively, the **2015 Regulations**) of the Code that provided rules for withholding on “dividend equivalent payments” on derivatives that reference U.S. equity securities. The 2015 Regulations initially were set to apply to transactions issued on or after January 1, 2017. However, in December 2016, the IRS issued [Notice 2016-76](#), announcing that the IRS intended to issue additional final regulations and would therefore phase in application of the new provisions. On January 19, 2017, the IRS and the Treasury Department issued new [final, temporary and proposed regulations](#) (the **Final Regulations**) that provide some clarifications to the 2015 Regulations and are substantially similar to the 2015 Regulations.

[Notice 2017-42](#), issued in August 2017, extends the phase-in application of section 871(m) to certain transactions and extends the period during which the simplified standard for combined transactions (initially set out in Notice 2016-76) applies to include 2018. Notice 2017-42 also extends the new “Qualified Derivative Dealer” regime and makes certain changes to that regime.

Section 385 Regulations

In July 2017, in [Notice 2017-38](#), the IRS included the 385 Final Regulations (as defined and discussed further below) in a list of regulations that are significant and either (i) impose an undue financial burden on U.S. taxpayers or (ii) add undue complexity to federal tax laws. This list was put together in response to an executive order from the Trump administration directing the Treasury Department to review “significant tax regulations” issued on or after January 1, 2016 in order to identify whether any can be modified or withdrawn, in an attempt to simplify the federal regulatory system.

Further to this Notice, in October 2017, the Treasury Department issued a [report](#) in which the 385 Final Regulations were included on a list of “Regulations to Consider Revoking in Part.” The report provides that the Treasury Department and the IRS are currently considering a proposal to revoke the documentation requirements as issued in favor of revised regulations that would be substantially simplified and streamlined. With respect to the other parts of the regulations, the report states that the Treasury Department is working with Congress on fundamental tax reform that should prevent base erosion in a manner that may make these aspects of the 385 Final Regulations unnecessary. However, if such tax reform does not take effect or does not adequately address this concern, the Treasury Department would reassess the 385 Final Regulations at that time.

Since their release in October 2016, the [final and temporary regulations](#) under Section 385 of the Code (the **385 Final Regulations**) have been the subject of much commentary and debate. The 385 Final Regulations would treat certain interests between members of the same “expanded group” as stock, rather than debt, for U.S. federal income tax purposes. For these purposes, a corporation is a member of an expanded group if 80% of the vote or value of such corporation is owned by expanded group members and the parent of the expanded group (which must itself be a corporation) owns directly or indirectly 80%

of the vote or value in at least one of the other corporations in the expanded group. Further, the 385 Final Regulations set forth documentation requirements in order for certain interests in a corporation between members of the same expanded group to be treated as debt for U.S. federal income tax purposes.

While theoretically targeting the perceived U.S. federal income tax avoidance of certain “inversion” transactions, the 385 Final Regulations are far broader in scope and will affect many transactions and arrangements that are part of the ordinary course of business for many investment funds and their portfolio companies, including certain aspects of blocker structures. Despite much criticism during the comment period, the Treasury Department declined to incorporate special rules for blockers in the 385 Final Regulations. However, the 385 Final Regulations are narrower than the proposed regulations in that debt issued by foreign issuers is excluded from the application of these new rules, and S corporations as well as noncontrolled (*i.e.*, not controlled by members of the expanded group) regulated investment companies and real estate investment trusts are excluded from the definition of an expanded group.

The 385 Final Regulations were intended to apply to taxable years ending on or after January 19, 2017 with respect to debt instruments issued after April 4, 2016, and the documentation requirements generally were to apply to debt instruments issued on or after January 1, 2018. In July 2017, however, the IRS issued [Notice 2017-36](#), extending the effective date for the documentation requirements to January 1, 2019. The Treasury Department report issued in October 2017, discussed above, leaves the final destiny of the 385 Final Regulations unclear.

BEPS and Country by Country Reporting

On a more global scale, multiple countries, including the United States, United Kingdom, and Ireland have adopted Country by Country Reporting (**CbCR**) in furtherance of Action 13 of the Organisation for Economic Co-operation and Development (**OECD**)’s Base Erosion and Profit Shifting (**BEPS**) project. All multinational enterprises (**MNEs**) with revenues of €750 million/U.S. \$850 million or greater are required to file a Country by Country (**CbC**) report with the competent authority in the tax jurisdiction of their ultimate parent entity. Revenue is a broadly defined term that includes essentially all amounts earned, generated or received. In the fund context, revenue would include fees, sales of securities and payments of dividends by unrelated parties. Some amounts that would result in double counting (such as dividends received by certain permanent establishments of a MNE) or amounts only recognized for tax purposes (such as deemed dividends) would not be included in calculating revenue.

United States

In the United States, U.S. MNEs must file Form 8975 with their annual tax returns. Form 8975 requires an MNE to provide a wide array of information, including the MNE’s revenues, profit and loss before tax, income tax paid on a cash basis in all jurisdictions (including withholdings on payments received), income tax accrued (excluding deferred taxes and provisions for uncertain tax positions), stated capital, accumulated earnings, number of employees on a full-time equivalent basis, and net book value of tangible assets (not intangibles or financial assets) other than cash or cash equivalents.

The U.S. regulations, like the OECD model, also provide broad definitions of terms like “full time equivalent employee” in order to facilitate a system of reporting that is not limited to any one jurisdiction’s definition. Therefore, while the broader definitions give MNEs some flexibility, the method used by a MNE with respect to determining how many “full time equivalent” employees it has, for example, will be the

method that the MNE is required to use going forward. Therefore, MNEs should give considerable thought to their CbCR filings especially in the first year an MNE makes filings.

It is also important to note that there is no exception to CbCR requirements for tax-exempt organizations. Therefore, tax-exempt organizations that are the ultimate parent entity of a U.S. MNE or a part of a U.S. MNE potentially could be subject to CbCR in the United States or to the surrogate filing requirements of other jurisdictions (including, in some cases, when such organizations do not meet the \$850 million annual revenue threshold applicable under the U.S. regulations but operate in other countries that require direct local reporting and do not have as high a revenue threshold).

The CbC reports will be exchanged among competent authorities. As of September 22, 2017, the United States already had negotiated and signed agreements for the exchange of CbC reports with over 20 countries, including the United Kingdom, Ireland, the Netherlands and Canada, with another 20 agreements being negotiated with countries such as Luxembourg, Mauritius and Spain. Notably, there is no agreement with the Cayman Islands, nor is any such agreement currently being negotiated. Concerns regarding confidentiality have been raised. Current agreements entered into by the United States, akin to the OECD model, include confidentiality safeguards. However, the degree of protection will vary by jurisdiction. For example, the European Commission has proposed changes to Accounting Directive 2013/34/EU, which if passed would require some of the information contained in a CbC report to be publicly disclosed for a five year period on the MNE's Web site.

ERISA Updates

The U.S. Department of Labor (**DOL**) new fiduciary rule, which significantly expanded when a person is considered to be a fiduciary under the Employee Retirement Income Security Act of 1974 (**ERISA**) and the Code as a result of providing investment advice, generally became applicable on June 9, 2017. The expanded fiduciary rule might cover certain marketing and other related activities common to the investment management industry (including the private investment fund industry).

When the DOL issued the fiduciary rule it also issued new prohibited transaction exemptions (including the Best Interest Contract Exemption, or **BICE**) and amendments to existing prohibited transaction exemptions, which were aimed at easing the impact of potential restrictions under ERISA and the Code's prohibited transaction provisions as a result of the expanded fiduciary rule. Although the BICE (or another exemption) may be available in certain cases to exempt certain forms of advice provided to IRAs and small plans from constituting a "prohibited transaction," compliance with the BICE (or such other exemption) may prove too complicated and burdensome for most fund managers in this context. The "impartial conduct" standard (acting in the client's best interest) requirement of the BICE and such other exemptions also became applicable as of June 9, 2017. However, certain other requirements of the BICE (including the written contract requirement and certain disclosure requirements) and the effective date of certain amendments to such other prohibited transaction exemptions were delayed until January 1, 2018 in order for the DOL to complete the review of the fiduciary rule ordered by the President on February 3, 2017. During this "transition period," the DOL noted that it would not pursue claims against fiduciaries who are working diligently and in good faith to comply with the fiduciary rule and the related exemptions. This temporary non-enforcement policy also included confirmation from the Treasury Department and the Internal Revenue Service that Section 4975 of the Code (which provides excise taxes relating to prohibited transactions) and related reporting obligations would not be applied during the transition period

with respect to any transaction or agreement to which the DOL's temporary non-enforcement policy would apply.

On August 30, 2017, the DOL issued a proposed rule to delay for 18 months until (July 1, 2019) both (i) the current January 1, 2018 applicability date for the above-mentioned prohibited transaction exemption conditions, and (ii) the expiration date of its temporary non enforcement policy "transition period" which currently is set to end on December 31, 2017.

In proposing the further delay, the DOL noted that it does not believe it will finish its review of the fiduciary rule and the related exemptions by the current January 1, 2018 deadline. Accordingly, in order to prevent service providers from having to incur undue expense to comply with conditions or requirements that the DOL ultimately may change or not implement, the DOL has proposed to further delay the applicable exemption effective dates and extend its non enforcement policy "transition period" for 18 months until July 1, 2019 in order for the DOL to continue and hopefully complete its review of the fiduciary rule and its related exemptions. The DOL also noted that, in lieu of a time-certain delay/extension for 18 months, it would consider some other form of delay/extension, such as a delay/extension that would end a specified period after a certain action on the DOL's part (e.g., a delay/extension lasting until 12 months after the DOL concludes its review of the fiduciary rule) or potentially upon the earlier or later to occur of a time certain or the end of such specified period.

Notwithstanding the January 1, 2018 effective date for certain exemption conditions and the proposed delay/extension (which, to be clear, is simply a proposal at this stage), investment managers and advisers still may need to act now – since, as noted above – the expanded fiduciary rule (which has been in effect since June 9, 2017) might cover certain marketing and other related activities common to the investment management industry (including the private investment fund industry). Investment managers and advisers should review their marketing and other investor communication activities to determine whether such activities or communications could constitute "investment advice" under the expanded fiduciary rule and consider how best to either alter such practices or ensure compliance with the fiduciary rule and, as applicable, its related exemptions.

On November 1, 2017, the DOL submitted a final rule to the Office of Management and Budget providing for the 18-month delay/extension, but as of November 7, 2017, the final rule had not yet been released to the public.

Separately, in Field Assistance Bulletin No. 2017-03 (which also was issued on August 30, 2017), the DOL confirmed that it will not enforce the condition currently set forth in the BICE (as well as another fiduciary rule-related exemption referred to as the "principal transactions exemption") that makes the exemption unavailable if the service provider's contract with the retirement investor includes a waiver or qualification (such as a provision requiring arbitration) of the retirement investor's right to bring or participate in a class action or other representative action in court. The DOL stated that it will not pursue a claim against any fiduciary based on a failure to satisfy such "arbitration limitation" or treat any such failure in and of itself as a failure to satisfy the conditions of the exemption.

For a high-level executive summary of certain material aspects of the new fiduciary rule as it relates to private investment fund managers and other investment advisers, including a list of potential action items to consider, please see our client alerts (available [here](#), [here](#) and [here](#)).

Employment Law Updates

Invalidation of the 2016 Federal Overtime Rule

In May 2016, the DOL issued a new federal overtime rule, raising the minimum salary for most exempt executive, administrative and professional employees from \$455 per week (\$23,660 per year) to \$913 per week (\$47,476 per year). The rule was slated to take effect on December 1, 2016. Faced with the new rule, employers across the U.S. had to decide whether to raise all of their salaries for exempt workers to this new minimum or to start paying these employees overtime pay for hours worked in excess of 40 per week. A coalition of business groups and State Attorneys General sued to block the new rule in federal district court in Texas, arguing that the DOL had no authority under the Fair Labor Standards Act (**FLSA**) to increase the minimum salary for exemption by such a meaningful degree. In November 2016, the court granted the plaintiffs' motion for a [preliminary injunction](#), blocking the new rule from taking effect nationwide. The DOL, then still under the Obama administration, appealed the injunction to the Fifth Circuit Court of Appeals.

On August 31, 2017, the court granted the plaintiffs' motion for summary judgment, declaring the new overtime rule invalid and ending the case at the district court. In rendering the decision, the court reasoned that in enacting the "white collar" overtime exemptions of the FLSA, Congress made clear that an employee's duties should determine whether the exemptions apply. The 2016 overtime rule set the minimum salary level for the exemption threshold so high as to "effectively eliminate the duties test" required by the FLSA.

In light of this decision, the DOL—now under the Trump administration—filed an unopposed motion to withdraw its [appeal](#) of the November 2016 injunction. The Court of Appeals granted the motion and dismissed the appeal on September 6, 2017. In light of these developments, the minimum salary for exemption from the federal overtime laws for most executive, administrative and professional employees remains \$455 per week (\$23,660 annually) under federal law.

Meanwhile, the DOL has received more than 124,000 comments in response to its June 2017 [Request for Information](#) regarding the overtime rule. The agency is likely to propose some new version of the overtime rule, but what exactly the new rule will look like—and when it will be published—remains to be seen. Based on [comments](#) made on June 26, 2017 by Labor Secretary Alexander Acosta, many expect a proposed increase in the minimum salary threshold for the executive, administrative and professional exemptions to the low \$30,000 range.

Please see our [August 31, 2017](#) and [September 7, 2017](#) posts on Proskauer's [Law and the Workplace Blog](#) for more information.

Newly Enacted State Paid Family Leave Laws

Within the past year, new laws and regulations regarding paid family leave have been passed in New York, Washington and Rhode Island. The New York State law is described in detail below.

On January 1, 2018, the statewide New York Paid Family Leave Law (**PFL**) will go into effect. The PFL ultimately will require employers to provide eligible employees with up to 12 weeks of paid, job-protected leave per year to care for a new child or for a family member with a serious medical condition, as well as when a family member is called to active military service. The amount of leave and payment percentages available under the PFL will be phased in, beginning in January 2018 with eight 8 weeks of paid leave at a rate of 50 percent of the individual's average weekly wage (up to a designated cap), and culminating in

2021 with a requirement to provide up to 12 weeks of paid leave at a rate of 67 percent of the individual's average weekly wage (again subject to a cap).

In [February 2017](#), the New York Workers Compensation Board (**NYWCB**) issued a proposed rule for implementation of the PFLC that addressed a range of issues that were left unanswered by the statutory text. On [May 24, 2017](#), the NYWCB issued revisions following a review of comments received on the initial proposed rules. The proposed rule was adopted finally on July 19, 2017 after the NYWCB made several changes to the prior proposed regulations. The following are some of the highlights of the [final regulations](#), as well as the NYWCB's [Assessment of Public Comment](#) issued in connection with the final rules (the **Assessment**).

Significantly, employers now are permitted to begin the necessary wage deductions for employee contributions under the PFLC (for benefits beginning on January 1, 2018) until January 1, 2018. On [June 1, 2017](#), the New York State Department of Financial Services (**DFS**) issued a statement setting forth the maximum employee contribution rate for PFLC coverage. Paid family leave benefits under the PFLC will be funded entirely through employee payroll deductions. According to the DFS statement, because PFLC benefit amounts will be based on a percentage of an employee's weekly wage up to a cap based on the New York State average weekly wage (**NYSAWW**), the maximum employee contribution will be based on a similar capped percentage. Thus, for coverage beginning January 1, 2018, the maximum employee contribution will be 0.126% of an employee's weekly wage not to exceed the NYSAWW (currently \$1,305.92). The PFLC authorizes the DFS to set the maximum employee contribution on an annual basis on or before September 1 of each year.

Additionally, the final regulations now indicate that the week the employee goes on leave should not be counted as part of the eight week look back period when calculating the employee's average weekly wage, so as to avoid reducing the amount of the employee's paid family leave benefits based on the employee's partial absence during that week. Employers also must provide employees who will not meet the minimum eligibility criteria under the PFLC – *i.e.*, 26 consecutive weeks for employees regularly scheduled to work 20 or more hours per week, and 175 workdays in a consecutive 52-week period for employees regularly scheduled to work less than 20 hours per week – with the option to file a waiver from the minimum eligibility criteria. Moreover, the NYWCB states in the Assessment that it plans to issue further guidance on what it means for an employee to be “restored to a comparable position” upon return from paid family leave.

Notably, the final regulations did not address taxability concerns. Therefore, questions remained as to how both the employee and payroll contributions and paid family leave benefits would be treated for tax purposes. On August 25, 2017, the New York State Department of Taxation and Finance issued [official guidance](#) on several of these taxability issues. Namely, (1) employee contributions to paid family leave benefit premiums will be deducted from employees' after-tax wages; (2) paid family leave benefits paid to employees will be taxable non-wage income that must be included in federal gross income; and (3) taxes will not be withheld automatically from benefits, but employees can request voluntary tax withholding from paid family leave benefits. With regard to reporting, the guidance provides that employers should report employee payroll contributions on Form W-2 using Box 13 – State disability insurance taxes withheld, and that paid family leave benefits paid to employees should be reported on Form 1099 – MISC.

Please see our [July 19, 2017](#) and [August 31, 2017](#) posts on Proskauer's [Law and the Workplace Blog](#) for more information.

DOL Wage and Hour Division Resumes Issuing Opinion Letters

On June 27, 2017, the DOL announced that it will return to the practice of issuing opinion letters to provide guidance to employers and employees on FLSA matters. The DOL stopped issuing opinion letters in 2010 and instead promulgated broad guidance in the form of Administrator's Interpretations. This announcement likely signals the end of this practice.

As Labor Secretary Alexander Acosta explained, "Reinstating opinion letters will benefit employees and employers as they provide a means by which both can develop a clearer understanding of the [FLSA] and other statutes. ... [DOL] is committed to helping employers and employees clearly understand their labor responsibilities so employers can concentrate on doing what they do best: growing their businesses and creating jobs."

The shift will be a welcome one for employers and business owners, who have been hoping for a more conciliatory, and less punitive, enforcement environment as well as more clarification of the many complex rules around wages and hours.

The DOL has established a [webpage](#) where the public can review existing DOL guidance and submit requests for new opinion letters.

Please see our [June 27, 2017](#) post on Proskauer's [Law and the Workplace Blog](#) for more information.

Newly Enacted Restrictions on Employer Inquiries into Salary History

Within the past year, new laws restricting an employer's ability to inquire into an applicant's salary history have been passed in New York City, Philadelphia, San Francisco and Oregon, and another bill currently is pending in the New York State Assembly.

New York City

On May 4, 2017, NYC Mayor Bill de Blasio signed into law a bill that makes it unlawful for employers to inquire into or rely upon job applicants' wage history during the hiring process, with limited exceptions. The law took effect on October 31, 2017.

The law prohibits employers, employment agencies and their agents from inquiring about an applicant's salary history, and/or relying on an applicant's salary history in determining the salary, benefits or other compensation for that applicant during the hiring process, including as part of the negotiation of a contract.

However, there are limited exceptions to the blanket prohibitions. Namely, an employer may (1) consider (as well as verify) salary information for the purpose of formulating salary, benefits and compensation where a prospective employee voluntarily and without prompting discloses his or her salary history; and (2) without inquiring about salary history, engage in discussion with an applicant about his or her expectations with respect to salary.

Finally, the law does not apply to certain circumstances, such as internal transfers or promotions with a current employer or where disclosure or verification of salary history is required by law.

The New York City Commission on Human Rights also has issued two Fact Sheets related to the new law regarding applicant rights and employer responsibilities. The [first fact sheet](#) is addressed to job applicants, while the [second fact sheet](#) is directed toward employers, recruiters and employment agencies.

Most recently, the City Commission published a [frequently asked questions \(FAQs\)](#) page, providing more concrete examples of what an employer is, and is not, allowed to ask about. Specifically, the FAQs explained that:

- **Salary History:** The law broadly defines “salary history” as including an applicant’s “current or prior wage, benefits or other compensation.” Salary history does not, however, include “any objective measure of the applicant’s productivity such as revenue, sales or other production reports.”
 - The terms “compensation” and “benefits” are defined broadly under the law and “may include many factors, including, but not limited to, a car allowance, retirement plan, or bonuses.”
 - With regard to commission-based compensation, employers *may not* ask about the percentage or amount of commission an applicant earned, but *may* ask about “objective indicators of performance such as the volume, value, or frequency of sales.”
 - For industries in which employees are compensated based on a profit percentage, employers may not ask about an applicant’s current or former profit percentage, but may ask about “the size of the applicant’s book of business, profits generated, or other objective indicators of performance.”
 - Prospective employers may ask about the value of competing offers that the applicant has received without running afoul of the law’s prohibitions.
- **Scope of Coverage**
 - If an applicant is asked about salary history during a job interview *that occurs in NYC*, regardless of whether the interview is in person, on the telephone, or through other electronic means, the law will apply regardless of whether or not the job is substantially based in NYC or whether the applicant is a resident of NYC or physically present in NYC for the interview. The law *will not* apply, however, where the applicant simply resides in NYC, but is both interviewed and will work outside of NYC.
 - The FAQs note that the law governs salary history inquiries by hiring employers and their agents only, and therefore does not place any express prohibitions on former employers with regard to disclosing salary history about a current or former employee. This said, entities and individuals that are not directly subject to the law’s prohibitions may nonetheless be liable under the law if they “intentionally aid and abet a violation of the law.” For this reason, employers should consider instituting policies under which compensation information regarding current or former employees will be disclosed only upon the express written consent of such individuals.
 - Headhunters and search firms are expressly covered by the restrictions of the law, as agents of prospective employers. Agents working on behalf of *applicants* may only disclose salary history information to a prospective employer if the applicant has consented to such disclosure.
 - In the context of a corporate acquisition, employees of the target company are not considered “applicants” for purposes of the law. An acquiring company *may* therefore seek compensation information about employees of the target company as part of its due diligence process. An acquiring company may only use such information, however, in setting the compensation of acquired employees when compensation decisions are being made on a non-individualized basis, and not if employees have to interview for jobs.
- **Salary History in Public Records and Background Checks**
 - The FAQs emphasize that the law prohibits employers from seeking salary history not only from an applicant’s current or prior employer, but also through searches of public records or background checks.

