Private Equity
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# Regulatory Developments and Annual Compliance Obligations Applicable to Private Fund Sponsors

*By David Wohl, Venera Ziegler and Gregory Denis*

Over the course of the last year, there have been a number of regulatory developments affecting private funds and their investment advisers that private equity sponsors should be aware of. We would also like to remind our private equity clients of important upcoming regulatory filings and compliance obligations in 2018.[i]

## CURRENT AREAS OF SEC FOCUS AND OTHER REGULATORY DEVELOPMENTS

### OCIE Announces 2018 National Exam Program Priorities

On February 7, the SEC's Office of Compliance Inspections and Examinations (OCIE) issued its examination priorities for 2018[ii] principally focused around five themes: (i) matters of importance to retail investors, including seniors and those saving for retirement; (ii) compliance and risks in critical market infrastructure; (iii) risks related to FINRA and the Municipal Securities Rulemaking Board; (iv) cybersecurity; and (v) anti-money laundering programs. Given the number of newly registered investment advisers and those that have not been examined for several years, OCIE stated that it would continue to select for examination those advisers that have elevated risk profiles. Of particular interest to private equity sponsors, OCIE affirmed its focus on firms with practices or business models that create risks that investors will pay inadequately disclosed fees, expenses or other charges, including "private fund advisers that manage funds with a high concentration of investors investing for the benefit of retail clients, including non-profit organizations and pension plans." With respect to cybersecurity, OCIE noted that it would continue to focus on governance and risk assessment, access rights and controls, data loss prevention, vendor management, training and incident response. Overall, while continuing to focus on protecting investors, conflicts of interest and disclosure issues, OCIE is also focused on evaluating new technologies and products and their effects on the market.

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### OCIE Risk Alert on Frequent Advertising Rule Compliance Issues

In September 2017, OCIE issued a Risk Alert that provided a list of compliance topics related to the Advertising Rule[iii] that OCIE has frequently identified in deficiency letters sent to SEC-registered investment advisers.[iv] OCIE identified a number of common deficiencies, including: (i) misleading performance results (e.g., presentation of performance results without deducting advisory fees and other expenses); (ii) misleading one-on-one presentations (e.g., not including relevant disclosures when presenting performance information gross of fees); (iii) misleading claims of compliance with voluntary performance standards (e.g., claiming that performance results complied with the Global Investment Performance Standards when they do not); (iv) cherry-picked profitable recommendations (e.g., including only profitable recommendations in advertisements); (v) failure to have compliance policies and procedures (e.g., failing to review and approve advertising materials prior to their publication or dissemination); (vi) misleading use of third-party rankings or awards (e.g., advertising awards or accolades that have been obtained by submitting potentially false or misleading information in the applications for such awards); (vii) misleading use of professional designations (e.g., referring to professional designations that have lapsed); and (viii) inappropriate use of testimonials (e.g., using client endorsements in advertisements).[v]

### Recent Speeches by SEC Officials Regarding Enforcement Priorities

Recent speeches by SEC Commissioner Michael Piwowar and SEC Division of Enforcement Co-Directors Stephanie Avakian and Steven Peikin indicate that the era of the “broken windows” approach, where relatively minor compliance infractions were broadly and aggressively policed and often punished in order to deter potentially larger violations, may be coming to an end. Further, one recent speech suggested that the number and scope of industry-wide “sweep” exams focused on technical violations may decline, with resources concentrated on more substantial (and intentional) wrongdoing. Ms. Avakian and Mr. Peikin have stated that under their watch the protection of retail investors and the detection and punishment of cyber-related misconduct will receive heightened attention, as evidenced by the Enforcement Division’s new Retail Strategy Task Force and Cyber Unit.

While the recent pronouncements indicate that the Enforcement Division may bring fewer cases for “foot faults,” those private fund managers who have not heeded the lessons of the recent past and tightened up their disclosure and compliance practices are surely leaving themselves exposed. Furthermore, new enforcement initiatives, such as investigating cyber-related compliance shortcomings, are generally as relevant to private fund sponsors as to other SEC-regulated persons. Finally, many investors are now hyper-focused on these issues and expect managers to be as well. Therefore, while the broken windows policy may be ending, now is not the time for the private fund industry to take its collective eye off the compliance ball. As Ms. Avakian said recently, “…we are always going to be focused on issues raised by the conduct of investment advisers, broker-dealers, and other registrants….”