- Employers may still conduct public record searches for general information about industry compensation standards, but employers may not search for information that is intended to uncover the compensation of a specific applicant.
- Salary history information obtained via background check is covered by the law, regardless of what stage in the hiring process the background check is conducted. As such, “the Commission recommends that employers specify to reporting agencies that information about salary history be excluded from the report.”
- **Salary Expectations and Deferred Compensation/Unvested Equity**
 - While a job application can request information about an applicant’s compensation expectations or demands, it may not include a request for information about applicants’ salary history, even if the employer makes clear that a response is voluntary.
 - As part of the permissible scope of discussion about salary expectations, employers may ask about forfeiture of deferred compensation or unvested equity that the applicant would face by leaving their current employer.
- **Voluntary Disclosure of Salary History Information**
 - The FAQ states that a disclosure will be considered to be “without prompting” where “the average job applicant would not think that the employer encouraged the disclosure based on the overall context and the employer’s words or actions.”

Please see our [April 7, 2017](#), [May 5, 2017](#), [October 2, 2017](#) and [October 10, 2017](#) posts on Proskauer’s [Law and the Workplace Blog](#) for more information.

Philadelphia

The City of Philadelphia passed [an ordinance](#) in January that will make it unlawful for employers to inquire into an applicant’s wage history during the hiring process. The law, which amends the city’s current Fair Practices Ordinance, was scheduled to take effect May 23, 2017, but implementation has been delayed indefinitely pending legal challenges from the City’s Chamber of Commerce. While the legal challenge was dismissed initially, the Chamber of Commerce filed an [amended complaint](#) in July 2017. For additional information on the legal challenges to the law, please see our [June 5, 2017](#) post on Proskauer’s [Law and the Workplace Blog](#).

If it takes effect, the ordinance states that—absent a federal, state or local law specifically authorizing the disclosure or verification of wage history for employment purposes—it will be unlawful for an employer or its agent to: (1) inquire about, or require disclosure of, a prospective employee’s wage history, whether in writing or otherwise; (2) condition employment or consideration for an interview or employment on disclosure of wage history; or (3) rely on an prospective employee’s wage history obtained from a current or former employer in determining the individual’s wages at any stage in the employment process—including the negotiation or drafting of any employment contract—unless the applicant “knowingly and willingly” discloses his or her wage history to the employer.

The ordinance also prohibits retaliation against a prospective employee for failing to provide his or her wage history or for enforcing his or her rights under the law.

Please see our [January 24, 2017](#) post on Proskauer’s [Law and the Workplace Blog](#) for more information.

San Francisco

San Francisco [passed an ordinance](#) on June 21, 2017 restricting employers from inquiring about prior salary history during the hiring process. The ordinance, which will go into effect on July 1, 2018, will

restrict employers from: (1) considering or relying on an applicant's salary history as a factor in determining whether to make an offer of employment or what salary to offer; (2) inquiring about an applicant's salary history; (3) refusing to hire or otherwise retaliating against an applicant based on failure to provide salary history; and (4) releasing the salary history of a current or former employee to that person's employer or prospective employer without written authorization from the current or former employee.

Employers will, however, be able to: (1) consider voluntarily disclosed or authorized salary history in determining salary for an applicant and/or verify the salary history information the applicant has voluntarily disclosed; and (2) without inquiring about salary history, engage in discussion about the applicant's expectations with respect to salary, including unvested equity or deferred compensation or bonus that an applicant would lose or forfeit by virtue of leaving current employment.

Employers will have a one year grace period (*i.e.*, until July 1, 2019) during which San Francisco will issue written warnings and notices to correct, but will not penalize employers for violation of the new ordinance. Thereafter, monetary penalties will be issued for violations.

Please see our [July 6, 2017](#) post on Proskauer's [Law and the Workplace Blog](#) for more information.

New York City Freelancer Law

The New York City Freelance Isn't Free Act (the **FIFA**), a local law ([No. 1017-2015](#)) establishing protections for freelance workers, went into effect on May 15, 2017. The law established and enhanced protections for freelance workers, including the right to receive a written contract for work valued at \$800 or more, the right to be paid timely and in full, and the right to be free from retaliation. The law also created penalties for violations of these rights, including statutory damages, double damages, injunctive relief, and attorney's fees.

In 2017, the NYC Department of Consumer Affairs published [final rules](#) implementing the FIFA, which went into effect on July 24, 2017. The rules explain that: (1) a hiring party includes, "their actual or apparent agent, or any other person acting directly or indirectly on behalf of a hiring party"; (2) freelance agreements cannot include waivers of procedural rights or the right to join a class action; (3) freelance agreements cannot include confidentiality provisions that restrict a freelance worker's ability to disclose the terms of the agreement to the Director of the NYC Office of Labor Standards; (4) retaliation under the FIFA is defined broadly to include any action that "is reasonably likely to deter a freelance worker from ... exercising or attempting to exercise any right" guaranteed under the FIFA and only requires proof that retaliation was a "motivating factor"; (5) freelance workers are entitled to the protections of the FIFA "regardless of immigration status" and protects retaliation based on "perceived immigration status or work authorization."

Please see our [October 28, 2016](#) and [July 12, 2017](#) posts on Proskauer's [Law and the Workplace Blog](#) for more information.

Supreme Court to Review Class Action Waivers in Arbitration Agreements

On January 13, 2017, the Supreme Court agreed to review whether class action waivers in employment arbitration agreements violated the National Labor Relations Act (the **NLRA**), which regulates unionization and protects employees' collective rights. The case was argued before the Court on [October 2, 2017](#). Employment contracts often include arbitration agreements requiring employees to pursue claims in arbitration rather than in court. Recently, these arbitration agreements increasingly have

included class and collective actions, thereby prohibiting employees from joining class or collective actions. The National Labor Relations Board, the agency responsible for implementing the NLRA, has taken the position that such agreements violate an employee's collective rights under the NLRA. The case will resolve a circuit split between the Fifth Circuit Court of Appeals, which holds that such waivers do not violate the NLRA, and the Seventh and Ninth Circuit Courts of Appeals that found that such waivers do in fact violate the NLRA. The Court will likely issue its decision in 2018.

Executive Compensation Updates

Hedge fund, private equity and other asset managers usually operate through non corporate entities established under Delaware law, such as management companies formed as LLCs or limited partnerships. They also provide carried interest through the same type of non-corporate entities. The underlying operating or limited partnership agreements for these entities generally have indemnification and advancement provisions that often are treated as boilerplate and do not receive the review and attention that they deserve.

The decision by the Delaware Chancery Court in *Harrison v. Quivus Systems, LLC*, C.A. 12084-VCMR (Del. Ch. Aug. 5. 2016) (Transcript), serves as a “wake up” call for principals and their counsel to pay particular attention to these provisions. The Chancery Court found that a former manager of a limited liability company was entitled to the advancement of his legal fees in connection with a lawsuit brought by the LLC for at least \$3 million in damages arising from his alleged malfeasance, mismanagement and looting of assets of the LLC. The punch line: here the former manager—allegedly a “bad actor” who damaged the LLC—was taking advantage of what is sometimes referred to as a “boomerang” advancement provision to fund his own defense costs (and presumably leverage a settlement).

Before addressing the facts and holding in *Harrison*, it is helpful to review some fundamental aspects of Delaware advancement and indemnification jurisprudence. For corporations, Section 145 of the Delaware General Corporation Law sets forth a fairly detailed statutory framework covering both permissive indemnification (if the indemnitee satisfies certain state of mind and other criteria) and mandatory indemnification (if the indemnitee is “successful on the merits or otherwise”), and allowing corporations to provide for advancement. In the case of partnerships and limited liability companies, however, the statutory scheme simply defaults to the provisions of the applicable partnership agreement or operating agreement. The issue then becomes one of contractual interpretation, and when these agreements are poorly drafted, ambiguous or reference boilerplate, questions of contract interpretation can result in former managers, partners, members or executives using these provisions to their benefit in “intra mural” litigation between the individual and the firm.

In *Harrison*, John Harrison was a member and CEO of a Delaware LLC that had been formed with a majority owner (a wealthy Saudi investor). After six years, the business relationship soured and Harrison was removed as CEO and manager of the LLC, and one year later the Saudi investor sued Harrison (individually and derivatively) in the District of Columbia courts (the **DC Action**) for alleged mismanagement, incompetence and corporate malfeasance. Harrison's counsel then demanded that the LLC advance legal fees and other expenses incurred in defending against the DC Action. When the demand was rejected, Harrison sued in Delaware Chancery Court seeking recovery on his advancement claim and “fees on fees” incurred in prosecuting the advancement claim. Since these cases involve contractual claims, they are, in the words of the *Harrison* court, “well-suited for resolution by way of a motion for summary judgment.”

In granting Harrison’s motion for summary judgment, the *Harrison* court noted the following:

- While Section 145 of the Delaware General Corporation Law authorizes corporations to indemnify parties who are made or threatened to be made a party “by reason of the fact that the person is or was a director, officer, employee or agent of the corporation,” the LLC indemnity provision does not have such limiting language.
- The right to advancement is separate from whether the indemnitee will prevail on indemnification, and in this case the LLC agreement stated that the “Company shall indemnify and advance expenses to each present and future Member or Manager of the Company to the full extent allowed by the laws of the State of Delaware.”
- Harrison was entitled to advancement, even though he was a “former” manager at the time he was sued by the LLC, because he effectively was vested when he became a manager, and subsequently rendered services in consideration of mandatory advancement and indemnification provisions to protect him while he served in such capacity.

Harrison is one of a long line of cases in which a former principal or manager is sued by the firm and then asserts advancement and indemnification claims in connection with the litigation. For example, the *Harrison* court relied on the decision of then Vice-Chancellor Strine in *DeLucca v. KKAT Management LLC*, 2006 Del Ch. LEXIS 19 (Del. Ch. Jan. 23, 2006), in which a CLO/CDO firm sued a departing portfolio manager for damages it allegedly incurred when the portfolio manager resigned and started a new firm. These cases often rely, by way of analogy, on cases in the corporate context, where advancement may be available to former executives involved in insider trading or other bad acts, on the grounds that advancement is a right separate and apart from whether indemnification is ultimately available on the merits.¹¹

What is to be done to protect the firm from the unanticipated “boomerang” claims? Consider the following:

- Review existing indemnity provisions in all relevant operating documents. This includes the indemnity provision in the management company agreement, as well as indemnity provisions in lower and upper tier carry documents, which often are overlooked, but which are reviewed carefully by individuals involved in litigation with the firm.
- Make sure that the indemnity provisions have express “carve-outs” for situations in which the firm may be involved in litigation with partners, members, managers or others. This can include provisions expressly excluding coverage for litigation between the firm and these individuals, and/or more general provisions expressly excluding coverage for any “bad acts” or activities not taken directly in such person’s capacity in furtherance of the interests of the firm.
- Make sure that advancement provisions not intended to be “mandatory” are written properly. For example, if the provision provides that the general partner must consent in advance to

¹¹See for example, *Holley v. Nipro Diagnostics, Inc.*, 2014 Del. Ch. LEXIS 268 (Del. Ch. Dec. 23, 2014). In these advancement cases, the firm can secure an “undertaking” from the indemnitee to repay amounts advanced if it turns out that the indemnitee is not eligible for indemnification, but at that point the indemnitee may be in dire financial circumstances. Note also that the unanticipated “boomerang” nature of advancement and indemnity provisions may also arise in other contexts. Recently the Delaware courts have dealt with buyouts, and the interaction between upper-tier deal level indemnification provisions in the transaction documents (for example, between a private equity sponsor/seller and the strategic/financial buyer), and preexisting indemnification/advancement provisions in the documentation of the operating entities. In these cases, situations can arise where a “bad actor” executive at the target operating company level may successfully claim advancement, post-closing, under the operating company documents for conduct that also may constitute an indemnifiable obligation of the seller to the buyer under the transaction documents (*i.e.*, because the “bad actor” conduct, while subject to advancement, also breached a representation of the seller in the deal documents). See *e.g.*, *Davis v. EMSI Holding*, 2017 WL 1732386 (Del. Ch. 2017).

advancement, make sure that there is not another provision referencing that advancement “shall” be made.

Advancement and indemnification provisions serve important public policy objectives, by providing individuals who serve the firm with peace of mind that they will be protected adequately from third party claims that might arise during their service. It behooves those who run the firm to make sure that these provisions also protect the firm, by ensuring that they are not used in an unanticipated manner when the firm takes its own protective action.

Insurance Updates

During 2017, Proskauer continued to work with a wide variety of private fund managers of all sizes to improve their insurance programs and recover on their insurance claims. As many fund managers have come to recognize, insurance serves not only to protect the managers and funds against significant claims, but also is a valuable asset to increase fund returns and improve investor satisfaction. Fortunately, the insurance market for fund managers and their funds has continued to be extremely competitive over the past year, which has placed significant pressure on insurance companies to offer lower prices and more favorable coverage terms in order to gain and retain business. This “soft market” has created significant opportunities for funds, managers and their key individuals to obtain enhanced coverage at lower prices. Below are a few of the key trends we saw in 2017, along with our thoughts on where we see things headed in 2018.

Enhancing Coverage for Government Investigations

The risk of SEC and other government investigations remained a critical concern for fund managers in 2017. Although these regulatory risks have continued to persist and evolve, the opportunity to protect against these risks through insurance expanded significantly during 2017. Traditionally, the coverage offered by management liability policies for government investigations had been limited in that coverage was not triggered until late in the investigation (after significant costs already had been incurred). However, because of the competitive directors and officers liability insurance (**D&O**) market in the fund manager space, there are now numerous insurers that will agree to provide coverage for the costs of defending government investigations from the earliest stages. This enhanced coverage is not a part of the insurers’ standard forms, however, and must be demanded and negotiated. Policyholders who explore the market and negotiate with insurers generally are able to obtain this enhanced coverage with no premium increase. We anticipate that the opportunity for such enhanced coverage for government investigations will continue into 2018, and, given its wide availability and critical importance, it would be a missed opportunity for a fund manager not to seek and obtain such enhanced coverage.

Protecting against Cyber Risks

Cyber-attacks have remained a front-page risk in almost every industry and a concern to fund managers, yet there remains a great deal of confusion about what various cyber policies and endorsements do and do not cover. Despite a growing number of managers that have explored cyber coverage, the market still has not yet developed a single product that fully and comprehensively protects against all of the cyber risks faced in the fund manager space, including business interruption, loss of use of trading platforms, loss of proprietary data and algorithms, and theft of assets. Instead, managers seeking maximum protection still generally are forced to address different types of cyber risks through a combination of products, such as stand alone cyber policies (that cover some, but not all, risks) and endorsements to

crime policies and fidelity bonds that cover other types of cyber risks. Although the market has not yet responded with a comprehensive cyber product, during 2017 several insurers have either broadened their cyber policies or enhanced the endorsements to their bonds in ways that have enhanced the available coverage for key risks. How such coverage continues to expand, and whether any insurer creates a comprehensive product addressing cyber risks in the fund space, will be a development to watch in 2018, and Proskauer will continue to develop advanced policy language to cover these emerging risks.

Focus on Protecting Key Individuals

As fund managers and key individuals continue to become more savvy about the availability of insurance to protect against the legal and regulatory risks they face for managing funds, the market has continued to see an increased emphasis on obtaining dedicated insurance limits for individuals, as well as efforts to limit the insurer's contractual ability to deny coverage for non-indemnifiable claims. We expect to see this enhanced focus on individual protection in the fund manager space continue as the risks faced by individuals in the area continue to grow.

Focus on Costs of Correction Coverage

During 2017, we saw an increased focus on obtaining and enhancing costs of correction coverage. This important coverage, which usually is included as an endorsement to a manager's D&O/errors and omissions (**E&O**) policies, provides coverage for the costs of correcting trade errors and other similar events before the customer brings a claim related to that error. Such coverage is valuable because it allows the manager to make its customer whole without the need for litigation and before the manager's relationships or reputation have suffered significant damage. While this coverage historically has included relatively stringent requirements for being triggered, such as providing almost immediate notice to the insurer, we have seen some insurers begin to relax those requirements in the past year, and the continued development of this coverage will be an issue to watch in 2018.

Increased Attention to Portfolio Company Risk and Insurance

It has become common for lawsuits against portfolio companies to name as defendants both individuals from the sponsor private equity firm (who serve as directors of the portfolio company) as well as the sponsor private equity firm itself. Due to this litigation trend, along with regulatory risk, private equity firms have begun focusing more closely on both their own insurance policies as well as those at the portfolio company level. Insurance companies have likewise begun focusing on this risk and, in some cases, have added exclusions to their fund policies that can limit coverage for certain portfolio company risks and operations. Thus, the importance of coordinating indemnification and insurance coverage at the portfolio company level and the fund level, and carefully reviewing the policies to ensure that the risks associated with portfolio companies have been addressed, continues to grow.

Looking Ahead to 2018

Fortunately for policyholders, the competitive insurance market in the fund manager space appears poised to continue into 2018, leading to continued opportunities for investment fund managers to obtain enhancements in their coverage if they explore the market and negotiate with potential insurers. Additionally, if this "soft market" continues, there will likely be greater acceptance by insurers of using manuscripted policy forms (forms drafted by the policyholder's counsel/broker, such as Proskauer) rather than simply making changes to the insurer's standard form. We anticipate continuous improvements and greater market acceptance of the advanced Proskauer manuscript fund management and professional

liability policy and expansion into cyber, privacy, computer fraud and social engineering coverage throughout 2018. Fund managers that take advantage of these developments will obtain competitive advantages over peer firms and will be better positioned than their counterparts to obtain coverage if/when they face claims from regulators, investors or other parties.

Activist Investing Updates

Section 16 Cases

In recent months, federal district courts in New York and California have shed some light on the Section 16 obligations of an investment adviser and its advised funds. These obligations can be opaque, and the new cases clarify some grey areas. For example, many advisers rely on the exemption for federal or state-registered advisers to avoid reporting and short-swing liability under Section 16, and the cases address whether the exemption is available when the adviser has an economic interest in its advised funds. They also address some factors that may subject the adviser and its advised funds to “group” status, which could cause inadvertent exposure to Section 16 obligations. After a brief background, we highlight key takeaways and summarize the cases below.

Background

Generally, a person that beneficially owns more than 10% of a public company’s common stock becomes subject to the reporting and short-swing profit disgorgement requirements of Section 16 of the Exchange Act. A person that individually does not own more than 10% still can become subject to Section 16 if (i) it is part of a group of persons that have agreed to act together for the purpose of acquiring, holding, voting or disposing the common stock and (ii) the members of the group beneficially own, in the aggregate, more than 10%.

Two exemptions from Section 16 available to persons that have exceeded 10% beneficial ownership are the exemptions for (i) registered investment advisers (the **RIA exemption**) and (ii) control persons of registered investment advisers who do not hold, directly or indirectly through non-qualified entities, more than 1% of the common stock of the company (the **control person exemption**). For either exemption to apply, the adviser must (i) hold the common stock for the benefit of third parties or in customer or fiduciary accounts and (ii) not have acquired the common stock with the purpose or effect of changing or influencing control of the issuer of the common stock.

Recent Court Decisions

As the cases demonstrate, determining whether a fund has beneficial ownership, whether a group exists and whether the RIA exemption or control person exemption applies depends, in large part, on the organizational structure of the fund and the relationship between the fund and its adviser. Furthermore, the analysis may vary from one jurisdiction to another.

We believe that the main takeaways from the cases are as follows:

- A fund should be cautious in concluding that it does not beneficially own securities that it directly holds simply because it has delegated voting and investment decisions for the securities to its adviser via the management agreement. This is especially true if the fund and the adviser are under common control or otherwise related.
- A court is more likely to find that a group exists when (i) funds share the same general partner; and/or (ii) funds and their adviser are under common control (25%) of one or a few individuals. Additionally, absent unique circumstances, a court is unlikely to find that funds that share a

common adviser are part of a group with the adviser solely due to the shared advisory relationship.

- An adviser and its control person should be cautious in claiming the RIA exemption and the control person exemption, respectively, when (i) the adviser or its control person has an equity interest in the advised fund (however, as discussed below, the significance of having an equity interest may depend on the jurisdiction); (ii) the adviser and the advised fund are under common control of the control person; and/or (iii) it is reasonably foreseeable that the fund may develop control intent with respect to the company in the future, even if it currently does not have any control intent.

Greenfield v. Cadian Capital Management, LP

In a September 2016 opinion, the Southern District of New York denied the defendants' motion to dismiss and analyzed the following issues: (i) funds delegating beneficial ownership to the adviser; (ii) whether the defendants formed a group; and (iii) the RIA exemption.

In this case, two funds shared a general partner. The two funds also had the same investment adviser. One individual – Bannasch – was the sole managing member of the general partner of the funds and the general partner of the investment adviser. The investment adviser also owned a 3% interest in one fund and an 11% interest in the other fund.

The court first held that the plaintiff had plausibly alleged that both funds beneficially owned the securities held by them and that their delegation of voting and investment decisions to the adviser via the management agreement was ineffective. In reaching this conclusion, the court stated that the Second Circuit previously had found that a person retains beneficial ownership when it delegates voting and investment decisions to an agent. The court highlighted the allegation that Bannasch was an agent of both the funds and the adviser through his control of the general partner of the funds and the general partner of the adviser.