### Amendments to Form ADV

We would like to remind private fund sponsors that the SEC’s recent amendments to Form ADV are now effective. These amendments (i) require registered investment advisers to provide additional information regarding the separately managed accounts (SMAs) they advise, (ii) make certain clarifying, technical and other revisions to Form ADV and (iii) codify the method for multiple private fund adviser entities operating a single advisory business to register using one Form ADV (Umbrella Registration). The new disclosure requirements regarding SMAs and the ability to use Umbrella Registration do not apply to exempt reporting advisers.

*Separately Managed Accounts*

Although the SEC declined to define the term “separately managed account”, for purposes of the amendments, SMAs are deemed to be any advisory accounts other than pooled investment vehicles (e.g., private funds and registered investment companies). The amendments increase the amount of reportable information related to SMAs in three broad categories. Advisers are required to report the approximate percentage of regulatory assets under management (“RAUM”) attributable to SMAs invested in 12 broad asset categories, including exchange- and non-exchange-traded equity securities, corporate and municipal bonds, derivatives and U.S. government securities. Advisers with at least $500 million of RAUM attributable to SMAs are required to provide aggregate information with respect to the amount of borrowings attributable to those accounts as of year-end. Advisers with $10 billion or more of RAUM attributable to SMAs are required to report information regarding derivatives exposure in the accounts across several broad categories, and the information must be reported as of the middle and end of the prior year. Advisers are also required to identify and provide additional information regarding any custodian that holds at least 10% of its RAUM attributable to SMAs.

*Other Amendments to Form ADV*

The SEC also added or revised a number of other questions on Form ADV, including, among other things, disclosures related to social media, shared compliance officers, assets under management and private fund ownership. Below is a table listing the significant changes to Form ADV provided by these amendments.

| Revision Type | ADV Provision | Revised Requirements |
|---|---|---|
| **Adviser’s Physical Office Locations** | **Item 1.F and Section 1.F. of Schedule D of Part 1A** | Disclose the total number of offices at which the adviser conducts investment advisory business as well as the 25 largest offices by total employees, the number of employees who perform advisory functions at each office and certain additional details about other investment-related business conducted in each office. |
| **Adviser’s Presence on Social Media** | **Item 1.I and Section 1.I. of Schedule D of Part 1A** | Disclose whether the adviser has accounts on social media platforms (Twitter, LinkedIn, Facebook, etc.) and the address of each of the accounts. Employees’ social media accounts and accounts of unregistered affiliates used solely to promote the non-investment advisory business of such affiliates are not required to be disclosed. |
| **Chief Compliance Officer** | **Item 1.J of Part 1A** | If the adviser’s chief compliance officer is compensated or employed by any person other than the adviser for providing chief compliance officer services to the adviser, report the name and tax i.d. number of the other person. |
| **Balance Sheet Assets** | **Item 1.O of Part 1A** | Adds ranges of adviser balance sheet assets of $1 billion to $10 billion, $10 billion to $50 billion, and $50 billion or more. |
| **Number of Clients and** | **Item 5 of Part 1A** | Disclose the number of clients for whom the |