The court next held that the plaintiff had plausibly alleged that the adviser beneficially owned the securities held by the funds because the RIA exemption did not apply. The court highlighted the requirement in the RIA exemption that the adviser hold the securities “for the benefit of third parties.” The court concluded that, by demonstrating that the adviser had some equity interest in both funds, the plaintiff had raised the inference that the adviser derived some benefit from the investment decisions it made on behalf of the funds. While the court acknowledged that there may be a *de minimis* amount of equity that the adviser can hold in an advised fund and still qualify for the RIA exemption, it stated that determining such a limit was not appropriate for a ruling on a motion to dismiss.

Finally, the court held that the plaintiff had raised a reasonable inference that the two funds, the adviser, their respective general partners and Bannasch were part of a group. The court highlighted the allegation that Bannasch was the sole decision maker for each entity and that the entities were “inexorably intertwined.” The court also noted that the entities operate out of the same office with the same employees and that Bannasch had signed all of the SEC filings on behalf of the funds, the funds' general partner and the adviser.

Packer v. Raging Capital Management, LLC

In a March 2017 opinion, the Eastern District of New York denied the defendants' motion to dismiss and analyzed the following issues: (i) a fund delegating beneficial ownership to the adviser; and (ii) the RIA exemption.

In this case, the defendants were a fund, its adviser and an individual – Martin – who served as the chief investment officer and managing member of the adviser. Furthermore, Martin was one of three directors of the fund, and he and his family owned “significant interests” in the fund.

Citing the *Cadian* opinion and without providing analysis of its own, the court rejected the fund’s argument that it did not beneficially own any securities because it had divested investment and voting decisions to the adviser.

The court also rejected the adviser’s argument that it qualified for the RIA exemption. In making this decision, the court held that the plaintiff had raised the reasonable inference that the adviser did not satisfy the two key conditions of the RIA exemption – (i) the adviser holds the securities for the benefit of third parties and (ii) the adviser does not have a control intent with respect to the issuer.

Greenfield v. Criterion Capital Management, LLC

In a June 2017 opinion, the Northern District of California granted the defendants’ motion to dismiss and analyzed the following issues: (i) whether the defendants formed a group; (ii) the RIA exemption; and (iii) the control person exemption.

In this case, three funds each had a separate general partner. The three general partners were managed by the same group of three directors (the directors were not defendants). The three funds also shared an adviser. The adviser served as the general partner and investment adviser to feeder funds that invested in the three funds. In addition to the three funds, their respective general partners and the adviser, there were also three individual defendants who were members and portfolio managers of the adviser. These three individuals and the adviser also beneficially owned, in the aggregate, between 2% and 12% of each of the three funds.

The court held that the plaintiff did not allege facts sufficient to find that the funds were part of a group with their adviser. The court highlighted that the plaintiff alleged only that the funds shared a common adviser, and that fact alone was insufficient to support a claim that the defendants constituted a group. The court also noted that an allegation of parallel investment activity among the funds is not the same as an allegation of an “agreement” among the funds and their adviser to act together, which is the standard for finding a group.

The court also held that the plaintiff did not allege facts sufficient to show that the RIA exemption was unavailable. In reaching this conclusion, the court noted that the adviser and the three individual defendants did not serve as a general partner of any fund or on the board of directors of the general partner of any fund. The court also stated that the RIA exemption’s requirement that the adviser hold the securities for the benefit of third parties does not mean that it must hold the securities “solely” for the benefit of third parties. The court did not address its difference with the *Cadian* court on this issue of whether an adviser’s equity interest in an advised fund causes the RIA exemption to be unavailable.

Finally, the court rejected the plaintiff’s argument that the control person exemption was unavailable to the three individual defendants that were members of the adviser. The plaintiff contended that the control person exemption was unavailable because (i) the three feeder funds, which are non-qualifying entities for purposes of the exemption, owned more than 1% of the public company’s common stock and (ii) the three individuals indirectly controlled the feeder funds. Without addressing whether the three individuals controlled the feeder funds and could be attributed the funds’ holdings, the court concluded that the plaintiff did not allege facts to show that the feeder funds beneficially owned any of the public company’s

common stock, as the feeder funds did not directly hold any common stock, but only had an interest in the three main funds that held the securities.

Sand v. Biotechnology Value Fund, L.P.

In a July 2017 opinion, the Northern District of California granted the defendants' motion to dismiss in part and denied the motion in part and analyzed the following issues: (i) whether the defendants formed a group; and (ii) the condition in the RIA exemption and control person exemption that the adviser must not have acquired the securities with control intent.

In this case, there were four funds. One entity – BVF Partners – served as the general partner of two of the funds and adviser to the other two funds. One individual – Lampert – served as the sole director and officer of the general partner of BVF Partners. The opinion did not specify whether BVF Partners, its general partner or Lampert owned any equity interest in any of the four funds.

In analyzing the group issue, the court separated the analysis of the two funds for which BVF Partners served as the general partner from the two funds for which BVF Partners served as the adviser. For the former two funds, the court held that the plaintiff pleaded sufficient facts to show that they were a group because they shared the same general partner, which acts as agent and makes decisions on behalf of both funds. The court stated that, in this sense, the BVF Partners “need only have agreed with itself” to form a group with the two funds for which it served as the general partner. For the two funds for which BVF Partners served as the adviser, the court emphasized that a common advisory relationship, by itself, is not sufficient to conclude that the advised funds agreed to act together. Accordingly, the court held that the plaintiff did not plead sufficient facts to show that a group existed among BVF Partners and the two funds that it advised. In highlighting the differences between the two sets of funds, the court stated that an “agreement” could be imputed to the two funds for which BVF Partners served as the general partner because of the relationship between the general partner and the funds, while an advisory relationship, by itself, was insufficient to impute an “agreement.”

The court also held that the plaintiff raised a plausible inference that BVF Partners, its general partner and Lampert acted with control intent with respect to the issuer and were, therefore, not entitled to the RIA exemption and control person exemption. In reaching this conclusion, the court noted the following facts raised by the plaintiff: (i) BVF Partners had a history as an activist investor; and (ii) following the transactions that gave rise to the Section 16 claim, BVF Partners switched from a Schedule 13G to a Schedule 13D (the former schedule being available only to holders that have no control intent) and ultimately took an activist posture with respect to the company. The court stated that, while it is possible that BVF Partners developed its control intent following the Section 16 period, it also was possible that BVF Partners “harbored an activist intent” during the Section 16 period and fully acted on it afterwards. The court concluded that in a situation where both explanations could be true, BVF Partners, its general partner and Lampert were not entitled to dismiss the plaintiff's claim in reliance on the RIA exemption and the control person exemption.

Brokaw Act

In our 2016 Annual Review, we discussed legislation introduced in March 2016 by Democratic Senator Tammy Baldwin, which was co-sponsored by Democratic Senators Jeff Merkely, Bernie Sanders and Elizabeth Warren, that proposed to amend aspects of Regulation 13D-G. That legislation, known as the Brokaw Act, did not gain any traction during the 2015-2016 Congressional session.

In August 2017, Senator Baldwin reintroduced the Brokaw Act, this time with Republican Senator David Perdue as a co-sponsor. The significant changes proposed by the Brokaw Act are summarized below. The 2017 version of the Brokaw Act is identical to the 2016 version, except that the proposal to shorten the current 10-day period for an initial Schedule 13D filing was changed from two business days to four business days.

- **Shorten the due date for an initial Schedule 13D filing.** Currently, a person that makes an acquisition causing it to beneficially own more than 5% of a company's outstanding shares has 10 days to file a Schedule 13D after its acquisition. The Brokaw Act shortens the 10 days to four business days.
- **Expressly include short positions as being subject to Regulation 13D.** Currently, absent unique circumstances, short sales do not affect a person's beneficial ownership of the subject securities. For example, a person that directly holds 3% of a company's shares and has a short position with respect to 6% of the company's shares should not need to file a Schedule 13D or 13G. The Brokaw Act would require a person that holds a short position representing more than 5% of a company's shares to file a Schedule 13D after acquiring the short position that caused it to exceed the five percent threshold. While there is some ambiguity in the legislation, the Brokaw Act does not appear to permit the use of a Schedule 13G to report a more than 5% short position.
- **Add pecuniary interest to what constitutes beneficial ownership.** Currently, Regulation 13D-G determines beneficial ownership based on a person's voting and/or dispositive power over the company's shares. The Brokaw Act would expand the concept of beneficial ownership to include pecuniary (or economic) interest, in addition to voting and dispositive power. The Brokaw Act would import some, but not all, of the Section 16 definition of pecuniary interest. Accordingly, a person that is the long party to a cash-settled swap may need to count the shares underlying the instrument in determining whether it beneficially owns more than 5% of the company's shares, even if it does not have the power to vote or sell such underlying shares.

It is unclear whether having a Republican co-sponsor for the Brokaw Act will help the legislation gain bipartisan support and advance in the Senate. While we do not believe that the legislation will pass the Senate or House in the near future, its passage may occur prior to the end of the current congressional session in early January 2019.

Estate Planning Updates

Lifetime Estate, Gift and GST Tax Exemptions

The American Taxpayer Relief Act of 2012 made the following permanent: (1) the reunification of the estate and gift tax regimes; and (2) the \$5 million estate, gift and generation-skipping transfer (**GST**) tax exemptions, as increased for inflation (as discussed below).

- In 2018, there is a \$5,600,000 federal estate tax exemption (increased from \$5,490,000 in 2017) and a 40% top federal estate tax rate.
- In 2018, there is a \$5,600,000 GST tax exemption (increased from \$5,490,000 in 2017) and a 40% top federal GST tax rate.
- In 2018, the lifetime gift tax exemption is \$5,600,000 (increased from \$5,490,000 in 2017) and a 40% top federal gift tax rate.
- In 2018, the annual gift tax exclusion is \$15,000 (increased from \$14,000 in 2017).

These increased exemptions create opportunities to make larger lifetime gifts, to leverage more assets through a variety of estate planning techniques (such as a sale to a grantor trust) and to 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 2018, the gift tax annual exclusion amount per donee will increase to \$15,000 for gifts made by an individual and \$30,000 for gifts made by a married couple who agree to “split” their gifts. If you have not already done so, now is the time to take advantage of your remaining 2017 gift tax exclusion amount being \$14,000 for gifts made by an individual and \$28,000 for gifts made by a married couple who agree to “split” their gifts, so that you can ensure that gifts are “completed” before December 31, 2017.

In lieu of cash gifts, consider gifting securities or interests in privately held companies or other family-owned entities. The assets that you give away now may be worth significantly less than they once were, and their value hopefully will increase in the future. So the \$28,000 gift that your spouse and you make today (and the \$30,000 gifts that your spouse and you make in 2018) may have a built-in discount that the IRS cannot reasonably question. That discount will inure to the benefit of your beneficiaries if the value of those assets rises.

Your annual exclusion gifts may be made directly to your beneficiaries or to trusts that you establish 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 you have created a trust that contains beneficiary withdrawal powers, it is essential that your Trustees send Crummey letters to the beneficiaries whenever you (or anyone else) make a trust contribution.

If you have created an insurance trust, 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.

2017 Gift Tax Returns

Gift tax returns for gifts that you made in 2017 are due on April 16, 2018. You can extend the due date to October 15, 2018 on a timely filed request for an automatic extension of time to file your 2017 income tax return, which also extends the time to file your gift tax return. If you created a trust in 2017, you should direct your accountant to elect to have your GST tax exemption either allocated or not allocated, as the case may be, to contributions to that trust. It is critical that you not overlook that step, which must be taken even if your gifts do not exceed the annual gift tax exclusion and would, therefore, not otherwise require the filing of a gift tax return. You should call one of our attorneys if you have any questions about your GST tax exemption allocation.

IRA Required Minimum Distributions Deadline

If you are the owner of a traditional IRA, you must begin to receive required minimum distributions (**RMDs**) from your IRA and, subject to narrow exceptions, other retirement plans, by April 1 of the year after you turn 70 ½. You must receive those distributions by December 31 of each year. If you are the current beneficiary of an inherited IRA, you must take RMDs by December 31 of each year regardless of your age. The RMDs must be separately calculated for each retirement account that you own, and you, not the financial institution at which your account is held, are ultimately responsible for making the correct calculations. The penalty for not withdrawing your RMD by December 31 of each year is an additional

50% tax on the amount that should have been withdrawn. Please consult us if you need assistance with your RMDs.

New Tax Legislation

As we finalize this annual review, the House Committee on Ways and Means released its tax reform plan, the Tax Act, and the Senate Finance Committee has released policy highlights of the Senate version, both of which would affect the estate, gift and GST exemptions in 2018 and beyond. It is unknown whether the legislation will be enacted, but under the proposed legislation:

Estate, Gift and GST Taxes

Beginning in 2018, in both the House and Senate versions of the Tax Act, the federal estate tax, gift tax and GST exemptions would double to \$11,200,000 for decedent's dying after December 31, 2017, and will continue to increase with inflation in each subsequent year. In the House version only, the estate tax and GST tax would be permanently eliminated after 2024 (the gift tax would remain in place but the top federal gift tax rate would be lowered in 2024 to 35% from the current 40% rate. The Senate version does not provide for the repeal of the estate tax and GST tax. Additionally, as in current law, beneficiaries who receive property from an estate will still receive a new in basis for income tax purposes equal to the property's fair market value as of the date of death. That means that any appreciation in the value of assets over a decedent's lifetime escapes being subject to capital gains taxes on that appreciation when the property is sold after death. The gift tax would remain in place even after the repeal of the estate tax on December 31, 2023, but the top federal gift tax rate would be lowered in 2024 to 35% from the current 40% rate.

If you wish to discuss any aspect of this material as it may relate to your estate planning, please contact one of the lawyers in the Private Client Services Department at Proskauer.

Reorganization and Chapter 11 Developments

Over the past year, important decisions have been rendered by federal courts (i) removing the incentive to use "structured dismissals" that avoid the United States Bankruptcy Code's (**Bankruptcy Code**) priority scheme, (ii) incentivizing creative reorganizations that avoid violating the Trust Indenture Act while potentially maximizing creditor recoveries and lowering administrative expense, and (iii) affirming the enforceability of "make-whole" provisions designed to compensate a creditor if the debtor pays its obligations early. Perhaps most importantly, two of these decisions were rendered by the United States Supreme Court and the Second Circuit, which includes New York, making it wise for managers to understand their implications when considering the form of potential restructurings and related investments, both in and out of Chapter 11.

Supreme Court Strikes Down Use of "Structured Dismissal" in Chapter 11 to Circumvent Absolute Priority Rule

"Structured dismissals" had become a popular Chapter 11 exit strategy. Typically, a successful Chapter 11 case culminates in the proposal of a plan of reorganization, confirmation of the plan by the bankruptcy court, occurrence of the effective date and consummation of the plan, followed by the bankruptcy court entering a final decree closing the case. Alternatively, a Chapter 11 case can be converted to Chapter 7 for liquidation. Both options commonly involve significant time and administrative expense. And where a debtor has sold substantially all its assets under section 363(b), both options may not result in

distributions to unsecured claimholders if the sale proceeds are not sufficient to pay administrative expenses in full. In such a situation, a “structured dismissal” became a popular third option to bring a Chapter 11 case to a successful conclusion while minimizing costs and, in turn, maximizing creditor recoveries.

Ordinarily, in a dismissal of a Chapter 11 case, the bankruptcy court attempts to restore the pre-petition financial status quo. But, if perfect restoration cannot be attained, the bankruptcy court may, “for cause,” alter the terms of the dismissal of the Chapter 11 case and order a “structured dismissal” that typically provides for, among other things, certain distributions to creditors, releases and injunctions. A structured dismissal also may be conditioned upon certain terms and outcomes agreed upon in advance by the stakeholders—serving as a hybrid dismissal and confirmation order. The Bankruptcy Code, however, does not expressly recognize “structured dismissals” and few courts have addressed the parameters of their use.

The *Jevic* Decision

In a recent decision in *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973 (2017), the United States Supreme Court narrowed the permissible use of “structured dismissals” and held that structured dismissals cannot be used to make distributions to creditors that circumvent the Bankruptcy Code’s priority scheme without the consent of the affected creditors.

In *Jevic*, Sun Capital Partners, a private equity firm, acquired Jevic Transportation, Inc. in 2006 through a leveraged buyout financed by a group of secured lenders led by CIT Group. By May 2008, Jevic shuttered substantially all of its operations, terminated a majority of its employees, and filed for Chapter 11 relief in Delaware. The circumstances leading to Jevic’s bankruptcy filing led to two lawsuits. First, a group of terminated truck drivers commenced a class action suit against Jevic and Sun for federal and state WARN Act violations, seeking approximately \$12.4 million in damages. Second, the committee of unsecured claimholders was authorized to commence a suit against Sun and CIT, alleging that the leveraged buyout hastened Jevic towards bankruptcy by saddling it with debts that it could not service.

By 2012, the WARN Act plaintiffs had obtained summary judgment against Jevic, leaving them with a judgment of approximately \$12.4 million, of which approximately \$8.3 million was entitled to treatment as a priority wage claim under Section 507(a)(4) to be paid ahead of general unsecured claims, but the WARN Act plaintiffs continued their suit against Sun. Jevic’s estate at that point was depleted, with remaining assets consisting of \$1.7 million in cash encumbered by a lien held by Sun and the committee’s claim against Sun and CIT. Sun, CIT, Jevic and the creditors’ committee negotiated a settlement of the committee’s lawsuit, which provided that: (1) the bankruptcy court would dismiss the committee’s lawsuit with prejudice; (2) CIT would deposit \$2 million into an account earmarked to pay the committee’s legal fees and administrative expenses; (3) Sun would assign its lien on Jevic’s remaining \$1.7 million of cash to a trust, which would pay taxes and administrative expenses and distribute the remainder on a pro rata basis to general unsecured creditors; and (4) Jevic’s Chapter 11 case would be dismissed. Notably, no assets would be distributed to the WARN Act plaintiffs in connection with the settlement and proposed structured dismissal, even though they asserted an \$8.3 million priority wage claim—which the Bankruptcy Code ranks senior to general unsecured claims. The only reason on the record that the settlement did not provide for payment of the WARN Act plaintiffs was that Sun, at the time of settlement, was still a defendant in the ongoing WARN Act lawsuit and did not want to help finance that litigation.

The bankruptcy court approved the settlement and dismissed the Chapter 11 case over the objections of the WARN Act plaintiffs that the settlement distributed estate assets to junior creditors in violation of the Bankruptcy Code's absolute priority rule. The bankruptcy court agreed that the distributions under the proposed structured dismissal violated the Bankruptcy Code's priority scheme, but that without a settlement and dismissal, there was no realistic prospect of a meaningful distribution for anyone other than secured creditors, a Chapter 11 plan was unattainable, and there would be no funds to administer a Chapter 7 proceeding. On appeal, the district court affirmed the bankruptcy court's decision, and the Court of Appeals for the Third Circuit affirmed the district court.

The Supreme Court reversed the Third Circuit, holding that a distribution scheme ordered in connection with the dismissal of a Chapter 11 case cannot, without the consent of the affected parties, deviate from the basic priority rules that apply under the primary mechanisms the Bankruptcy Code establishes for final distributions of estate value in business bankruptcies. Describing the priority rules applicable to distributions in Chapter 7 and Chapter 11 cases as "fundamental to the Bankruptcy Code's operation," the Court noted that "[w]e would expect to see some affirmative indication of intent if Congress actually meant to make structured dismissal a backdoor means to achieve the exact kind of nonconsensual priority-violating final distributions" prohibited under Chapter 7 and Chapter 11. Furthermore, the Court acknowledged that Congress did not authorize a "rare case" exception to deviate from the Bankruptcy Code's priority scheme, explaining that it would be difficult to give precision to the concept of "sufficient reasons" and such an exception may turn into a general rule and introduce uncertainty with "potentially serious" consequences.

Structured Dismissals Going Forward

The Court's decision in *Jevic* significantly limits the ability of debtors and creditors to achieve creative Chapter 11 exit strategies through structured dismissals that minimize administrative cost and maximize recoveries. Given the Court's ruling that no "rare case" exception exists, lower courts will not be able to further explore the circumstances in which deviation from the Bankruptcy Code's priority scheme may be appropriate in a structured dismissal. Furthermore, the Court did not specifically address the question of whether structured dismissals were permissible under the Bankruptcy Code otherwise (in fact, the majority noted that it expresses no view about the legality of structured dismissals generally).

Reorganizing Around the Trust Indenture Act

Recent developments concerning the Trust Indenture Act (**TIA**) have called into question just what exactly the statute protects. Section 316(b) of the TIA itself simply states: "the right . . . to receive payment . . . shall not be impaired or affected without the consent of such holder." Bondholders have used the ambiguity regarding the "right" protected to argue that out-of-court reorganizations designed to impair their practical ability to get paid, but leaving all legal remedies and governing documents intact, violate the TIA.

The *Marblegate* Decision

In a recent decision in *Marblegate Asset Mgmt., LLC v. Educ. Mgmt. Fin. Corp.*, 846 F.3d 1 (2d Cir. 2017), the Second Circuit provided clarity by declining to adopt a broad reading of the TIA, holding Section 316(b) only protects the legal right to receive payment, but not the practical ability.

In *Educ. Mgmt. Fin. Corp.*, EDMC was a for-profit education company that relied heavily on federal Title IV funding and was experiencing financial distress. However, it could not file a bankruptcy petition

because doing so would result in it losing eligibility for further Title IV funds. Its subsidiary, EDM Issuer, owed approximately \$1.3 billion on account of secured credit, and the collateral securing the debt consisted of virtually all its assets. EDM Issuer also had \$217 million of unsecured notes outstanding, which were guaranteed by EDMC, but the governing indenture informed lenders that the guaranty was issued solely to satisfy EDMC's reporting obligations, it could be released solely by operation of the release of any later guaranty EDMC issued to secured creditors, and noteholders, therefore, should not assign any value to it.

In late 2014, as a consequence of negotiations, a majority of secured creditors agreed to relieve EDM Issuer of certain imminent payment obligations and covenants under the secured credit agreement, and, as consideration, EDMC agreed to guarantee the secured debt (the **Secured Guaranty**). Contemporaneous negotiations between EDMC and a group of creditors resulted in the development of two separate avenues to relieve EDMC of its debt obligations. Under the first, all creditors would have to consent unanimously to exchange their debt for new secured debt and equity. However, a noteholder and sole holdout, Marblegate, prevented this path from being realized. Under the second avenue, secured creditors would exercise their preexisting rights to foreclose on the issuer's assets and release EDMC from the Secured Guaranty. The release of the Secured Guaranty would, in turn, trigger a release of the unsecured noteholders' guaranty under its indenture's terms. After foreclosing, the collateral agent would then sell the foreclosed assets to a newly constituted subsidiary of EDMC, and the new subsidiary, carrying on the business, would distribute debt and equity to secured creditors and consenting unsecured creditors. To incentivize acceptance, nonconsenting unsecured creditors would receive nothing, but no term of the indenture governing the notes would be altered. In effect, the unsecured noteholders would retain a contractual right to collect payments due under the notes, but since the sale would transform the EDM Issuer into an empty shell, the right would have little or no economic value. EDMC and the creditor group explicitly warned of this outcome, and ultimately all creditors except Marblegate consented to the sale.

In response, Marblegate sued to enjoin the sale, alleging the impairment of its practical ability to receive payment violated Section 316(b) of the TIA. After the district court sided in favor of Marblegate, EDMC appealed.

The Second Circuit, highlighting the ambiguity in Section 316(b), noted it could be interpreted to favor either side, each with resulting issues. To resolve the ambiguity, the court turned to the TIA's legislative history, noting, among other things, that reorganizations based on foreclosures like the one at issue were used widely at the time the TIA was drafted, and the TIA does not prohibit foreclosures even when they affect a bondholder's ability to receive full payment. Rather, the court stated that the relevant portions of legislative history exclusively addressed formal amendments and indenture provisions like collective-action provisions, which can alter the amount of principal or interest due, and no-action clauses, which work to prevent the filing of lawsuits. Bolstered by similar contemporaneous congressional reports and testimony, the court was unpersuaded that an expansive interpretation of Section 316(b) was appropriate, and held that it only protects the contractual right to receive payment. So long as no formal amendments had been made, no violation had occurred. Indeed, the court noted, since EDMC had forgone the bankruptcy process, it was unable to receive a discharge, and unsatisfied creditors could pursue state- and federal-law remedies, including successor liability and fraudulent conveyance.

However, the decision was not unanimous. The dissent would have prohibited the sale transaction, noting that the "right" to receive payment is severely diminished under the transaction because it was

made worthless to Marblegate. Had Congress intended merely to protect against modification of an indenture's payment terms, the dissent noted, it could have so stated. But since it did not and the dissent believed Section 316(b) of the TIA to be otherwise unambiguous, it would have held in favor of Marblegate.

Creative Out-of-Court Restructurings

The Second Circuit's decision opens the door to creative restructurings, especially in circumstances where releases of guaranties can be effectuated by creating and subsequently releasing new guaranties. These restructurings could serve to remedy holdout problems and provide higher recoveries for all creditors through the avoidance of the costs and uncertainty associated with a Chapter 7 or 11 proceeding. Due to the Court's decision, however, bondholders in future offerings also may refuse to agree to these types of provisions, resulting in the need to use a formal amendment process to eliminate guaranties. If so, *Marblegate* is likely to be of limited use to such debtors.

Making Creditors Whole

Make-whole provisions are common in debt instruments, and are intended to preserve a creditor's economic position in the event a debtor determines to pay its debt before maturity. Generally, these provisions require the debtor to pay an extra amount, measured against the prevailing treasury rate, to the creditor that makes it economically indifferent to early payment. By investing the extra amount, the creditor can situate itself to receive the same amount in payments at maturity as if the debtor had not paid its debt early. The enforceability of these provisions, though, is hotly contested in bankruptcy proceedings, and the United States Bankruptcy Court for the Southern District of Texas is the latest court to weigh in on the issue.

The *Ultra Petroleum* Decision

In *In re: Ultra Petroleum Corp., et al.*, Case No. 16-32202, 2017 WL 4221098 (Bankr. S.D. Tex. Sept. 21, 2017), the debtors, an oil and gas enterprise, filed for bankruptcy in April 2016. The filing constituted an event of default under certain unsecured notes, triggering acceleration of the notes, including principal, prepetition interest, post-petition interest and make-whole amounts. During the case, commodity prices increased, causing the debtors to become solvent. Accordingly, the debtors' Chapter 11 plan proposed to pay all unsecured claims in full and in cash, less any make-whole premium, and classified them as unimpaired. Certain noteholders, however, objected to the plan on the basis that, among other things, the make-whole amount must be paid for their claims to be unimpaired. The debtors responded by asserting the make-whole amount is an unenforceable liquidated damages provision under New York law and default interest rates double-counted obligations owed to the noteholders.

The court rejected the debtors' position, noting that to be enforceable, the amount liquidated must bear "a reasonable proportion to the probable loss," and the amount of the actual loss must be "incapable or difficult of precise estimation." After analyzing the debtors' circumstances, the court held the damages from prepayment were not readily ascertainable at the time the parties entered into the agreement governing the notes, nor were they conspicuously disproportionate to the foreseeable damage amounts. Indeed, the court noted, measurement of damages can be notoriously difficult to quantify due to changes that may take place between the notes' issuance and subsequent payment. Moreover, the court rejected any argument that recovering on account of both a default interest rate and the make-whole provision constitutes double recovery because, had the notes been paid off on the date of acceleration, no default

interest would have accrued. Indeed, the court emphasized, default interest compensates noteholders for the debtors' failure to pay a current and owing obligation, a separate injury.

Alternative Arrangements

The court's decision presents an obstacle for debtors hoping to avoid make-whole provisions and provide a recovery to junior stakeholders. Creditors still will want to consider what the enforcement of those claims means for their debtor. If the assertion of such claims in their full amount will prevent the debtor from successfully reorganizing, the creditor may be better served by negotiation and compromise. In addition, debtors also may want to consider strongly whether the reinstatement of notes, an option not pursued by the *Ultra Petroleum* debtors, represents a better outcome for all parties, especially since, after reinstatement, the debtors may be able to pay down the notes. While this would not prevent the need to pay the make-whole amount, it could prevent the creditor from asserting the accrual of post-petition interest on top of such amount during the pendency of the debtor's case.

European Union Regulatory Updates

Brexit Update

Brexit: Outcome Still Uncertain

In late March 2017, Theresa May, Prime Minister of the United Kingdom (**UK**), formally notified the European Union (**EU**) Council of the UK's intention to leave the EU under Article 50 of the EU's Lisbon Treaty. This triggered a two-year period during which the terms of the UK's exit from the EU must be agreed, unless there is agreement between the UK and all other 27 member states (**Member States**) of the EU to extend this period.

After triggering Article 50, Prime Minister May subsequently held an early general election in June in the hope that her Conservative Government would increase its overall majority and further strengthen her Government's negotiating position with the EU. However, this gamble failed as Prime Minister May lost her overall majority in the UK Parliament. As a consequence, the UK Government has been and remains weaker domestically, and weaker in its negotiating position with the EU. Despite various attempts by the UK Government to provide a degree of clarity on what the post-Brexit settlement may look like, there is still uncertainty as to whether a deal will be agreed, and what this will look like if there is one.

Expected Loss of the Financial Services Cross-Border "Passport"

From a financial services perspective, firms authorized in the UK currently benefit from an EU financial services "passport" under one or more EU Directives (such as the Markets in Financial Instruments Directive (**MiFID**) or the Alternative Investment Fund Managers Directive (**AIFMD**)). This allows such firms to carry out cross-border activities (be this through the provision of services or the establishment of a branch in other EU Member States).

It is widely expected that the UK will not become a member of the European Economic Area (**EEA**) when it leaves the EU, as a consequence it would become a "third country" (*i.e.*, a non-EEA country) and the provisions applicable to third countries will become applicable to UK firms. This will result in a curtailment of the freedoms UK firms currently enjoy. For example, UK alternative investment fund managers (**AIFMs**) would no longer be able to use the cross-border marketing passport when marketing their alternative investment funds across the EU. Instead they would need to market in other EU Member States through making national private placement regime (**NPPR**) notifications in each Member State into

which they wish to market. It is possible that UK firms may be given a special status under a Brexit deal which would allow UK firms to continue to have access to the passport under special conditions, but this remains just one of a number of possible Brexit outcomes.

For U.S. managers marketing their funds in the UK, it is expected the UK will retain the AIFMD regime it implemented into its domestic law for the foreseeable future (and beyond Brexit). Therefore, U.S. managers will continue to need to submit NPPR notifications to the UK Financial Conduct Authority (**FCA**) prior to marketing their funds in the UK.

Brexit negotiations between the UK and the EU should be monitored closely and firms potentially impacted should be contingency planning on the potential longer-term effects of the UK leaving the EU.

EU Anti-Money Laundering Update

Fourth Anti-Money Laundering Directive came into Effect

The Fourth Anti-Money Laundering Directive (**4MLD**) came into effect across EU Member States in June 2016. It applies to all authorized financial services firms in the EU, including EU fund managers and placement agents. The requirements of 4MLD build on those of the Third Money Laundering Directive which had been in place since 2007. One of the key changes is the requirement for EU firms to apply a more risk-based approach to AML processes. As a result, EU firms' practices and procedures for complying with the new requirements will vary depending on the nature of the money laundering risks they face and the types of products they deal in.

Changes to the UK Persons with Significant Control Regime

Among the other changes arising from the transposition of 4MLD in the UK was to broaden the "persons with significant control" (**PSC**) regime. Prior to the change, the UK PSC regime required most UK companies and all UK limited liability partnership to keep a register of "persons with significant control." Under the changes that came about under 4MLD, the scope of entities caught by the requirements of the PSC regime expanded to include Scottish limited partnerships as well as additional UK companies. There was also an increase in the reporting obligations on those UK companies and UK limited liability partnerships that already were subject to the PSC regime. Scottish limited partnerships often are used by UK fund managers as fund vehicles and so the enhanced requirements have increased the compliance burden placed on such fund managers.

Further information on the changes to the PSC Regime in the UK can be found in our [briefing](#) on the topic.

AIFMD Update

No Extension of the Passport Expected in the Foreseeable Future

In July 2016, the European Securities and Markets Authority (**ESMA**) published its final advice (**ESMA Advice**) on extending the application of the marketing passport under the AIFMD to non-European managers. This advice was largely positive in extending the marketing passport to the United States, Canada, Guernsey, Japan, Jersey and Switzerland. Further details on ESMA's advice can be found in our previous [briefing](#) on the subject.

Since the publication of ESMA's advice in July 2016 there has been no further development which indicates that the third country passport will be extended to non-EEA countries in the foreseeable future.

The delay and lack of progress in extending the passport is primarily due to the Brexit vote in the UK and the wider political considerations that accompany any decision to extend the AIFMD marketing passport to one or more non-EEA countries. The consequence of this lack of progress means that the non-EEA managers will continue to only be able to market funds in the EEA via the making of NPPR notifications in each Member States where it is possible (and feasible) to do so.

FCA Increased its Reporting Requirements for Some AIFs

On June 29, 2017, the FCA changed its rules and guidance on Annex IV reporting under the AIFMD.

The changes apply to fund managers established outside the European Economic Area (**non-EEA AIFMs**) that market feeder alternative investment funds (**AIFs**) in the UK under the AIFMD NPPR and submit Annex IV reports in relation to these feeder AIFs on a quarterly basis. For these AIFs, non-EEA AIFMs now are required to report quarterly information on the master AIF as well as the feeder, notwithstanding that the master AIF has not been registered for marketing in the UK.

Further information on the changes to the FCA's Annex IV reporting requirements can be found in our [briefing](#) dated May 15, 2017 on the topic.

Packaged Retail and Insurance-Based Investment Products Regulation Update

Background

On January 1, 2018, the EU Regulation on Packaged Retail and Insurance-based Investment Products (**PRIIPS**) (Regulation (EU) No 1286/2014) (the **PRIIPs Regulation**) will come into effect across the EU.

The aim of the PRIIPs Regulation is to encourage efficient EU markets by helping retail investors within the territory of the EU to better understand and compare the key features, risk, rewards and costs of different PRIIPs, through access to a short and consumer-friendly Key Information Document (**KID**). It is the manufacturer of the PRIIP (which in the case of a fund would generally be the fund manager) that is required to prepare a KID for each PRIIP that they produce and provide this to retail investors within the territory of the EU. The manufacturer is then required to publish each such KID on their Web site.

The definition of "retail investor" in the PRIIPS Regulation cross-refers to the definition in the Second Markets in Financial Instrument Directive (Directive 2014/65/EU and related EU legislation collectively referred to as **MiFID II**). The definition essentially applies to all EU investors that do not fall within the definition of "professional client" under Annex II of MiFID II.

Natural persons in the EU may only be categorized as a "professional client" under MiFID II if they can be "opted-up." Under the qualitative criteria, the investor must be assessed (taking into account the investor's expertise, experience and knowledge) and deemed to be capable of making his, her or its own investment decisions and understanding the risks involved with the transaction envisaged. Certain disclosures are also required to be made to the investor (normally through a standalone notice or letter). To be opted-up they must meet quantitative and qualitative criteria. Under the quantitative criteria, two of the following three conditions must be met:

- The person has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters;
- The size of the person's financial instrument portfolio, defined as including cash deposits and financial instruments exceeds €500,000; and

- The person works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged.

It is therefore difficult for individuals that have high net worth, but no experience of working in the financial sector to be opted-up to professional client status. In such circumstances, such an investor would be categorized as a retail investor and a KID would need to be produced and provided to the investor before they invest in the fund.

The PRIIPS Regulation applies to PRIIPS manufacturers established anywhere in the world in circumstances where they make their product available to retail investors within the territory of the EU. Consequently, from January 1, 2018 fund managers around the world that do not want to produce to KID should ensure that only investors within the territory of the EU meeting the “professional client” definition under MiFID II are permitted to invest in their funds.

Requirements for the KID

The PRIIPS Regulation requires that a KID is a stand-alone, standardized document prepared for each investment. A KID can be up to a maximum of 3 sides of A4-sized paper and may refer to other documents such as a prospectus if the cross-reference is related to the information required to be included in the KID, or refer to where detailed information can be found.

Each KID will need to contain the following information, presented in a pre-determined sequence of sections. The sections are:

- What is this product?
- What are the risks and what could I get in return?
- What happens if the PRIIP manufacturer is unable to pay out?
- What are the costs?
- How long should I hold it and can I take money out early?
- How can I complain?
- Other relevant information.

The PRIIPS Regulation outlines the layout of the KID and delegated regulation (referred to as EU Regulatory Technical Standards) contains detailed rules on: the content and presentation of the KID; how to calculate some of the information in the KID; the review of the KID and revision and republication of the KID; and the timing of delivery of the KID.

As noted above, fund managers should ensure they have necessary policy and procedures in place to either ensure that no retail investors within the territory of the EU are permitted to invest in their fund or they should ensure that a KID is produced and ongoing requirements under the PRIIPS Regulation.

GDPR Update

The General Data Protection Regulation (the **GDPR**) comes into force across each EU Member State on May 25, 2018. Many of the requirements under the GDPR are similar to those set out in existing EU legislation on data protection. However, there are certain key differences arising from the GDPR that all those within its scope will need to comply with.

What Does the GDPR Do?

The GDPR will implement more stringent operational requirements for processors and controllers of personal data, including, for example, expanded disclosures about how personal information is to be used, limitations on retention of personal data, increased requirements to delete or hand over an individual's information upon request, mandatory data breach notification requirements, requirements to maintain records of data processing activities and transfers of personal data, and higher standards for data controllers to demonstrate that they have obtained valid consent for certain data processing activities.

Who Does the GDPR Apply To?

Broadly, the GDPR applies to controllers and processors based in the EU as well as controllers and processors not based in the EU where the activities that the controllers or processors carry out are either (i) offering goods or services in the EU, and/or (ii) monitoring data subjects' EU activities (e.g., the tracking of individuals online to create profiles, including where this is used to take decisions to analyse/predict personal preferences, behaviours, attitudes, etc.). This change from the previous data protection legislation will significantly increase the extra-territorial reach of European data privacy legislation. If a controller or processor does not have a base in the EU but the GDPR applies to them then they may need to appoint a representative in the EU.

Why Does the GDPR Matter?

The GDPR significantly increases penalties for non-compliance, with fines for non-compliance of up to the greater of EUR 20 million or 4% of worldwide annual turnover. If a company's privacy or data security measures fail to comply with the GDPR, the company may be subject to actions taken by the relevant EU data supervisory authority, which may lead to enforcement orders, fines or other liabilities; equally, actions brought by individuals against non-compliant firms may lead to claims for damages. The UK's data supervisory authority is already taking a more proactive approach and issuing increased fines, generally in relation to direct marketing and data breaches. It is expected that this will continue across EU Member States when the GDPR comes into force.

What would bring Non-EU Fund Managers within the Scope of the GDPR?

Broadly, there are two ways a non-EU fund manager could be brought within the scope of the GDPR:

- If the non-EU fund manager has an establishment in the EU, then that establishment would be subject to the GDPR, as it will process personal data.
- If a non-EU fund manager does not have an establishment in the EU, but either (i) offers goods or services in the EU, or (ii) monitors a data subject's EU behavior, then the non-EU fund manager may be subject to the GDPR and its attendant operational requirements as discussed earlier.

What are the Next Steps Fund Managers Should be Taking to Prepare for the GDPR?

EU fund managers, as well as non-EU fund managers which are brought within the scope of the GDPR, will have to meet the full requirements of the GDPR applicable to them. Fund managers should therefore carry out an analysis of how GDPR may apply to their business. This would include carrying out a data mapping exercise and then putting in place appropriate documents and contractual provisions with respect to any personal data, including employee and client data that the manager processes.

Further information on the GDPR and the changes arising from it can be found in our [briefing](#) dated August 3, 2016 on the topic.

MiFID II Update

Background and Application to Fund Managers

MiFID II comes into force on January 3, 2018. It will replace the existing MiFID I regulatory framework which has been in effect across the EU since November 2007. Broadly, the MiFID framework regulates firms which provide services to clients linked to “financial instruments” (shares, bonds, units in collective investment schemes and derivatives), and the venues where those instruments are traded. This will continue to be the case after January 3, 2018.

Fund management is not an investment activity caught by MiFID I, and will not be caught under MiFID II, rather such activities would fall within the scope of the Undertakings for the Collective Investment in Transferable Securities Directive or the AIFMD. However, EU fund managers that manage segregated accounts would be carrying out the MiFID activity of portfolio management and therefore will be caught by the new requirements arising under MiFID II as discussed below.

Some of the MiFID II requirements that EU-based discretionary portfolio managers will need to comply with are:

- **Inducement and Investment Research** – EU firms providing independent investment advice and portfolio management services are not permitted to accept and retain fees, commissions or any monetary or non-monetary benefits provided by a third party in relation to the relevant client services (these are referred to as “inducements” in MiFID). “Minor non-monetary benefits” capable of enhancing the quality of client service are excluded from this prohibition, although they must be clearly disclosed to clients. Under the MiFID II rules, the provision of research by third parties to portfolio managers will be treated as a prohibited “inducement” unless it is unbundled from execution costs and received in return for either: (a) direct payments by the portfolio manager out of its own resources; or (b) payments from a separate research payment account controlled by the portfolio manager.
- **Best Execution** – MiFID II imposes increased requirements on EU investment firms to seek best execution for customer and portfolio orders. Order execution policies will need to be amended to ensure that the factors used to choose trading venues are applied to more subcategories of financial instrument and firms will need to provide greater transparency on the top five execution venues used for each subclass of financial instrument they trade for managed portfolios.
- **Transaction Reporting** – MiFID II will increase the scope of reportable transactions to include financial instruments traded, or admitted to trading, on all EU trading venues, not just EU-regulated markets. Discretionary portfolio managers are potentially within this scope, because the reporting requirement will apply to both counterparties that are market-facing and those that are not. In addition, transaction reporting itself will become more onerous because of an increase in the information that must be reported.
- **Telephone taping** – certain investment firms, including discretionary portfolio managers, will need to comply with new, more burdensome communication-recording requirements. In addition, there is a requirement for telephone conversations that lead to, or are likely to lead to, the conclusion of transactions are to be recorded. These recordings are required to be held for five years.
- **Product Governance** – MiFID II will introduce a number of requirements that in broad terms will require EU manufacturers and EU distributors of investment products to identify target markets, ensure that such products are compatible with those markets and carry out regular reviews of how the product is distributed.
- **Categorization of Local Authorities/Municipalities** – local authorities and municipalities in the EU will be categorized as retail clients rather than professional clients unless they can be opted-

up to professional client status. This is relevant for firms that provide services, or sell investment products, to EU local authority pension funds.

Some EU Member States have chosen to “gold-plate” national laws so as to impose MiFID requirements on non-MiFID firms. This is the case in the UK, where the FCA has applied some of the MiFID II requirements to AIFMs. UK fund managers will need to have assessed which of the new FCA rules apply to them, and implemented necessary changes to their policies and procedures to ensure that they comply with the new MiFID II requirements that are applicable to them, and which come into force on January 3, 2018.