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| **Assets under Management** | | adviser provides advisory services, the amount of RAUM attributable to each type of client, the number of clients for whom the adviser provides advisory services without RAUM, whether the adviser reports client assets differently in Part 2A (brochure) from RAUM in Part 1A, and the amount of the adviser's RAUM attributable to non-U.S. persons. |
| **Assets under Management Attributable to SMAs** | **Section 5.K.(1) of Schedule D of Part 1A** | Disclose the percentage of RAUM attributable to SMAs invested in each of 12 asset categories as of year-end. Advisers with $10 billion or more in RAUM attributable to SMAs will be required to report the amounts as of mid-year and year-end. |
| **Borrowings and Derivatives of SMAs** | **Section 5.K.(2) of Schedule D of Part 1A** | Advisers with at least $500 million in RAUM attributable to SMAs must disclose the aggregate amount of borrowings related to those accounts as of year-end. Advisers with at least $10 billion in RAUM attributable to SMAs will also be required to disclose information related to aggregate derivatives exposure and to report the amounts as of mid-year and year-end. |
| **Custodians of SMAs** | **Section 5.K.(3) of Schedule D of Part 1A** | Disclose information regarding custodians that maintain at least 10% of RAUM attributable to SMAs and report the amount of RAUM attribute to SMAs held by each of the custodians. |
| **Sales to non-Qualified Clients** | **Section 7.B.(1) of Schedule D of Part 1A** | An adviser to a private fund that qualifies for the exclusion from the definition of investment company under Section 3(c)(1) must disclose whether it limits sales of such private fund to "qualified clients." |
| **Private Fund Financial Statements** | **Section 7.B.(1) of Schedule D of Part 1A** | Advisers answering whether a private fund's audited financial statements have been distributed to the fund's investors should now answer with respect to the financial statements for the most recently completed fiscal year. Advisers answering whether the auditor's report contains an unqualified opinion for a private fund should now answer with respect to all of the reports prepared by the auditing firm since the adviser's last annual updating amendment. |
| **Relying Advisers** | **Schedule R of Part 1A** | Requires relying advisers to disclose identifying information, the basis for SEC registration, type of organization and control persons. |

*Umbrella Registration*

The Form ADV amendments also codify Umbrella Registration, a concept originally provided for by a 2012 SEC no-action letter permitting "relying advisers" to be part of, and rely on, an affiliated "filing adviser's" SEC registration as long as the relying and filing advisers conduct a single advisory business. The amendments expand the disclosure required with respect to the advisers covered by Umbrella Registration (including adding a new Schedule R to Form ADV for each relying adviser). In its adopting release, the SEC stated that exempt reporting advisers may not make use of Umbrella Registration, but noted that the "Frequently Asked Questions" previously released that allowed certain exempt reporting advisers to file a single Form ADV on behalf of multiple special purpose vehicles was not withdrawn as a result of the amendments.

Under the amendments, and consistent with the 2012 no-action letter, five conditions must be met by the filing and relying advisers in order to rely on Umbrella Registration:

- The advisers must advise only private funds and clients in SMAs that are qualified clients (as defined in Rule 205-3 under the Investment Advisers Act of 1940 (Advisers Act)) and are otherwise eligible to invest in the advisers' private funds and whose accounts pursue investment objectives and strategies that are substantially similar or otherwise related to those private funds.
- The filing adviser must have its principal office and place of business in the United States (and therefore the filing adviser and all relying advisers will be subject to the substantive provisions of the Advisers Act regardless of their or their clients' locations).
- Each relying adviser, its employees and persons acting on its behalf must be subject to the filing adviser's supervision and control.
- The advisory activities of each relying adviser must be subject to the Advisers Act and examination by the SEC.
- The filing adviser and each relying adviser must operate under a single code of ethics and a single set of written policies and procedures adopted and implemented in accordance with Rule 206(4)-7 under the Advisers Act and administered by a single chief compliance officer.

**New EU Privacy Laws That May Impact U.S. Private Fund Sponsors**

As many will by now be aware, a major new data privacy law - the "General Data Protection Regulation" (GDPR) - will come into force in May 2018, introducing substantial changes to current European privacy laws. U.S. based private fund sponsors that market fund interests to individual (i.e., non-institutional) investors in the European Union (EU) may become subject to regulation under the GDPR.

In line with current law, most organizations with a presence within the EU that use or hold data relating to living individuals – including by means only of equipment located within the EU – will fall within the scope of the GDPR. However, one of the most significant changes under the GDPR is to extend the jurisdictional application of the new law to non-EU fund sponsors holding or using data about individuals located in the EU, even in the absence of any EU presence. Accordingly, non-EU based private fund sponsors that are not caught by the current regime would be well advised to consider whether the forthcoming changes in laws will bring them within the scope of the GDPR.