In general, the requirements of MiFID II will apply to EU investment firms and will not be directly applicable to non-EU fund managers. However, non-EU fund managers which deal with, or provide services to, EU investment firms will likely be indirectly impacted by the MiFID II requirements as the EU investment firms amend and adapt their processes to comply with the new requirements. For example, EU investment firms executing trades on behalf of non-EU clients will require more information from their clients (such as the client’s legal entity identifier (**LEI**)) in order to meet their own MiFID II transaction reporting obligations. Equally, EU managers that delegate portfolio management services to non-EU managers may seek to revise their delegation agreements to reflect MiFID II requirements. In so doing, the EU managers may contractually seek to impose some of the MiFID II requirements on their non-EU delegates.

Fund managers should be assessing how the new MiFID II requirements could affect their business (directly or indirectly) and taking necessary steps to plan for these changes.

UK Tax Updates

OECD Base Erosion and Profit Shifting and the UK’s Response

We discussed one aspect of the OECD’s Base Erosion and Profit Shifting (**BEPS**) project in last year’s Annual Review. There has been a great deal of progress on the BEPS project during 2016 and 2017, and we discuss here some of the more significant developments, focusing particularly on the United Kingdom’s implementation of the BEPS action points.

Gaps and mismatches in the current international tax rules can make profits “disappear” for tax purposes or allow the shifting of profits to no- or low-tax locations where the business has little or no economic activity. These activities are referred to as BEPS. Work started by the OECD in 2013 resulted in the Action Plan on BEPS which identified 15 action points (**Actions**) to be addressed along three fundamental pillars: introducing coherence in the domestic rules that affect cross-border activities; reinforcing substance requirements in the existing international standards; and improving transparency, as well as providing certainty for businesses that do not take aggressive positions. The Actions address a wide range of areas of taxation. The full list is set out below. All G20 and OECD countries have participated in this project.

By early 2017, Final Reports had been issued, which agreed on all Actions, and participating jurisdictions are now charged with implementing them into domestic law. This will take some time, but there has been significant progress already, as noted below. The United Kingdom has been at the forefront of implementation.

The Actions are as follows:

- Action 1 – Addressing the Tax Challenges of the Digital Economy
- Action 2 – Neutralizing the Effects of Hybrid Mismatch Arrangements
- Action 3 – Designing Effective Controlled Foreign Company Rules
- Action 4 – Limiting Base Erosion Involving Interest Deductions and Other Financial Payments
- Action 5 – Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance
- Action 6 – Preventing the Granting of Treaty Benefits in Inappropriate Circumstances
- Action 7 – Preventing the Artificial Avoidance of Permanent Establishment Status
- Actions 8-10 – Transfer Pricing – Aligning Transfer Pricing Outcomes with Value Creation
- Action 11 – Measuring and Monitoring BEPS
- Action 12 – Mandatory Disclosure Rules
- Action 13 – Guidance on Transfer Pricing Documentation and Country-by-Country Reporting
- Action 14 – Making Dispute Resolution Mechanisms More Effective
- Action 15 – Developing a Multilateral Instrument (**MLI**) to Modify Bilateral Tax Treaties

Action 2 – Neutralising the Effects of Hybrid Mismatches

As stated above, one of the key aims of the BEPS project is to prevent the exploitation of tax rules or the tax treatment of payments and receipts in different jurisdictions that allow deductions in one jurisdiction without a corresponding recognition of taxable income in another, deductions in more than one jurisdiction or claiming tax credits in more than one jurisdiction in respect of a single tax payment. Preventing these sort of mismatches are dealt with under Action 2 by providing for specific rules to be introduced when such mismatches arise as a result of the use of hybrid entities (entities treated as tax transparent in one jurisdiction and tax opaque in another, such as an English limited company which has elected to be treated as a disregarded entity in the U.S.) or hybrid financial instruments (which generate a tax deductible amount for one party without the other party (direct or, in the case of imported mismatches, indirect)) recognizing a corresponding amount as taxable income.

While the OECD has not prescribed a date for participating countries to introduce domestic rules to implement the Actions (where such rules are required, as is the case with Action 2), the UK became the first country to implement such rules, which became effective January 1, 2017. The rules are long and complex, and in some areas are drafted more broadly, and can apply more broadly, than is prescribed in the OECD's Final Report on Action 2. The UK's Her Majesty's Revenue and Customs (**HMRC**) published 380 pages of guidance on the rules in March this year.

The UK's hybrid mismatches can be divided, broadly, into two types of mismatches arising from the use of hybrid entities or hybrid instruments. The first are direct mismatches, where the mismatch involves the two parties to the transaction or the hybrid entity is party to the transaction. The UK's implementation of these rules is broadly in line with the OECD's recommendation. Notwithstanding this, the rules are wide ranging and should now be considered by any organization that is relying on a UK tax deduction in circumstances where there is a hybrid entity (for example, a UK company borrower that is disregarded for

U.S. tax purposes) or a finance instrument issued by a UK company that is treated as an equity instrument in another jurisdiction.

The second are indirect mismatches, covered by the imported mismatch rules. These effectively apply the direct mismatch rules where there is only an indirect link between the entity claiming the tax deduction and the entity that does not recognize the income. This rule is intended to prevent multinational enterprises particularly from structuring mismatch arrangements through a chain of participators. These rules can apply where the wider arrangement is either entered into by members of a “control group” or where there is a “structured arrangement.” One specific area of current interest where these rules could apply is where direct lending funds lend to UK borrowers. This sort of arrangement is recognized in the OECD’s Final Report on Action 2, which states that it should only be a structured arrangement if the relevant party (the UK borrower) “is involved in the design or has sufficient information about the arrangement to understand its operation and effect.” Unfortunately, this important safeguard is not included in the UK’s implementation of Action 2 or referred to in HMRC’s guidance.

These new rules are now, therefore, an important element of UK tax law which will have to be considered in a wide range of transactions that result in UK tax deductions.

The Member States of the EU have also agreed to introduce domestic hybrid rules, but do not have to do so before January 1, 2019, or January 1, 2020 in the case of the hybrid mismatch rules, and it is to be seen what approach they will take to the rules.

Action 4 – Limiting Base Erosion Involving Interest Deductions and Other Financial Payments

The purpose of Action 4 is to restrict a group’s interest deductions in a particular jurisdiction to an amount that is proportionate to the group’s taxable activities in that jurisdiction. This is primarily to prevent international groups from borrowing large amounts of external debt in high tax jurisdictions or using intra-group loans in excess of the third-party interest expense, thereby generating excessive interest deductions and/or tax shelters.

The final report on Action 4 recommended the implementation of rules limiting interest deductions to address this BEPS risk. In response to the recommendation, the UK government quickly introduced the “Corporate Interest Restriction” rules, which were applicable beginning April 1, 2017. As with the UK government’s implementation of several of the BEPS action points, the rules go beyond the OECD recommendations by imposing additional and harsher restrictions on interest deductibility.

The basic feature of the rules (as prescribed by the BEPS report) is called the fixed ratio rule (the **FR**). Under the FR, net interest deductions are capped at 30% of the group’s UK tax-adjusted EBITDA (referred to as **tax-EBITDA**). The UK rules apply a further “modified debt cap” rule, which may impose a further limit if the worldwide group’s net external interest expense is lower than 30% of tax-EBITDA.

For groups that are highly leveraged on a worldwide basis, there is an alternative rule which can be applied, the group ratio (the **GR**). The GR limits interest deductions to a percentage equal to the ratio of the worldwide group’s interest expense to global EBITDA (with certain adjustments, including ignoring related party debt). This percentage is limited further by the modified debt cap rule in a similar way to the FR.

Any unused interest capacity (where interest deductions in a given year fall below the limit imposed by the new rules) can be carried forward for five years, and any deductions restricted by the new rules can be carried forward indefinitely.

The compliance burden imposed by the new rules is expected to be onerous, as the legislation requires a separate filing to be made with the UK tax authority, and the legislation incorporates a number of tax-specific concepts and definitions. However, a *de minimis* provision is included in the rules ensuring that they will not be applicable to groups with less than £2 million of net interest expense, which the UK tax authority predicts will exclude around 95% of UK businesses.

For the worldwide groups that do fall within the rules, compliance will not be the only cost, as the UK tax authority expects to generate almost £4 billion in extra tax revenue over the next four years as a result of the application of the new rules.

Action 6 – Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

The purpose of Action 6 is to address treaty shopping (a situation where “a person who is not a resident of a State attempts to obtain benefits that a tax treaty concluded by that State grants to residents of that State, for example by establishing a letterbox company in that State”). The Final Report on Action 6 contained two key strategies for dealing with treaty shopping:

- including a clear statement in the preamble of double tax treaties stating that the relevant treaty states do not intend to create opportunities for non-taxation or reduced taxation through tax evasion/avoidance, including through treaty shopping; and
- introducing unified minimum standards to counter treaty shopping through either the relevant treaty states adopting a “Principal Purpose Test” (**PPT**) or a “Limitations on Benefits” (**LOB**) provision (or a combination of the two).

The Final Report on Action 6 contained further recommendations dealing with specific matters, such as the removal of the dual-residency tie breaker from relevant treaties in favor of a procedure for the resolution of the issue by agreement between the competent authorities of the relevant jurisdictions.

In accordance with the guidance on the OECD’s Model Tax Convention, the preamble is viewed as setting out a general statement of the object and the purpose of the treaty and so is important in the interpretation of the provisions of the relevant treaty. Therefore, by including this additional wording, the prevention of treaty shopping will become a more significant consideration when it comes to interpreting the relevant treaty.

As one might expect, the PPT would operate so as to prevent a person from claiming treaty benefits when one of the principal purposes of the relevant arrangements was to obtain the benefits under a double tax treaty (either directly or indirectly). This provision therefore operates as a form of anti-abuse rule.

The LOB rules would operate so as to only allow treaty benefits to be claimed by certain specified types of persons (including, for example, individuals or entities resident in a treaty state or entities which are engaged in the “active conduct of a business” in a treaty state). This type of provision already exists in certain double tax treaties, including, for example, the double tax treaty between the United States and the UK.

The recommendations under Action 6 will be largely adopted by a number of signatory jurisdictions as part of the MLI. The MLI follows the recommendations set out above in that, once it comes into force, it

will amend the preamble of the double tax treaties of the relevant signatory jurisdictions and will also allow the signatory jurisdictions to choose one of three options to counter treaty shopping. The three options available are as follows: (1) to impose a PPT; (2) to impose a detailed LOB; or (3) to impose a PPT with a simplified LOB. It is not yet clear which options will be chosen by a majority of the relevant signatory jurisdictions, although the UK government has indicated that it wishes to adopt the PPT only.

While the intention is for a large part of Action 6 to be dealt with in the MLI, there remain a number of areas of uncertainty, including in relation to how the recommendations under Action 6 will be applied to so-called “non-collective investment vehicles” (**non-CIVs**) (which include, for example, pension funds and private equity funds). The OECD recognizes the difficulty of applying the current recommendations on treaty abuse to non-CIV entities and so has published a discussion draft of a paper which contains certain examples of how the new rules under Action 6 will be applied to non-CIVs. However, as the examples are very fact-specific, the usefulness of the discussion draft is very limited and a large amount of uncertainty still remains in this area.

Action 7 – Preventing the Artificial Avoidance of Permanent Establishment Status

Action 7 targets multinational enterprises (**MNEs**) who avoid paying tax in foreign countries in which they have substantial operations because, as a technical matter, those operations do not form a taxable presence (a **permanent establishment**). In particular, the OECD has raised concerns regarding the avoidance of a permanent establishment through the use of certain so-called “commissionaire” arrangements (where an agent acts at the request of the principal but in its own name rather than the name of the principal) and the classification of activities as being merely “preparatory or auxiliary.”

In the broadest terms, the OECD’s recommendations in Action 7 look to reduce the threshold at which a permanent establishment in a foreign country is established. For example, and in particular, an agent no longer needs to “conclude contracts” on behalf of its principal to form a permanent establishment of the principal; it will now form a permanent establishment where it “habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise.” In the private funds context, this may put pressure on the use of onshore advisory structures for offshore general partners/managers. The OECD’s proposals are set out in the MLI, itself developed through the work under Action 15, which, to the extent adopted by participating countries, modifies the interpretation of existing double tax treaties. The UK signed up to the MLI on June 7, 2017, but, as it was entitled, either reserved the right to not adopt the MLI provisions relating to Action 7 in its double tax treaties or set out the view that the relevant provisions were already covered.

The UK had, however, already (beginning April 1, 2015) introduced a “diverted profits tax” (**DPT**) with the similar objective of counteracting the diversion by multinational groups of profits from the UK, thereby reducing their profits subject to UK corporation tax.

The DPT applies to the “taxable diverted profits” of the MNE, which, in broad terms, are profits arising to a non-UK entity by virtue of arrangements with a related UK company that reduce UK tax liabilities where the arrangements lack economic substance and result in an effective tax rate on those profits of less than 80% of the UK’s corporation tax rate.

Amounts of “taxable diverted profits” are subject to 25% plus interest, compared to the current 19% UK corporation tax rate, and it is not clear that double tax relief would be available in respect of DPT levied, and HMRC have indicated that they do not consider that it would. The DPT may be regarded, therefore, as a penal tax which incentivizes MNEs to structure their arrangements appropriately.

The extra-territorial reach and broad terms of the DPT have unsurprisingly been very controversial. Perhaps more surprisingly, even the OECD has been critical of the DPT on the basis that they would prefer an approach to BEPS across all jurisdictions that is consistent with its own proposals.

Actions 8-10 – Transfer Pricing – Aligning Transfer Pricing Outcomes with Value Creation

The final report on Actions 8 to 10 sets out revisions to the OECD Transfer Pricing Guidelines to align transfer pricing outcomes with value creation. The revised guidance focuses on the following key areas: transfer pricing issues relating to transactions involving intangibles; contractual arrangements, including the contractual allocation of risks and corresponding profits, which are not supported by the activities actually carried out; the level of return to funding provided by a capital-rich multinational enterprise group member, where that return does not correspond to the level of activity undertaken by the funding company; and other high-risk areas. The resulting revised 2017 edition of the OECD Transfer Pricing Guidelines (**Guidelines**) for Multinational Enterprises and Tax Administrations was published on July 10, 2017.

United Kingdom domestic tax law immediately gives effect to the revised Guidelines, as Section 164 Taxation (International and Other Provisions) Act 2010 requires UK transfer pricing law to be read so as to achieve consistency with the Guidelines as updated and replaced from time to time.

The revised Guidelines give more emphasis to where value is created in a supply chain. As a result, transfer pricing studies carried out for investment fund groups, for example, may result in lower attribution of profits to offshore jurisdictions if the functions carried out there are of low value or have inadequate substance.

Article 13 – Transfer Pricing Documentation and Country by Country Reporting

In the United Kingdom, any UK resident ultimate parent entity of an MNE with a consolidated group turnover of €750 million or more must deliver a CbC report. The rules apply to accounting periods commencing on or after January 1, 2016 and companies will have 12 months from the end of the relevant accounting period to file a report with HMRC.

The UK Regulations also include a requirement for the top UK entity of an MNE to file a CbC report when it is not the ultimate parent entity (**UPE**) of the MNE and the UPE is resident in a country that either does not require a CbC report or does not exchange reports with HMRC in accordance with an effective multilateral competent authority agreement. This local filing requirement will mean that the top UK entity of an MNE will file a CbC report covering all entities within the sub group of which it is head. There are exceptions if the UK entity that would be required to file has already been included in a CbC report that HMRC can receive or has received.

Recent amendments to the rules oblige a UK entity in each MNE group that is within the scope of CbC reporting to tell HMRC annually which entity in the MNE group will file the CbC report and where the report will be filed, as well as provide names and reference numbers for all of the MNE group's UK entities.

HMRC have also confirmed that the required format for country-by-country reporting will be via an extensible markup language (**XML**) schema to ensure international consistency.

China Regulatory Updates

New AMAC Regulations on the Registration and Conduct of Private Fund Managers

The Asset Management Association of China (**AMAC**), a self-regulatory organization authorized by the China Securities Regulatory Commission (**CSRC**) to regulate the private investment fund industry in China, released the Announcement on Certain Issues Concerning Further Regulation of Manager Registrations for Privately-Placed Funds and the Administrative Measures on Fundraising Activities of Privately-Placed Funds on February 5, 2016 and April 15, 2016, respectively (collectively, **New AMAC Regulations**). The New AMAC Regulations apply to all private funds and private fund managers domiciled in China, including wholly-owned subsidiaries of international private fund managers in China. Compared to existing regulations, the New AMAC Regulations provide more onerous requirements on the registration and conduct of private fund managers.

Under the New AMAC Regulations:

- All private fund managers (including those that were registered with AMAC before the release of the New AMAC Regulations) must launch and register their first fund within six months of registration of the private fund manager (or before a specified date in the case of those private fund managers that were already registered prior to the release of the New AMAC Regulations). Failure to do so will result in the manager being deregistered by AMAC;
- All senior management (e.g., the legal representative, general manager, deputy general manager and compliance officer) of a registered private fund manager must obtain the proper qualification to conduct fund business (by passing an exam organized by AMAC on a regular basis or by possessing the requisite experience in investment management);
- Registered private fund managers must submit ad hoc, quarterly and annual reports to AMAC within the specified timeframe;
- Private fund managers must submit a formal legal opinion at the time of (i) its initial registration; (ii) any subsequent material change; or (iii) making a filing for a managed fund. The legal opinion must address the corporate registration, team qualification, risk management policies and practices and certain other matters of the manager; and
- Any placement agent of a private fund must hold a fund distribution license issued by the CSRC and be a member of AMAC.

Restriction on Foreign Ownership of Private Securities Investment Fund Management Companies Lifted

On June 30, 2016, AMAC released the Tenth FAQs in Relation to the Registration and Filing of Private Funds (**10th FAQs**). AMAC's responses in the 10th FAQs indicate that international financial institutions are permitted to engage in the privately-placed securities investment fund (also known as a "sunshine fund") management business in China by setting up a wholly-owned subsidiary or a joint venture with a PRC partner. This is a product of recent commitments made by the Chinese government, during its dialogues with the U.S. and UK, to further open up its private fund management market to foreign capital. Prior to the 10th FAQs, international financial institutions were generally (with certain exceptions, e.g., securities investment fund management companies set up under the Mainland China and Hong Kong Closer Economic Partnership Arrangement) subject to a 49% foreign ownership cap in the privately placed securities investment fund management business. The 10th FAQs are only applicable to managers of privately placed securities investment funds, while publicly-raised securities investment fund managers (also known as **retail fund managers**) remain subject to the 49% foreign ownership cap.

Certain AMAC Self-Regulatory Rules can be Expected to be put in a Higher Level of Law

On August 30, 2017, the legislative affairs office of the State Council of China published the draft *Interim Administrative Regulation on Private Investment Funds (Draft Regulation)* to solicit public comments. The Draft Regulation is intended to be a comprehensive national regulation governing private investment fund managers and their fundraising activities in China. The provisions of the Draft Regulation address almost all aspects of private investment fund management, including, among others, fund manager registration, filing for fund products, fund raising, investment operations, information disclosure, fund custodians and special rules applicable to venture capital funds. However, to private fund industry practitioners, most of the provisions of the Draft Regulation may not be unfamiliar requirements, as the same or similar requirements can be found in existing national regulations and self-regulatory rules issued by AMAC. The main purpose of the Draft Regulation is to put certain existing rules issued by AMAC in the past few years as an industry self-regulatory organization in a higher level of law (*i.e.*, national regulation promulgated by the Chinese State Council).

Hong Kong Regulatory Updates

Bond Connect Launched

Following the commencement of trading on December 5, 2016 through Shenzhen-Hong Kong Stock Connect (**Stock Connect**), which permitted both Northbound and Southbound trading in eligible shares on both the Hong Kong Stock Exchange (**HKEX**) and the Shenzhen Stock Exchange, the next phase of mutual market access commenced on July 3, 2017 with the launch of Bond Connect. This scheme is intended to enable investors from Mainland China and overseas to trade in each other's bond markets through dedicated mechanisms established on both markets. While Northbound trading commenced as from the launch date, allowing overseas investors to invest in the China interbank bond market, Southbound trading is to be explored at a later stage.

With three phases of the market connection between Hong Kong and Mainland China in place, the Hong Kong Stock Exchange is now planning ahead for the next phase, known as the "primary equity connect." Currently, Stock Connect does not include IPOs launched, but this next phase would extend Stock Connect to include these IPOs.

SEC and Hong Kong SFC Sign New Memorandum of Understanding

A new Memorandum of Understanding (**MOU**) signed between the SEC and the Hong Kong Securities and Futures Commission (**SFC**) took effect on January 18, 2017. The subject of the MOU is mutual assistance in the supervision and oversight of regulated entities that operate on a cross-border basis in both the United States and Hong Kong. Overall, this latest MOU suggests a phase of closer cooperation between the two regulators. The MOU complements while not replacing the terms of the existing arrangements between the two regulators.¹²

¹²See: (i) the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information of IOSCO (May 2002 version (revised May 2012)) to which both the SEC and the SFC are signatories; (ii) the MOU signed on October 5, 1995; and (iii) the Declaration on Cooperation and Supervision of Cross-Border Investment and Management Activity, signed on October 5, 1995.

The MOU applies to “Cross-Border Regulated Entities,” which broadly refers to a person regulated by one or both of the regulators; a person regulated by one regulator but exempted by the other; persons within the same group where each is regulated by a different regulator; a person who is a regulated entity of one regulator that is physically situated in the territory of the other regulator; and a person regulated by one regulator that manages or advises an investment vehicle that is authorized by the other regulator. Specifically, this term includes: brokers or dealers; investment advisers; investment fund managers; investment funds or investment companies; clearing agencies or houses; and credit rating agencies.

The MOU also sets out specific procedures that each regulator will comply with before conducting an on-site regulatory visit or inspection of the books, records and premises of a Cross-Border Regulated Entity for the purposes of ongoing supervision and oversight. These provisions in particular, which are key also to the process of regulatory enforcement, require that a regulator seeking to examine a Cross-Border Regulated Entity located in the other regulator’s territory consult and work collaboratively with the second (*i.e.*, local) regulator in conducting an on-site visit.

Consultation Paper on Expansion of Categories of Professional Investors

In March 2017, the SFC issued a [consultation](#) paper containing proposals to broaden the existing categories of individual and corporate professional investors, which will have the effect of enlarging the pool of professional investors to whom fund managers may have access as potential investors. The SFC has previously granted waivers on an individual basis from aspects of the rules applying to professional investors, and is now proposing to standardize these waivers within the rules that prescribe who is a professional investor and the types of evidence that may be relied upon when assessing professional investor status.

In summary, the proposed changes are:

- Allowing aggregation of certain assets: This would include, for example, for an individual, aggregating the portfolio of an individual, the portfolio or share of the portfolio of any corporation which is wholly or partially owned by the individual at the relevant date, the principal business of which is to hold investments. This contrasts with the current position where the corporation must be wholly-owned and its sole business must be to hold investments.
- Expanding the definition of corporations to qualify as professional investors: This category would include any corporation whose principal business at the relevant date was to hold investments, where it was wholly owned by one or more persons each of whom is qualified as a professional investor. This category would also be expanded to permit a corporation to qualify as a professional investor if it wholly owns another corporation that qualifies as a professional investor.
- Allowing alternative forms of evidence: The two alternative forms of evidence being proposed are (i) public filings made under legal or regulatory requirements in or outside of Hong Kong, and (ii) certificates (as opposed to statements of account) issued by custodians. It is also proposed to allow the use of certificates issued by auditors or certified public accountants for this purpose for corporations, trust corporations and partnerships. Certificates for individuals issued by auditors or certified public accountants are already permitted for this purpose.

As at the date of writing, the SFC has yet to issue its conclusion paper.

Requirement to Include Suitability Clause in Client Agreements

On June 8, 2017, the Code of Conduct for Persons Licensed by or Registered with the SFC (**Code of Conduct**) was amended to require that all client agreements between all licensed corporations and their clients should include this clause:

“If we [the intermediary] solicit the sale of or recommend any financial product to you [the client], the financial product must be reasonably suitable for you having regard to your financial situation, investment experience and investment objectives. No other provision of this agreement or any other document we may ask you to sign and no statement we may ask you to make derogates from this clause.”

This resulted from consultation conclusions published by the SFC in December 2015 (see our 2016 Annual Review), which sought to correct the lack of contractual redress for a client for breach of the Suitability Requirement under the Code of Conduct which required that when making a recommendation or solicitation, the licensed intermediary would be required to ensure that the suitability of the recommendation or solicitation for the client was reasonable in all the circumstances. Before the amendment to the Code of Conduct, while a breach of the requirement might have been a disciplinary matter for the intermediary concerned, it did not give the client a remedy for compensation against the intermediary.

The starting point is that all licensed intermediaries, including fund managers, whose client under local law would be the fund, would be required to include this provision in their client agreements. However, a licensed intermediary providing services to a client who is a corporate (this term includes a partnership) professional investor (but not an individual) is entitled to seek that investor’s consent for its treatment under the Code of Conduct as a professional investor. This would entitle the intermediary to the benefit of certain waivers, including dispensing with the client agreement (*i.e.*, including the above clause). If, however, an agreement is needed by the fund manager for other, for example, non-regulatory reasons, the SFC accepts that, provided the client has consented to professional investor treatment, the agreement need not include the clause. Obtaining the client’s consent to professional investor treatment is therefore a condition to omitting the clause from the client agreement.

Augmented Responsibility Regime for Senior Management of Licensed Corporations (Managers-in-Charge of Core Functions)

In April 2017, the SFC introduced an augmented responsibility regime for the senior management of both existing licensed corporations (**LC(s)**) and corporate license applicants under the licensing regime for intermediaries. These measures are intended to heighten the accountability of the senior management of LCs and promote awareness of senior management obligations under the licensing regime, and in so doing fill gaps in the Responsible Officer (**RO**) regime where it was perceived that there have been issues in identifying who has real responsibility within LCs.

The SFC takes the view that the senior management of an LC includes not only directors and ROs of the corporation, but also individuals referred to as Managers-in-Charge of Core Functions (**MICs**). The three categories need not be treated as mutually exclusive of one another, meaning that an individual could be all three at the same time in relation to an LC.

The SFC identified the following eight “Core Functions” within an LC which it regards as instrumental to the operations of any such corporation: (i) overall management oversight; (ii) key business line; (iii) operational control and review; (iv) finance and accounting; (v) risk management; (vi) information technology; (vii) compliance; and (viii) anti-money laundering and counter-terrorist financing. Senior management of the LC in charge of Core Functions (i) and/or (ii) are expected to be ROs. Otherwise, an LC is required to ensure that any person it employs or appoints as an MIC is a fit and proper person to manage the function in question.

The SFC recognizes that the organizational structure of LCs will vary, and that in some cases one individual may be appointed as the MIC for several Core Functions, or that two or more individuals are appointed as MICs to jointly manage a particular Core Function. An MIC need not be located in Hong Kong provided he or she is properly accountable to the LC. Nor does an MIC need to be employed by the LC, but he or she must hold a position of authority within the LC and should be properly accountable to it.

In determining whether an individual is an MIC of a particular Core Function, an LC needs to take account of that person's apparent or actual authority as regards to that Core Function. This would include the individual having one or more of the following attributes: (i) the person occupies a position within the LC which is of sufficient authority to enable the individual to exert a significant influence on the conduct of that Core Function; (ii) the person has authority to make decisions (e.g., assume business risks within pre-set parameters or limits) for that Core Function; (iii) the person has authority to allocate resources or incur expenditures in connection with the particular department, division or functional unit carrying on that Core Function; and (iv) the person has authority to represent the particular department, division or functional unit carrying on that Core Function (e.g., in senior management meetings or in meetings with outside parties). The individual's seniority should also be taken into account, and in this context, the SFC generally expects that an MIC should: (i) report directly to the LC's board or to the MIC for Core Function and (ii) be accountable for the performance or achievement of business objectives set by the board or by the MIC for Core Function (i).

From the commencement of this augmented regime, existing LCs and corporate license applicants have been required to submit up-to-date management structure information and organizational charts to the SFC. MICs for Core Function (i) and/or (ii) who are not already ROs have been required to apply for approval for RO status. Additionally, an LC will have an obligation to submit an updated organizational chart to the SFC when there is a change in the identity of any of the MICs it has engaged, or in the job title of the person to whom an MIC reports.

Expansion of the Short Position Reporting Regime

As reported in our 2016 Annual Review, effective March 15, 2017, the regime for reportable short positions was expanded so that reporting is now required for reportable short positions in all securities (referred to as **Designated Security**) that can be short sold under the rules of HKEX. The [updated list](#) of all Designated Securities is maintained on the HKEX Web site. Previously, reporting was limited to a narrower list of securities published by the SFC which had been in place since the regime was introduced five years ago. There has been no change to the reporting threshold trigger for Designated Securities (i.e., 0.02% of the market capitalization of the listed issuer concerned or HK\$30 million, whichever is lower), except for collective investment schemes, (**CISs**) which include exchange-traded funds and REITs, for which a person must report to the SFC if, as of the end of the last trading day of a week, the person holds a net short position in a CIS which has a value that is equal to or more than HK\$30 million.

Open-Ended Fund Companies

As reported in our 2016 Annual Review, in June 2016, legislation was passed (but is not yet in effect) for the use of Hong Kong incorporated open-ended fund companies (**OFCs**) as local investment fund vehicles. Traditionally, investment funds in Hong Kong have been established in unit trust form rather than corporate form, owing to restrictions under the local Companies Ordinance on capital reduction and distribution out of capital.

In June 2017, the SFC issued its consultation paper with a set of draft Rules (**OFC Rules**) and a draft Code (**OFC Code**) on OFCs setting out the detailed legal and regulatory requirements for OFCs. It is anticipated that the OFC Rules and OFC Code will come into force sometime during 2018, simultaneously with the coming into effect of the legislation. While this new type of vehicle is likely to be attractive mainly to retail funds, they are also designed for use as private funds, including as hedge fund vehicles.

While all OFCs (whether publicly or privately offered) will be required to be registered with the SFC, private OFCs would be allowed flexibility to pursue their investment strategies set out in their instrument of incorporation and offering documents, as long as they met the basic principles in the OFC Code. The investment management function of an OFC would be required to be delegated to an investment manager licensed by the SFC to carry out a Type 9 (asset management) regulated activity, so that the investment manager would also be required to comply with the conduct requirements applicable to that license type, including the Fund Manager Code of Conduct.

In line with the 2016 consultation conclusions, the OFC Code sets out the investment scope of private OFCs as follows:

- at least 90% of the OFC's gross asset value should consist of (1) those asset types the management of which would constitute a Type 9 regulated activity¹³, and (2) cash, bank deposits, certificates of deposit, foreign currencies and foreign exchange contracts;
- the OFC may invest in other asset classes of a value not exceeding a maximum of 10% of the gross asset value of the OFC (10% de minimis limit);
- in the case of an umbrella OFC, the 10% de minimis limit is applicable to each sub-fund as well as to the umbrella OFC as a whole; and
- the 10% de minimis limit must be set out in the OFC's instrument of incorporation.

The offering documents of a private OFC are required to be filed with the SFC following the registration of the OFC, as well as after any changes are made to any of those documents.

Additionally, the legislation provides for the segregation of liability of sub-funds for an OFC which has an umbrella and sub-funds structure. The OFC Rules will include implied terms for contracts and transactions entered into by an umbrella OFC to provide protection for the sub-funds, such as that a party contracting with the OFC agrees not to seek recourse to any assets of any sub-fund of the OFC for a liability not incurred on behalf of that sub-fund.

Enhancements to the Open Position Limit Regime

As reported in our 2016 Annual Review, in September 2016 the SFC published a consultation paper on proposed enhancements to the open position limit regime for stock options. The enhancements were intended to take forward the recommendations of the conclusions of the HKEX in its consultation paper on the subject. The SFC had proposed to raise the statutory position limit for stock options from 50,000 contracts to 150,000 contracts to facilitate the introduction of a three-tier system proposed by HKEX.

In its consultation conclusions published in March 2017, the SFC confirmed that it would proceed with the enhancements as set out in its consultation paper. This included the proposals for the Asset Manager

¹³The asset types currently include securities and futures contracts. OTC derivative products will be added once the relevant legislation comes into effect.

Excess Position Limit, but with one change being the reduction of the required assets under management (**AUM**) for the licensed intermediary from HK\$100 billion, as originally proposed, to HK\$80 billion (approximately US\$10 billion). The existing statutory rules were amended to incorporate these enhancements effective from June 2017.

SFC Statement on ICOs

In September 2017, the SFC issued a statement on ICOs to raise funds in Hong Kong and elsewhere. The point was made in the statement that depending on the facts and circumstances of an ICO, digital tokens offered or sold may be “securities” as defined in the Securities and Futures Ordinance (**SFO**), and thus could be subject to the securities laws of Hong Kong.

The following main points were made in the statement:

- Where digital tokens offered in an ICO represent equity or ownership interests in a corporation, they may be regarded as “shares” (and thus may be subject to the prospectus regime). Token holders may for example be given shareholders’ rights, such as the right to receive dividends and the right to participate in the distribution of surplus assets upon winding up of the issuer.
- Where digital tokens are used to create or to acknowledge a debt or liability owed by the issuer, they may be considered as a “debenture” (and thus may be subject to the prospectus regime). An issuer may, for example, repay token holders the principal of their investment on a fixed date or upon redemption, with interest paid to token holders.
- If token proceeds are managed collectively by the ICO scheme operator to invest in projects with an aim of enabling token holders to participate in a share of the returns provided by the project, the digital tokens may be regarded as an interest in a CIS, and thus a security (and thus may be subject to authorization by the SFC).
- Where the digital tokens involved in an ICO are “securities” (as defined in the SFO), dealing in or advising on the digital tokens, or managing or marketing a fund investing in such digital tokens may constitute a “regulated activity,” which requires a license from the SFC (under the regime for the licensing of intermediaries).

Changes to Disclosure of Interests Regime

The SFC has introduced some changes to the disclosure of interests regime that took effect as of July 3, 2017. The regime requires shareholders and the holders of equity derivatives to disclose their interests in any class of voting shares of a company listed on the Hong Kong Stock Exchange once that interest reaches 5% of all issued shares, and then to make further disclosure when the percentage interest crosses further prescribed thresholds.

There are three main aspects to these changes:

Electronic Filing

As from early October, all filings can only be made electronically through the new [Disclosure of Interests Online System \(DION System\)](#). It is no longer possible for forms to be filed by hand, post, fax or email. A user of the system (*i.e.*, a filer) must register with the DION system to be able to submit DI notices using this method, and each filer will need to register its own account online before making its first filing through the DION system. Two points to note are, first, that each filer must register its/his/her own account in the system, so that where for example a filing is to be made by a general partner of a fund, with several layers of ownership above the general partner, each person in the chain of ownership who has incurred a filing obligation must register an account with the system and make its/his/her filing using that account. And second, the system will not permit an agent to register an account on behalf of the person with the

filing obligation. This means that while in the past it was common for a person's lawyers to submit the filing on their behalf, this is no longer possible.

New Forms and Event Codes

New [prescribed forms](#) for filing disclosures of interests must be used which are compatible with the DION system. The content of these new forms is substantially the same as the previous forms in use apart from the introduction of a much expanded list of event codes (*i.e.*, the events triggering disclosure) which can also be found at the above link. This expanded list is helpful both from the perspective of the person preparing the form in determining whether a filing obligation may have been triggered; as well as from that of a reader of the form once it has been published on the HKEX Web site, as they will provide greater clarity on the nature of the event. Previously, a lack of specific codes, when combined with some general non-specific codes for all other events, sometimes left the reader with an opaque picture as to the nature of the event that had been disclosed.

No Filing with Listco

It will no longer be necessary (or possible) to make a filing of the disclosure with the listed company (*i.e.*, in parallel the filing made with the HKEX) in which the interest is held. Instead, the HKSE will notify the listed company that there has been a filing and it will be able to access the filing through its own account.

No other changes were made to the disclosure of interests regime.

Latin America Regulatory Updates

Introduction to the Legal Framework of Brazilian Funds

Brazilian fund administrators, portfolio managers, investment funds (both closed-ended and open-ended funds) and distributors of funds are regulated by, and subject to registration with, the Brazilian Securities and Exchange Commission, the *Comissão de Valores Mobiliários (CVM)*.

Under Brazilian law, Brazilian investment funds are considered as a pool of assets incorporated under the form of a condominium. A condominium is a type of unincorporated entity, meaning the fund itself does not constitute a legal entity nor does it have an existence separate from that of the investors who hold interests in it. The participation of each investor in a fund is evidenced by "quotas," which ultimately represent the percentage each investor holds in the pool of assets. In addition to economic rights, holders of quotas also have voting rights (pursuant to the rules set forth in the bylaws of the fund), with the general principle being one quota, one vote. Unlike other jurisdictions, in the normal course of business investors in a Brazilian fund are always responsible for the fund's liabilities, including capital deficiencies.

Every fund must have an administrator who is responsible for the back office functions of the fund. The administrator may or may not also be responsible for portfolio management activities. It is rather common to outsource portfolio management to a separate entity, namely, the portfolio manager.

Brazilian funds also may have investment committees comprised of quota holders. It is worth noting that despite the existence of an investment committee, the ultimate investment or divestment decision on any specific asset is incumbent on the administrator or the investors in the fund.

Regardless of whether or not a fund has a portfolio manager or an investment committee, a Brazilian fund is always represented by its administrator when entering into any transaction or performing any act.

Absent gross mismanagement or fraud perpetrated by the fund administrator or portfolio manager, among other similar circumstances, neither the fund administrator nor the portfolio manager will be held liable for the losses and liabilities of the fund.

During the life of a fund, fund assets are kept inside the pool and are managed by the administrator as if they were owned by a distinct entity rather than by the investors. The frequency of distributions of profits of a Brazilian fund will depend on the rules established in its bylaws.

New Regulatory Framework for Brazilian Funds

Beginning in 2014, the CVM introduced a number of changes to the regulatory framework of Brazilian funds with a view to, among other things, bring it closer in line with international standards of marketing and distribution, corporate governance and valuation and accounting of assets.

On December 17, 2014, the CVM enacted:

- CVM Instruction no. 554 (**Instruction 554**), which amended the Brazilian definition of “accredited investor” and created a new category of investor, the so-called “professional investor”; and
- CVM Instruction no. 555 (**Instruction 555**), which replaced, in its entirety, the regulatory framework of investment funds contained in CVM Instruction no. 409.

On August 30, 2016, the CVM enacted:

- CVM Instruction no. 578 (Instruction 578), which replaced the regulatory framework for private equity investment funds – Fundos de Investimento em Participações (FIPs), revoked CVM Instructions 209, 391, 406 and 460 and consolidated the rules governing the various types of FIPs; and
- CVM Instruction no. 579 (Instruction 579), which established a new accounting standard for the valuation of FIP assets and the preparation of financial statements.

Below is an overview of the most relevant provisions of Instructions 554, 555, 578 and 579:

Professional Investor. Instruction 554, which came into effect on July 1, 2015, (i) created the new “professional investor” classification (which is conceptually similar to the U.S. definition of “qualified institutional buyers” in Rule 144A under the Securities Act) and (ii) amended the definition of “accredited investors.” Under Instruction 554, all non-Brazilian investors are deemed to be professional investors and all professional investors are accredited investors. Professional investors, however, are permitted to invest in more complex and higher-risk investments than accredited investors.

Investment Funds Regulatory Framework. Instruction 555 sought to update and modernize the regulatory framework of Brazilian investment funds. Specifically, Instruction 555 amended (i) fee regulations, (ii) fund classifications, and (iii) the rules on overseas investments to permit Brazilian investment funds to increase their allocation of offshore investments. Under Instruction 555, the concentration limits for investments in non-Brazilian assets were increased as follows:

- Retail funds: Increased from 10% to 20%;
- Investment funds offered to accredited investors: Increased from 20% to 40% in most cases; and
- Investment funds offered exclusively to professional investors have no limits for investing abroad.

Private Equity Investment Funds: FIPs. Instruction 578 introduced several changes to the regulatory framework of FIPs, which are one of the most commonly used vehicles by non-Brazilian investors for

investments in Brazil. Instruction 578 consolidated the different types of FIPs and created the following new categories of FIPs based on the composition of a FIP's portfolios:

- **FIP – Seed Capital.** FIPs focused on investing in corporations or Brazilian LLCs (the so-called *limitadas*, the most common type of corporate entity in Brazil) with annual gross revenues of up to R\$16 million. These FIPs cannot be controlled directly or indirectly by a group with assets over R\$80 million, or annual gross revenues in excess of R\$100 million, in the fiscal year preceding the fund's first capital contribution. In the event a target company is not considered an investment entity under Instruction 578, the target company's financial statements must be audited by an independent accountant registered with the CVM.
- **FIP – Emerging Companies.** FIPs focused on investing in corporations or LLCs with annual gross revenues of up to R\$300 million cannot be controlled directly or indirectly by a group with assets over R\$240 million, or annual gross revenues in excess of R\$300 million, earned in the fiscal year preceding the fund's first capital contribution.
- **FIP – Infrastructure and Intensive Economic Production in Research, Development and Innovation.** FIPs that must keep their net equity invested in bonds, warrants, equity, debentures (convertible or not) and other securities issued by corporations pursuant to terms and conditions set forth in Instruction 578, or companies that invest in new infrastructure projects or intensive economic production regarding research, development and innovation in Brazil in the energy, transport, water and basic sanitation, irrigation and other sectors deemed as priorities by the Federal Executive Branch.
- **FIP – Multi-Strategy.** FIPs that do not fit into the other categories and that may invest in companies from several different industries at different development stages. Multi-Strategy FIPs dedicated only to professional investors can invest up to 100% of their net equity in overseas private equity assets, subject to the following conditions: (i) investing abroad is expressly permitted under the bylaws of the fund; (ii) such bylaws expressly indicate the percentage of fund investments permitted abroad; (iii) the bylaws expressly permit only professional investors; and (iv) the name of the fund contains the term "Offshore Investment."

Instruction 578 also introduced the following changes:

- **Investments.** FIPs are now permitted to have nonconvertible debentures (up to 33% of the subscribed capital of the fund), securities and bonds representing equity in LLCs, as part of their portfolios. The invested companies are exempted from several governance requirements under Instruction 578. In the event that these requirements are not met, the company will have a two-year window to meet all governance requirements under Instruction 578.
- FIPs must maintain at least 90% of their net worth invested in eligible assets. FIPs can invest in quotas of other FIPs and equity funds to comply with the minimum 90% threshold.
- FIPs are permitted to invest up to 20% of their subscribed capital in overseas private equity assets, and Multi-Strategy FIPs dedicated only to professional investors can invest up to 100% of their subscribed capital in overseas private equity assets, subject to the conditions discussed above.
- **Borrowing and Loans.** FIPs may obtain financial support from development agencies (borrowings and loans) in an aggregate amount not to exceed 30% of the respective FIP's assets. Such borrowing can be used as a substitute for subscribed for but unpaid quotas by quota holders.
- **Governance.** FIPs are permitted to grant Advances for Future Capital Increase – *Adiantamentos para Futuro Aumento de Capital (AFAC)* to corporations, provided, among other conditions, that the relevant FIP holds an equity interest in the invested company and AFACs are expressly permitted under the bylaws of the fund.