Where the extra-jurisdictional provisions do apply, non-EU based sponsors are required to comply with the entirety of the GDPR or face potential fines up to the greater of EURO20m and 4% of worldwide revenue for the most serious infractions. Full compliance with the GDPR's 99 articles will require, among other things, rapid reporting of data breaches to EU privacy regulators, disclosures about data usage to

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individual EU investors, compliance with various rights granted to individuals, the appointment of an EU representative (unless very limited use is made of EU investor data) and the maintenance of detailed internal records of data processing operations.

The GDPR will apply to U.S. based private fund sponsors where:

- goods or (more relevant) services are offered to individual EU investors; or
- the behavior of EU individuals is monitored by the sponsor (for example, by tracking website visitors using cookie technologies).

Where either circumstance described above applies, the non-EU sponsor will be subject to the GDPR even if it has no physical EU presence and does not process data within the EU. Note, however, that the GDPR will not apply to offers to, or monitoring of behavior of, trusts and institutional or other non-living person investors.

*What is an "offer" of goods or services?*

A key test for extra-territorial application of the GDPR to fund sponsors is likely to focus on whether an "offer" has been made to EU investors.

The GDPR makes it clear that mere online accessibility to non-EU products and services is not sufficient to apply the GDPR to non-EU businesses which are in possession of data relating to EU individuals (for example, as a result of a non-solicited and/or unexpected approach to the fund sponsor by an individual European investor).

Some form of targeting, solicitation or facilitation of EU trade or investment is required before an "offer" of goods or services will be deemed to be made. Factors which tend towards the making of an offer include:

- local EU language versions of a website;
- acceptance of EU currency;
- acceptance of material amounts or volumes of EU investment;
- a demonstrable intention by a fund sponsor to target EU investors; and
- advertisements or marketing targeting EU investors.

*What constitutes monitoring of behavior in the EU?*

The tracking of individuals over the internet will often constitute "monitoring" for the purposes of the GDPR. This would create a jurisdictional risk for a fund sponsor that routinely places tracking/persistent cookies on devices operated by website users. This provision of the GDPR also has the potential to unexpectedly bring non-EU organizations within the scope of the GDPR given that (i) the use of tracking technologies has become widespread and commonplace; and (ii) no intention to target is required where tracking technologies are used to track EU internet users.

At first blush, the monitoring gateway to GDPR application may appear broad and problematic. However, the GDPR implies that tracking technologies would usually process personal data which is used to make decisions about an individual or predict their personal preferences, behavior or attitudes. Accordingly, the incidental placement of tracking technologies does not appear to be the focus of the monitoring provisions.

Our view is that, all other things being equal, privacy regulators are unlikely to focus their enforcement efforts on non-EU organizations that inadvertently invoke the extraterritorial provisions of the GDPR as a result of using tracking technologies where there is no active targeting, solicitation or facilitation of EU investment. Accordingly, whilst as a technical matter, no targeting is required to bring a non-EU organization within the scope of the GDPR where monitoring of EU individuals occurs, in reality we expect targeting to be a relevant jurisdictional consideration for EU privacy regulators. Nevertheless, for organizations wishing to mitigate the risk of application of the GDPR, tracking technologies could be disabled in respect of EU countries or substituted, for EU users, with cookies that do not collect personal data or track website users (such as session cookies which are used to provide website functionality only).

*What will be EU privacy regulators' approach to non-EU enforcement?*

Any regulator seeking to enforce the GDPR against a non-EU fund sponsor with no EU presence at all would face significant practical difficulties. Regulatory behaviors under the GDPR in respect of foreign enforcement therefore remains an area of considerable uncertainty. To date, regulators wishing to address egregious breaches of EU data protection laws have sought to invoke jurisdiction on the basis of a very limited presence within the EU by a foreign transgressor – this could consist, for example, of a single sales representative being present in an EU jurisdiction, even if the relevant business does not have any form of entity or branch established within the EU. Where there are no EU touchpoints at all, enforcement may, in time, be made more practical by the conclusion of cooperation agreements between EU privacy regulators and their foreign counterparts.