- An FIP is not required to participate in the decision-making process of the invested companies when the amount invested in such company (i) has been reduced to less than 50% of the percentage originally invested, and (ii) represents less than 15% of the invested company's capital. The CVM's intention was to make it unnecessary for FIPs to participate in the decision-making process when divesting.
- **Rights of Quotas.** FIPs are permitted to issue different classes of quotas with varying economic rights, including differing management and performance fees and order of preference in the payment of distributions to investors. FIPs offered only to professional investors have even further flexibility in establishing different rights to different classes of quotas.
- **Quorums/Votes.** Quota holders, the Brazilian equivalent of fund shareholders, must now exercise the right to vote. In the event quota holders default on their obligation to pay their subscribed quotas, the defaulting quota holders will lose their right to vote with respect to their respective subscribed for but unpaid quotas. Bylaws may impose additional penalties, such as impeding the right to vote with respect to quotas paid in and held by the defaulting quota holder. An FIP may establish in its bylaws that certain matters, other than those set forth in Instruction 578, will be subject to a qualified voting quorum.
- **Committees/Boards and Management.** Quota holders' meetings resolutions do not exempt the administrator and/or manager from their duties in respect of the FIP's operations. It is worth noting that the manager's obligations regarding the procurement of services related to investment or divestment, as well as its influence on the pricing of the FIP's investments have become more stringent.

Under Instruction 578, fund managers and administrators are no longer jointly liable for their obligations to the fund and investors. Nevertheless, it is still unclear if and to what extent this new rule will be applied by Brazilian courts since, in addition to CVM rules, such liability has been applied by courts based on Brazilian consumer protection laws.

The compensation of members of boards and committees of FIPs may not be paid directly by the FIP, but a portion of the administration fee may be allocated to such payment.

Instruction 578 also sets forth the specific duties of portfolio managers, and make it clear they are authorized to (i) negotiate and acquire assets on behalf of the fund; (ii) negotiate and hire, on behalf of the FIP, third parties for advisory and consulting services; and (iii) monitor the assets invested by the FIP and exercise voting rights arising from these assets.

Instruction 578 established a 12-month period from August 30, 2016 for current FIPs to comply with the new rules.

Accounting. Instruction 579 details the accounting criteria for recognition, classification and measurement of assets and liabilities of FIPs, as well as the criteria for revenue recognition, appropriation of expenses and disclosure of information in financial statements. In general, FIPs must use the same accounting criteria for recognition, classification and measurement of assets and liabilities and recognition of revenues and expenses applicable to Brazilian listed companies. Moreover, in order to make accounting principles more consistent with internal standards, FIPs qualified as investment entities are required to mark their portfolio assets according to their fair value. In the event of a material change in the fair value of their invested companies during a fiscal year, FIPs must (i) report such change to their investors and (ii) submit to both their investors and the CVM an audited financial statement.

Brazilian Tax Authorities Increased Scrutiny over FIP Ownership Structures

Pursuant to Brazilian law number 11,312, of June 27, 2006 and regulations thereunder (**Law 11,312**), dividends and capital gains distributed by FIPs to international investors upon the amortization, redemption or liquidation of an FIP are subject to a zero percent Brazilian income tax rate (**Beneficial Tax Rate**), provided that, among other requirements, no non-Brazilian investor holds more than 40% of the relevant FIP.

Pursuant to Law 11,312 and other Brazilian laws and regulations, the administrator of an FIP is also responsible for the withholding and payment of Brazilian income tax on distributions made to investors of the FIP, and, as such, an administrator may be held liable by Brazilian tax authorities for any failure to withhold and pay income tax in respect of distributions by the FIP at the applicable Brazilian tax rate, including in the event of (i) a failure of, or delay by, investors in the provision of information and documents required by such authorities in respect of the application of the Beneficial Tax Rate, and (ii) irrespectively of the investors' timely provision of such information and documents, such authorities' determination that they do not support the application of the Beneficial Tax Rate.

Due to certain local developments, the Brazilian Revenues Services (the Brazilian equivalent to the U.S. IRS) have recently required certain Brazilian administrators of FIPs to disclose the entire ownership structure of certain FIPs, all the way to the ultimate beneficial owner in the investment chain. For corporate and commercial reasons, Brazilian administrators are facing difficulties to comply with such requirement. It remains to be seen how the local fund industry will adjust and respond to this increased scrutiny over the ownership structure of FIPs.

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. Further, the adviser should consider whether revising the offering documents will necessitate an amendment to regular filings (e.g., Form ADV) and/or require notice to (either before or after the revisions) any party pursuant to a side letter or other agreement.

Compliance Policies and Procedures Review and Employee Training

The Advisers Act requires registered 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 and/or any mock 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, cyber security 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, 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.¹⁴ 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. On June 1, 2016, the SEC settled an action with a private equity fund adviser which one of the agency's Assistant Regional Directors described as "the first case of a private-equity adviser violating section 15(a) of the [Exchange Act] for acting as a broker and failing to register as a broker." 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 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); 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

¹⁴ If a disqualifying event is discovered, an investment adviser that is required to file Form ADV may be required to amend its Form ADV.

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.

Business Continuity and Disaster Recovery Plans

Under the Advisers Act, the SEC has stated that an investment adviser's fiduciary obligation includes taking 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. On June 28, 2016, the SEC proposed a new rule that would require registered investment advisers to adopt and implement written business continuity and transition plans reasonably designed to address operational and other risks related to a significant disruption in their operations. The rule proposal is sufficiently detailed with respect to SEC staff's expectations for the content and coverage of investment advisers' business continuity and transition plans. Accordingly, investment advisers would be well served by comparing their current business continuity and transition plans to the SEC's rule proposal and updating them as necessary.

Investment advisers should periodically test their technology and computer systems to make sure that they are up to date on the best means to detect and protect against a cyber attack. This could include internal reviews, hiring third parties to review systems, simulating cyber attacks and/or retaining other professionals to do a tabletop cyber attack exercise.

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 that 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. On August 25, 2015, FinCEN had also proposed AML rules which would be applicable to registered investment advisers and enforced by the SEC through its examination program. The comment period on the proposed rule ended in November 2015. On March 8, 2017, FinCEN indicated that the agency still plans to move forward with the proposal.

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

On August 25, 2016, the SEC announced the adoption of numerous substantive and technical amendments to Form ADV, Part 1A. Several of the amendments will affect how investment advisers to private investment funds file initial and annual updating amendment reports with the SEC on Form ADV. Advisers were required to begin complying with the amendments on October 1, 2017.

Umbrella Registration for Multiple Related Advisers

The changes adopted amended Form ADV to accommodate the registration of private fund advisers operating a single advisory business through multiple legal entities via the filing of a single Form ADV.

The new amendments set forth the following conditions under which a private fund adviser (**filing adviser**) can file a single Form ADV on behalf of itself and other advisers that are controlled by, or under common control with, the filing adviser (each, a **relying adviser**), provided that they together conduct a single advisory business (collectively, an **umbrella registration**):

- The filing adviser and each relying adviser advise only (i) private funds, and (ii) separately managed accounts that (a) are beneficially owned by qualified clients (as defined in Rule 205-3 under the Advisers Act), (b) are otherwise eligible to invest in the private funds advised by the filing adviser or a relying adviser, and (c) pursue investment objectives and strategies that are substantially similar or otherwise related to those private funds;
- The filing adviser has its principal office and place of business in the U.S. and, therefore, all of the substantive provisions of the Advisers Act and the rules thereunder apply to the filing adviser's and each relying adviser's dealings with each of its clients, regardless of whether any client or the filing adviser or relying adviser providing the advice is a United States person;
- Each relying adviser, its employees and the persons acting on its behalf, are subject to the filing adviser's supervision and control and, therefore, they are all "persons associated with" the filing adviser (as defined in Section 202(a)(17) of the Advisers Act);
- The advisory activities of each relying adviser are subject to the Advisers Act and the rules thereunder, and each relying adviser is subject to examination by the SEC; and
- The filing adviser and each relying adviser operate under a single code of ethics and a single set of written policies and procedures that are administered by a single chief compliance officer.

For purposes of umbrella registration, the SEC stated that it would consider the following factors as indicia of multiple legal entities conducting a single advisory business:

- A commonality of advisory services and clients;
- A consistent application of the Advisers Act and the rules thereunder to all advisers in the business; and
- A unified compliance program.

To accommodate umbrella registration, several additional modifications were made to Form ADV:

- The Glossary in the Instructions to Form ADV was amended to include definitions of the terms: (i) "filing adviser"; (ii) "relying adviser"; and (iii) "umbrella registration." As defined, a "relying adviser" itself must be eligible to register with the SEC.
- Form ADV was amended to include a new Schedule R, which requires each relying adviser to disclose: (i) its basic identifying information; (ii) its basis for SEC registration; (iii) its form of organization; and (iv) its control persons.
- A new question was added to Schedule D that requires advisers to identify the filing advisers and relying advisers that manage or sponsor private funds reported on Form ADV.

The SEC also clarified that it was not expanding the concept of umbrella registration to include multiple exempt reporting advisers. However, the SEC noted that the previous views of SEC staff, which permitted certain exempt reporting advisers to file a single Form ADV on behalf of multiple special purpose entities, would not be withdrawn as a result of the new amendments to Form ADV.

Additional Reporting Requirements for Separately Managed Accounts

The new amendments also require investment advisers to report certain aggregated information about their separately managed accounts (**SMAs**) (*i.e.*, advisory accounts that are not pooled investment vehicles). These additional reporting requirements include:

- New Section 5.K.(1) of Schedule D will require advisers to report the approximate percentage of SMA regulatory assets under management that are invested in twelve broad asset categories. Advisers to \$10 billion or more in SMA regulatory assets under management will have to annually report both mid-year and end-of-year percentages. Advisers should not look through investments in pooled investment vehicles for purposes of reporting the underlying asset type.
- New Section 5.K.(2) of Schedule D will require advisers with at least \$500 million, but less than \$10 billion, in SMA regulatory assets under management to report under Section 5.K.(2)(b) the amount of SMA regulatory assets under management and the dollar amount of borrowings attributable to those assets that correspond to three levels of gross notional exposures. Advisers with at least \$10 billion in SMA regulatory assets under management will also be required to report under Section 5.K.(2)(a) the derivative exposure across six derivatives categories. Advisers may limit their reporting for both (a) and (b) to individual accounts of at least \$10 million.
- New Section 5.K.(3) of Schedule D will require advisers to identify any custodians that maintain at least 10% of SMA regulatory assets under management, and report the amount of the adviser's regulatory assets under management attributable to SMAs held by each of the custodians.

In addition, the SEC clarified that a sub-adviser to an SMA should provide information only about the portion of the account that it sub-advises. Moreover, the SEC clarified that advisers with a principal office and place of business outside the U.S. are required to report information regarding SMAs for all of their clients, including clients who are not United States persons.

Additional Information Regarding Investment Advisers

Investment advisers will also be required to provide additional disclosure about themselves, including the following:

- **Social Media Platforms.** Form ADV Item 1.I. will require an adviser to disclose whether it has one or more accounts on social media platforms (e.g., Twitter, Facebook or LinkedIn), and the address of such social media pages (in addition to the address of the adviser's Web site(s)). An adviser is only required to disclose accounts on publicly available social media platforms over which the adviser controls the content. Social media accounts of an adviser's employees and social media accounts used solely to promote the business of an adviser's affiliate or affiliates that are not themselves advisers registered with the SEC are excluded from the disclosure requirement.
- **Offices.** Advisers will be required to (i) report the total number of offices at which they conduct investment advisory business, (ii) identify the adviser's 25 largest offices in terms of number of employees, (iii) report the number of employees who perform advisory functions from each office, (iv) identify from a list of securities-related activities the business activities conducted from each office, and (v) provide a description of any other investment-related business conducted from each office.
- **Compensation of CCO.** Form ADV, Item 1.J. will require an adviser to report whether its chief compliance officer is compensated or employed by any person or entity other than the adviser

(excluding certain related persons of the adviser and investment companies registered under the ICA, advised by the adviser) for providing chief compliance officer services to the adviser and, if so, to report the name and IRS Employer Identification Number (if any) of that other person or entity.

- **Assets.** In connection with the SEC's proposed rules concerning incentive compensation discussed below, Form ADV Item 1.O will require advisers with assets of \$1 billion or more (that is, their own assets and not assets they manage for others) to report their assets within three ranges: (i) \$1 billion to less than \$10 billion; (ii) \$10 billion to less than \$50 billion; and (iii) \$50 billion or more.
- **Clients.** Form ADV, Item 5 will require an adviser to report: (i) the number of clients for whom the adviser provides advisory services; (ii) the amount of regulatory assets under management attributable to each category of clients; (iii) the number of clients for whom the adviser provides advisory services, but does not have regulatory assets under management; (iv) whether the adviser reports client assets in Part 2A of Form ADV differently from the regulatory assets under management reported in Part 1A of Form ADV; and (v) the approximate amount of an adviser's total regulatory assets under management that is attributable to clients that are non-United States persons.
- **Audit Firm.** Form ADV, Item 7 will require an adviser relying on the annual audit or annual surprise examination for compliance with the Custody Rule to report the auditing firm's PCAOB assigned number (if applicable). However, an auditing firm performing a surprise examination will not be required to be registered with the PCAOB, unless the adviser or its related person is serving as qualified custodian.
- **Qualified Client Status.** Section 7.B.(1) of Form ADV, Schedule D will require an adviser to a private fund that qualifies for the exclusion from the definition of investment company under section 3(c)(1) of the ICA to report whether it limits sales of the fund to "qualified clients" (as defined in Rule 205-3 under the Advisers Act). Advisers will not be required to recertify the qualified client status of their investors annually. In addition, advisers that are not registered with the SEC (e.g., exempt reporting advisers) will not be required to determine whether the fund's investors are qualified clients and may therefore simply respond "No" to the question.

Clarifying and Technical Amendments to Form ADV

Several technical amendments of note to private fund advisers were made to Form ADV, including the following:

- Section 7.B.(1) of Schedule D requires advisers to provide information about the private funds they manage. Item 7.B was amended to clarify that Section 7.B.(1) of Schedule D should not be completed if another SEC-registered adviser or SEC-exempt reporting adviser reports the same information.
- Text from Question 10 of Section 7.B.(1) of Schedule D that directs advisers to refer to the underlying funds of a fund-of-funds when selecting the type of fund (e.g., hedge fund, private equity fund, venture capital fund, etc.) will be removed.
- Question 19 of Section 7.B.(1) of Schedule D was amended to make it clear that an adviser should not consider feeder funds as clients of the adviser to a private fund when answering whether the adviser's clients are solicited to invest in the private fund.
- Question 21 of Section 7.B.(1) of Schedule D was amended to ask if the private fund has ever relied on an exemption from registration of its securities under Regulation D, in order to better reflect the intention of the question.
- Question 23.(g) of Section 7.B.(1) of Schedule D currently asks whether the private fund's audited financial statements are distributed to the private fund's investors. The question as revised will now add "for the most recently completed fiscal year" to clarify the question.

- Question 23.(h) of Section 7.B.(1) of Schedule D currently asks whether the report prepared by an auditing firm auditing a private fund contains an unqualified opinion. The question as revised will now ask whether all of the reports prepared by the auditing firm since the date of the adviser's last annual updating amendment contain unqualified opinions.
- Item 8.H. of Part 1A of Form ADV currently asks whether the adviser or any related person of the adviser, directly or indirectly, compensates any person for client referrals. This item is addressing advisory clients and not investors in private funds. Item 8.H. was revised to divide the question into two parts. Revised Item 8.H.(1) covers compensation to persons other than an adviser's employees for client referrals. Revised Item 8.H.(2) covers compensation to employees, in addition to employees' regular salaries, for obtaining clients for the adviser.
- Item 8.I. currently asks whether the adviser or any related person of the adviser, directly or indirectly, receives compensation from any person other than the adviser or related person of the adviser for client referrals. Item 8.I. was amended to clarify that advisers should not include the regular salary that the adviser pays to an employee in responding to this item.
- In coordination with revisions to Item 7 and Section 7.B.(1) of Schedule D discussed above, Section 9.C. of Schedule D, which asks an adviser to identify any independent public accountant engaged to perform a surprise examination or perform an audit of a pooled investment vehicle managed by the adviser, was amended in two respects. First, an adviser will now be required to provide the PCAOB-assigned number of the adviser's independent public accountant. Second, Section 9.C.(6) will now ask whether all reports prepared by the independent public accountant since the date of the last annual updating amendment have contained unqualified opinions.

Amendments to Performance Reporting Record-Keeping Rules

Rule 204-2(a)(16) under the Advisers Act currently requires registered advisers to maintain records supporting performance claims in communications that are distributed or circulated to ten or more persons. Rule 204-2(a)(16) was amended by removing the ten or more persons condition and replacing it with "any person." Accordingly, under the amended rule, registered advisers will be required to maintain all materials listed under Rule 204-2(a)(16) that demonstrate the calculation of the performance or rate of return in any communication circulated or distributed by the adviser, directly or indirectly, to any person.

The SEC also adopted amendments to Rule 204-2(a)(7) under the Advisers Act, which currently requires registered advisers to maintain certain categories of written communications received and copies of written communications sent by such advisers. Rule 204-2(a)(7) was amended to require advisers to maintain originals of all such communications relating to the performance or rate of return of any or all managed accounts or securities recommendations.

Compliance Dates

Any adviser filing an initial Form ADV or an amendment to an existing Form ADV on or after October 1, 2017 is required to provide responses to the form revisions. Accordingly, most advisers will be utilizing the revised Form ADV in connection with their 2018 annual updating amendments due on March 31, 2018 (for an adviser employing a calendar fiscal year). The SEC's amendments to Rule 204-2 under the Advisers Act apply to communications circulated or distributed after October 1, 2017. Accordingly, investment advisers that distribute communications after October 1, 2017 that contain performance information in respect of the period prior to October 1, 2017 are required to maintain the records required by amended Rule 204-2 supporting the prior performance claims.

Please see our [May 22, 2015](#) and [August 31, 2016](#) client alerts for more information.

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 **April 2, 2018** 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 30, 2018** 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 annual amendment to 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 U.S., if the RAUM attributable to private fund assets managed at a place of business in the U.S. 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 30, 2018** 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 March 1, 2018 for the quarter ending December 31, 2017).
- **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 30, 2018 for investment advisers with a December 31 fiscal year-end).
- **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 16, 2018 for the quarter ending December 31, 2017).

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 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 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 2017, the first Form 13F filing deadline in 2018 will be **February 14, 2018** (for the quarter ending December 31, 2017).

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 14, 2018 for 2017). 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 14, 2018** for 2017).

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 2017 amendments will be **February 14, 2018**.

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 14, 2018** 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 14, 2018** for 2017). Amendments to Form 13H must be filed promptly following the end of a calendar quarter if any information on the Form 13H becomes inaccurate. For example, the addition or removal of brokers would need to be reported at the end of a calendar quarter.

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 via the NFA’s Electronic Exemption System within 60 days of calendar year-end (by **March 1, 2018** for 2017).

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 **April 2, 2018**, 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 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.

The NFA has imposed a \$200 late fee for each business day the NFA Form PQR is filed after the due date. The late fee is effective for all NFA Forms PQR required under NFA Compliance Rule 2-46, beginning with reports dated September 30, 2016 and later.

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	CFTC Form CPO-PQR	CFTC Form CPO-PQR	CFTC Form CPO-PQR	CFTC Form CPO-PQR

Filing Requirements				
CPO Size	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
(CPO with AUM of at least \$1.5 billion)	Schedules A, B and C (within 60 days of quarter-end)	Schedules A, B and C (within 60 days of quarter-end)	Schedules A, B and C (within 60 days of quarter-end)	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, 2017 will be **March 1, 2018** for Large CPOs and **April 2, 2018** 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, 2017 will be **February 14, 2018**. The NFA has imposed a \$200 late fee for each business day the NFA Form PR is filed after the due date. The late fee is effective for all NFA Forms PR required under NFA Compliance Rule 2-46, beginning with reports dated September 30, 2016 and later.

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. 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 exceed 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 be 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 and 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. 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., a 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.

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 (e.g., by **January 23, 2018** for December 2017). 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

BE-13 collects data on new foreign direct investment in the U.S. from U.S. persons that meet the reporting requirements, even if such U.S. person has not been contacted by the BEA.

A U.S. entity is required to make a BE-13A 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-13A if the cost of acquiring or establishing such interest exceeds \$3 million. However, U.S. private funds will not have to report on BE-13 unless a foreign person acquires 10% or more of the voting interests in an operating company indirectly through the U.S. private fund.

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. The BE-13 forms are due no later than 45 calendar days after an acquisition is completed, a new U.S. business enterprise is established or the expansion is begun.

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.

Section 83(b) Elections. For 2015 and earlier, if an individual filed a Section 83(b) election with the IRS during a given year, that individual was required to attach a copy of the filed election to his or her U.S. federal income tax return for such year. However, as of 2016, this requirement no longer applies.

Form 8832 Filings. If an entity filed an IRS Form 8832 (an entity classification election) with respect to 2017, 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 2017 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 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 2017 will be the due date (including any applicable extensions) of that U.S. person's 2017 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 2017 (and subsequent years), the deadline will be the due date (including any applicable extensions) of the private fund's 2017 U.S. federal income tax return.

FATCA Reporting. “Foreign financial institutions” (FFIs) located in jurisdictions without intergovernmental agreements (IGAs) or in “Model 2” IGA jurisdictions must satisfy reporting requirements with respect to their accounts for 2016 by filing IRS Form 8966 by March 31, 2018. FFIs located in “Model 1” IGA jurisdictions, such as the Cayman Islands, should consult with their local advisors regarding applicable reporting deadlines.

CbCR Reporting. A U.S. tax resident parent entity of a MNE that has revenues of \$850 million or more during the taxable year must file IRS Form 8975 by the due date (including any applicable extensions) of its 2017 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);
- 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 2017 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.

Under proposed regulations released in March 2016 (the **FBAR Proposed Regulations**), officers, employees, and agents of U.S. entities who previously had an FBAR filing obligation as a result of having signatory or other authority over, but no financial interest in, a non-U.S. financial account, are relieved of their own requirement to file an FBAR with respect to that account, provided that U.S. entity or any U.S. entity "within the same corporate or business structure" is required to report the non-U.S. financial account on an FBAR. While this will relieve certain individuals of their FBAR filing responsibility, it is important to note that such individuals are only relieved of that responsibility if the requirement highlighted in the prior sentence is satisfied. This is different from past FinCEN guidance and from guidance provided in Notice 2016-1 (the **FBAR Notice**), issued on December 16, 2016. Under the FBAR Notice, the FBAR filing requirement (extended to **April 15, 2018** in the FBAR Notice) applies to a narrower set of individuals than under the Proposed FBAR Regulations. The FBAR Notice extension applies both to certain individuals with signature or other authority over (but no financial interest in) employer-owned foreign financial accounts during the 2016 calendar year and to individuals for whom the FBAR reporting deadline was extended under prior notices.

Thus, while the scope of individuals relieved of filing an FBAR under the FBAR Proposed Regulations generally is broader than those relieved of such obligation under current guidelines, the fact that this exception will only apply if another U.S. filer is filing an FBAR with respect to the relevant non-U.S. account narrows the exception such that employees of registered investment advisers with signatory or other authority over, but no financial interest in, a non-U.S. account could have to file an FBAR if the FBAR Proposed Regulations are finalized in their current form.

In addition, employers are required to maintain information identifying all officers, employees or agents with signature or other authority over, but no financial interest in, foreign financial accounts. Such records must be maintained for five years and made available to FinCEN or law enforcement on request. The FBAR Proposed Regulations would also remove a special rule allowing simplified reporting for persons with financial interest in, or signature or other authority over, 25 or more accounts.

Under the FBAR Proposed Regulations, FBARs for calendar years 2016 and onward must be filed by the April 15 following the close of the calendar year, using the E-Filing System maintained by FinCEN. Filers must first register on the FinCEN site, so it is advisable to register well in advance of the April 15 filing deadline. The FBAR Proposed Regulations also provide taxpayers the ability to request and be granted an extension for filing until October 15 of the following calendar year. While these proposed regulations generally are not effective until final, the new due date of April 15 has been enacted for 2016 onwards pursuant to a short-term highway funding measure that included certain procedural tax matters (P.L. 114-41).

Please see our [March 10, 2016](#) and [January 5, 2017](#) client alerts for more information.

Other Annual Requirements and Considerations

Audited Financial Statements Delivery

- The 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 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 30, 2018, if the fiscal year ends on December 31); or
 - Within 180 days of the private fund's fiscal year-end, if the private fund is a fund-of-funds (by June 29, 2018, 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. Currently, only auditors to public companies are subject to regular inspection by the PCAOB. However, on October 4, 2016, the staff of the SEC's Investment Adviser Regulation Office in the Division of Investment Management issued a [no-action letter](#) which affirmed continuing relief that the SEC would not recommend enforcement action against an investment adviser engaging an auditor that is not subject to inspection by the PCAOB to audit the financial statements of a pooled investment vehicle in connection with the annual audit provision, on the condition that such auditor was (i) registered with the PCAOB, and (ii) engaged to audit the financial statements of a broker or a dealer as of the commencement of the professional engagement period and as of each calendar-year end. This relief was extended by the SEC through the earlier of (i) the date the SEC would approve a PCAOB-adopted permanent program for the inspection of broker and dealer auditors, or (ii) December 31, 2019.

Privacy Policy Delivery

On December 4, 2015, President Obama signed the Fixing America's Surface Transportation Act (**FAST Act**). Hidden among provisions authorizing funding for roads and bridges were provisions intended to simplify rules applicable to financial institutions. One such provision under the Fast Act, Title LXXV—Eliminate Privacy Notice Confusion, amends the existing law that requires financial institutions (including investment advisers) to distribute annual privacy notices to their natural person customers.

Under the new law, financial institutions will no longer be required to deliver annual privacy notices to clients (including fund investors) who are natural persons, if (i) the financial institution's privacy policy has not changed and (ii) the financial institution does not share nonpublic personal information with non-affiliated third parties (except as permitted under certain exceptions, e.g., to service providers who perform services on behalf of the financial institution). Annual privacy notices will only be required if a financial institution's privacy policies and practices have changed since the last distribution of a privacy notice.

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 financial institution must deliver an updated notice to clients and provide them a reasonable opportunity to opt out of the new disclosure.

Please see our [January 25, 2016](#) client alert for more information.

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.

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.” Any party contemplating retention of a placement agent or any solicitation of CalSTRS, CalPERS or the University of California pension system can contact a member of their 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.

2018 Federal Filings and Other Document Delivery Calendar

<u>Filing / Delivery</u>	<u>Who must file</u>	<u>Deadline</u>
<u>November 2017</u>		
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, 2017)
NFA Form PR	Registered CTAs	November 14 (for the quarter ending September 30, 2017)
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 2017)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding \$350 million as of any month	November 15 (for October 2017)
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 24 (for October 2017)
Form PF	Large Hedge Fund Advisers	November 29 (for the quarter ending September 30, 2017)
CFTC Form CPO-PQR	Large CPOs	November 29 (for the quarter ending September 30, 2017)
NFA Form CPO-PQR	All registered CPOs, except Large CPOs	November 29 (for the quarter ending September 30, 2017)
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 2017)
<u>December 2017</u>		
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 2017)

<u>Filing / Delivery</u>	<u>Who must file</u>	<u>Deadline</u>
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding \$350 million as of any month	December 15 (for November 2017)
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 26 (for November 2017)
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 2017)
January 2018		
Form PF	Large Liquidity Fund Advisers	January 16 (for the quarter ending December 31, 2017)
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 16 (for December 2017)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding \$350 million as of any month	January 16 (for December 2017)
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 22 (for the quarter ending December 31, 2017)
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 23 (for December 2017)
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	January 30 (for the quarter ending December 31, 2017)
Delivery of Monthly Account	Registered CPOs (except for CPOs	January 30 (for December

<u>Filing / Delivery</u>	<u>Who must file</u>	<u>Deadline</u>
Statements to Pool Participants	exempt under CFTC Reg. 4.7 or with respect to commodity pools with NAV below \$500,000)	2017)
<u>February 2018</u>		
Form 13F	Investment advisers that exercise investment discretion over \$100 million or more in Section 13(f) securities	February 14 (for the quarter ending December 31, 2017)
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>i.e.</i> , Qualified Institutional Investors and/or passive investors)	February 14 (for 2017)
Form 13H Annual Amendment	Large traders of Regulation NMS securities	February 14 (for 2017)
Form 5	Insiders required to report any exempt or other insider transactions not previously reported on Form 4	February 14 (if the issuer has a December 31 fiscal year-end)
CFTC Form CTA-PR	Registered CTAs	February 14 (for the quarter ending December 31, 2017)
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 15 (for January 2018)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding \$350 million as of any month	February 15 (for January 2018)
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 2018)
<u>March 2018</u>		
Form PF	Large Hedge Fund Advisers	March 1 (for the quarter ending December 31, 2017)
CFTC Form CPO-PQR	Large CPOs	March 1 (for the quarter ending December 31, 2017)

<u>Filing / Delivery</u>	<u>Who must file</u>	<u>Deadline</u>
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)	March 1 (for 2017)
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 2 (for January 2018)
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 2018)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding \$350 million as of any month	March 15 (for February 2018)
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 2018)
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 2018)
CRS Information Reports	Financial institutions in "Participating Jurisdictions" (which currently do not include the US)	Consult local advisers
FATCA Information Report	Participating FFIs (except for FFIs in Model 1 IGA jurisdictions) FFIs in Model 1 IGA jurisdictions	March 31 Consult local advisers
April 2018		
Form ADV Part 1 Annual Update	Registered investment advisers and exempt reporting advisers	April 2 (for an investment adviser with a December 31 fiscal year-end)
Form ADV Part 2A Annual Update	Registered investment advisers	April 2 (for an investment adviser with a December 31 fiscal year-end)

<u>Filing / Delivery</u>	<u>Who must file</u>	<u>Deadline</u>
CFTC Form CPO-PQR	All registered CPOs, except Large CPOs	April 2 (for 2017)
NFA Form CPO-PQR	Small CPOs	April 2 (for the quarter ending December 31, 2017)
NFA Commodity Pool Annual Financial Statements Filing	Registered CPOs	April 2 (for a pool with a December 31 fiscal year-end)
FBAR	Hedge funds and private equity funds, and their investment advisers, if they have non-U.S. bank or other financial accounts	April 15 (with a six-month extension available upon request)
Form PF	Large Liquidity Fund Advisers	April 16 (for the quarter ending March 31, 2018)
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 16 (for March 2018)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding \$350 million as of any month	April 16 (for March 2018)
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, 2018)
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 23 (for March 2018)
Delivery of Updated Form ADV Part 2A to Clients	Registered investment advisers	April 30 (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 30 (for private fund with a December 31 fiscal year-end)

<u>Filing / Delivery</u>	<u>Who must file</u>	<u>Deadline</u>
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	April 30 (for the quarter ending March 31, 2018)
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)	April 30 (for March 2018)
Form PF	Registered investment advisers with at least \$150 million in RAUM attributable to private funds, including Large Private Equity Fund Advisers	April 30 (for an investment adviser with a December 31 fiscal year-end)
<u>May 2018</u>		
Form 13F	Investment advisers that exercise investment discretion over \$100 million or more in Section 13(f) securities	May 15 (for the quarter ending March 31, 2018)
NFA Form PR	All registered CTAs	May 15 (for the quarter ending March 31, 2018)
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 15 (for April 2018)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding \$350 million as of any month	May 15 (for April 2018)
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 2018)
Form PF	Large Hedge Fund Advisers	May 30 (for the quarter ending March 31, 2018)
CFTC Form CPO-PQR	Large CPOs	May 30 (for the quarter ending March 31, 2018)
NFA Form CPO-PQR	All registered CPOs, except Large CPOs	May 30 (for the quarter ending March 31, 2018)
Delivery of Monthly Account Statements to Pool	Registered CPOs (except for CPOs exempt under CFTC Reg. 4.7 or with respect to commodity pools with NAV	May 30 (for April 2018)

<u>Filing / Delivery</u>	<u>Who must file</u>	<u>Deadline</u>
Participants	below \$500,000)	
June 2018		
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 2018)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding \$350 million as of any month	June 15 (for May 2018)
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 25 (for May 2018)
Delivery of Annual Audited Financial Statements to Clients	Registered investment advisers (with respect to fund-of-funds)	June 29 (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 2018)
July 2018		
Form PF	Large Liquidity Fund Advisers	July 16 (for the quarter ending June 30, 2018)
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 16 (for June 2018)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding \$350 million as of any month	July 16 (for June 2018)
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	July 20 (for the quarter ending June 30, 2018)

<u>Filing / Delivery</u>	<u>Who must file</u>	<u>Deadline</u>
	billion (no country limit) (Form BQ-3)	
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 23 (for June 2018)
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	July 30 (for the quarter ending June 30, 2018)
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)	July 30 (for June 2018)
August 2018		
Form 13F	Investment advisers that exercise investment discretion over \$100 million or more in Section 13(f) securities	August 14 (for the quarter ending June 30, 2018)
NFA Form PR	All registered CTAs	August 14 (for the quarter ending June 30, 2018)
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 2018)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding \$350 million as of any month	August 15 (for July 2018)
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 2018)
Form PF	Large Hedge Fund Advisers	August 29 (for the quarter ending June 30, 2018)
CFTC Form CPO-PQR	Large CPOs	August 29 (for the quarter ending June 30, 2018)
NFA Form CPO-PQR	All registered CPOs, except Large CPOs	August 29 (for the quarter ending June 30, 2018)

<u>Filing / Delivery</u>	<u>Who must file</u>	<u>Deadline</u>
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 2018)
September 2018		
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 17 (for August 2018)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding \$350 million as of any month	September 17 (for August 2018)
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 24 (for August 2018)
FATCA Information Report	Participating FFIs in Model 1 IGA jurisdictions	September 30
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 2018)
October 2018		
Form PF	Large Liquidity Fund Advisers	October 15 (for the quarter ending September 30, 2018)
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 15 (for September 2018)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding \$350 million as of any month	October 15 (for September 2018)
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	October 22 (for the quarter ending September 30, 2018)

<u>Filing / Delivery</u>	<u>Who must file</u>	<u>Deadline</u>
	excess of \$50 million (no country limit) (Form BQ-2 Part 2), or in excess of \$4 billion (no country limit) (Form BQ-3)	
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 23 (for September 2018)
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 30 (for the quarter ending September 30, 2018)
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 30 (for September 2018)
<u>November 2018</u>		
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, 2018)
NFA Form PR	All registered CTAs	November 14 (for the quarter ending September 30, 2018)
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 2018)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding \$350 million as of any month	November 15 (for October 2018)
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 2018)
Form PF	Large Hedge Fund Advisers	November 29 (for the quarter ending September 30, 2018)
CFTC Form CPO-PQR	Large CPOs	November 29 (for the quarter ending September 30, 2018)

<u>Filing / Delivery</u>	<u>Who must file</u>	<u>Deadline</u>
NFA Form CPO-PQR	All registered CPOs, except Large CPOs	November 29 (for the quarter ending September 30, 2018)
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 2018)
<u>Other Floating Deadlines</u>		
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
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>i.e.</i> , 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

<u>Filing / Delivery</u>	<u>Who must file</u>	<u>Deadline</u>
		increases or decreases 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
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 \$78.2 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-13A 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 If the cost of the transaction exceeds	Within 45 days after a reportable transaction

<u>Filing / Delivery</u>	<u>Who must file</u>	<u>Deadline</u>
	<p>\$3 million, then the U.S. entity should file Form BE-13A</p> <p>If the cost of the transaction does not exceed \$3 million, then the U.S. entity should file a BE-13 Claim for Exemption</p>	
New Issues Affirmations	Private funds that invest in new issues	Annually
Delivery of Privacy Policy Notice to Clients	Financial institutions who have changed their privacy policies and practices since the last distribution of a privacy notice (see above)	Annually
Delivery of ERISA/VCOE Annual Certification to ERISA Investors	Private funds operating as a VCOE 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
Form 8832 Filing	Entities that filed an IRS Form 8832 with respect to 2017	Due date (including any applicable extension) of that entity's 2017 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 2017 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 2017 U.S. federal income tax return
CbCR – Form 8975	U.S. tax resident parent entity of a MNE that has revenues of \$850 million or more during the taxable year	Due date (including any applicable extension) of that entity's 2017 U.S. federal income tax return
Certain U.S. Tax Filings with	Private funds and their U.S. investors may be required to make certain filings	Generally, due date (including any applicable extensions) of

<u>Filing / Delivery</u>	<u>Who must file</u>	<u>Deadline</u>
respect to Non-U.S. Entities	with respect to non-U.S. entities owned by the private fund, including, without limitation: <ul style="list-style-type: none"> ■ IRS Form 5471 ■ IRS Form 926 ■ IRS Form 8621 ■ IRS Form 8865 ■ IRS Form 8858 ■ IRS Form 8938 	the U.S. person's 2017 U.S. federal income tax return

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
+1.212.969.3355
rleonard@proskauer.com

Michael F. Mavrides
+1.212.969.3670
mmavrides@proskauer.com

Christopher M. Wells
+1.212.969.3600
cwells@proskauer.com

PRIVATE INVESTMENT FUNDS

Monica Arora
+1.212.969.3003
marora@proskauer.com

Howard J. Beber
+1.617.526.9754
hbeber@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
+1.617.526.9769
scherry@proskauer.com

Niamh A. Curry
+1.212.969.3474
ncurry@proskauer.com

Anthony M. Drenzek
+1.617.526.9655
adrenzek@proskauer.com

Camille Higonnet
+1.617.526.9738
chigonnet@proskauer.com

David T. Jones
+1.617.526.9751
djones@proskauer.com

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

Bruce L. Lieb
+1.212.969.3320
blieb@proskauer.com

Matthew McBride
+1.617.526.9670
mmcbride@proskauer.com

Stephen T. Mears
+1.617.526.9775
smears@proskauer.com

Malcolm B. Nicholls III
+1.617.526.9787
mnicholls@proskauer.com

Charles (Chip) Parsons
+1.212.969.3254
cparsons@proskauer.com

Marc A. Persily
+1.212.969.3403
mpersily@proskauer.com

Robin A. Painter
+1.617.526.9790
rpainter@proskauer.com

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

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

Michael R. Suppappola
+1.617.526.9821
msuppappola@proskauer.com

David W. Tegeler
+1.617.526.9795
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
+1.212.969.3553
rcorn@proskauer.com

Michael Fernhoff
+1.310.284.5671
mfernhoff@proskauer.com

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

Martin T. Hamilton
+1.212.969.3964
mhamilton@proskauer.com

Marguerite R. Lombardo
+1.617.526.9472
mlombardo@proskauer.com

Scott S. Jones
+1.617.526.9772
sjones@proskauer.com

Anne Kim
+1.310.284.4575
akim@proskauer.com

Mary B. Kuusisto (London)
+44.20.7280.2159
mkuusisto@proskauer.com

Arnold P. May
+1.617.526.9757
amay@proskauer.com

David S. Miller
+1.212.969.3006
dmiller@proskauer.com

Amanda H. Nussbaum
+1.212.969.3642
anussbaum@proskauer.com

Jamie E. Poindexter
+1.617.526.9773
jpoindexter@proskauer.com

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

MARKETS AND TRADING/REGULATION

Edward A. Kwalwasser
+1.212.969.3515
ekwalwasser@proskauer.com

Frank Zarb
+1.202.416.5870
fzarb@proskauer.com

PRIVATE EQUITY AND HEDGE FUND LITIGATION

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

Peter Duffy Doyle
+1.212.969.3688
pdoyle@proskauer.com

Timothy W. Mungovan
+1.617.526.9412
tmungovan@proskauer.com

Kevin J. Perra
+1.212.969.3454
kperra@proskauer.com

SEC ENFORCEMENT

Robert J. Cleary
+1.212.969.3340
rjcleary@proskauer.com

Ralph C. Ferrara
+1.202.416.5820
rferrara@proskauer.com

Joshua M. Newville
+1.212.969.3336
jerichman@proskauer.com

Jonathan E. Richman
+1.212.969.3448
jerichman@proskauer.com

BROKER-DEALER

Benjamin J. Catalano
+1.212.969.3980
bcatalano@proskauer.com

Edward A. Kwalwasser
+1.212.969.3515
ekwalwasser@proskauer.com

Kathy H. Rocklen
212.969.3755
krocklen@proskauer.com

CFTC

Christopher M. Wells
212.969.3600
cwells@proskauer.com

TRUSTS AND ESTATES

Henry J. Leibowitz
+1.212.969.3602
hleibowitz@proskauer.com

David Pratt
+1.561.995.4777
dpratt@proskauer.com

ERISA

Ira G. Bogner
+1.212.969.3947
ibogner@proskauer.com

Adam W. Scoll
+1.617.526.9486
ascoll@proskauer.com

EXECUTIVE COMPENSATION

Michael J. Album
+1.212.969.3650
malbum@proskauer.com

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

Michael S. Sirkin
+1.212.969.3840
msirkin@proskauer.com

EMPLOYMENT

Allan S. Bloom
+1.212.969.3880
abloom@proskauer.com

John P. Barry
+1.212.969.6081
jbarry@proskauer.com

WHISTLEBLOWER

Connie N. Bertram
+1.202.416.6810
cbertram@proskauer.com

Lloyd B. Chinn
+1.212.969.3341
lchinn@proskauer.com

CAPITAL MARKETS

Julie M. Allen
+1.212.969.3155
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
+1.212.969.3492
flopez@proskauer.com

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

Jay D. Waxenberg
+1.212.969.3606
jwaxenberg@proskauer.com

BANKRUPTCY AND RESTRUCTURING

Martin J. Bienenstock
+1.212.969.4530
mbienenstock@proskauer.com

Vincent Indelicato
+1.212.969.4665
vindelicato@proskauer.com

FCPA/OFAC/ANTI-MONEY LAUNDERING

Chantel L. Febus
+1.212.969.3429
cfebus@proskauer.com

CYBERSECURITY/ INTELLECTUAL PROPERTY AND TECHNOLOGY

Daryn A. Grossman
+1.212.969.3665
dgrossman@proskauer.com

Kristen J. Mathews
+1.212.969.3265
kmathews@proskauer.com

Jeffrey D. Neuburger
+1.212.969.3075
jneuburger@proskauer.com

PRIVATE CREDIT

Gary J. Creem
+1.617.526.9637
gcreem@proskauer.com

Steven M. Ellis
+1.617.526.9660
sellis@proskauer.com

Monica J. Shilling
+1.310.284.4544
mshilling@proskauer.com

Michael A. Woronoff
+1.310.284.4550
mworonoff@proskauer.com

NON-COMPETE/TRADE SECRET DISPUTES

John P. Barry
+1.212.969.6081
jbarry@proskauer.com

Steven M. Kayman
+1.212.969.3430
skayman@proskauer.com

MERGERS & ACQUISITIONS

Jonathan Benloulou
+1.310.284.5698
jbenloulou@proskauer.com

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

James P. Gerkis
+1.212.969.3135
jgerkis@proskauer.com

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

Ronald R. Papa
+1.212.969.3325
rpapa@proskauer.com

Steven M. Peck
+1.617.526.9890
speck@proskauer.com

Peter G. Samuels
+1.212.969.3335
psamuels@proskauer.com

Proskauer.com

Beijing | Boca Raton | Boston | Chicago | Hong Kong | London | Los Angeles
New Orleans | New York | Newark | Paris | São Paulo | Washington, D.C.