## COMPLIANCE OBLIGATIONS FOR PRIVATE EQUITY FUND ADVISERS[vi]

FORM ADV

***(Annual Amendment due by April 2, 2018)***

Investment advisers that are registered with the SEC under the Advisers Act, and advisers filing as exempt reporting advisers with the SEC, must file an annual amendment to Form ADV within 90 days of the end of their fiscal year (i.e., by April 2, 2018 (because the 90th day falls on a weekend) for advisers with a fiscal year-end of December 31).[vii]

Registered investment advisers must file an updated Part 1 and Part 2A brochure of such adviser's Form ADV, while exempt reporting advisers must file an updated Part 1. Registered investment advisers are also required to update, but are not required to file with the SEC, Part 2B brochure supplements of their Form ADV. In addition, registered investment advisers are required to provide a copy of the updated Form ADV Part 2A brochure (or a summary of changes with an offer to provide the complete brochure) and, in certain cases, a Part 2B brochure supplement to each client.

FORM PF

***(Annual Filing due by April 30, 2018)***

Registered investment advisers to private equity funds with more than $150 million of assets under management attributable to those funds (as of the last day of their most recent fiscal year) are required to file Form PF with the SEC within 120 days after such adviser's fiscal year-end (i.e., by April 30, 2018 in the case of an adviser with a fiscal year-end of December 31).[viii] Form PF requires disclosure of the adviser's assets under management and information on each private fund it advises.

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## CFTC FILINGS

***(Annual Affirmation of De Minimis Exemption due by March 1, 2018)***

Many private equity fund sponsors are able to rely on the exemption from registration with the National Futures Association (NFA) that is available under CFTC Rule 4.13(a)(3) (the de minimis exemption) and have claimed such exemption.[ix] The de minimis exemption is subject to an annual affirmation which must be completed within 60 days after the end of each calendar year. Failure to affirm the exemption is deemed a withdrawal of the exemption once the 60 day period has elapsed. Private fund sponsors that do not qualify for the de minimis exemption may be subject to registration with the NFA as commodity pool operators and commodity trading advisors.

## CUSTODY RULE

Registered investment advisers to private funds must comply with certain custody procedures, including generally maintaining client funds and securities with a qualified custodian and either (i) undergoing an annual surprise examination of client assets conducted by an independent public accountant or (ii) obtaining an audit of each private fund by an independent public accountant and delivering the audited financial statements, prepared in accordance with generally accepted accounting principles, to fund investors within 120 days of the fund's fiscal year-end. Private fund sponsors should review their custody procedures to ensure compliance with these rules.

## ANNUAL REVIEW OF COMPLIANCE POLICIES AND PROCEDURES

Registered investment advisers are required to perform a review to assess the adequacy of the adviser's compliance policies and the effectiveness of their implementation and, if necessary, to update their compliance policies and procedures on an annual basis. In determining the adequacy of an annual review, the SEC has indicated that it will consider a number of factors, including the persons conducting the review, the scope and duration of the review and the adviser's findings and recommendations resulting from the review. Written evidence of the results of the annual review should be kept and reviewed by the adviser's chief compliance officer, senior management and, if applicable, outside counsel. Employee compliance training should be conducted at least annually based on the results of the compliance review.

## REVIEW OF OFFERING MATERIALS

As a general disclosure matter, and for purposes of U.S. federal and state anti-fraud laws, an investment adviser must continually ensure that each of its fund offering documents is kept up to date, is consistent with its other fund offering documents and contains all material disclosures that may be required in order for investors to be able to make an informed investment decision.

Accordingly, it may be an appropriate time for an investment adviser to review its offering materials (including investor newsletters and pitch books) and confirm whether or not any updates or amendments are necessary. In particular, an investment adviser should take into account the impact of recent market conditions on its funds and review its current disclosure regarding: investment objectives and strategies; valuation practices; performance and related disclaimers; any mention of specific investments to confirm that there are no "cherry picking" issues; conflicts of interests; risk factors; personnel; service providers; "bad actor" disclosures; and any relevant legal or regulatory developments. In light of the SEC's focus on the allocation of private fund fees and expenses, conflicts of interest, allocation of co-investment opportunities, misallocation of broken deal expenses, acceleration of monitoring fees, valuation methodologies and receipt of transaction fees, managers must take special care in reviewing their practices and disclosure in these areas.

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## CERTAIN FILINGS REQUIRED UNDER THE SECURITIES EXCHANGE ACT OF 1934

### Form 13F

The Securities Exchange Act of 1934 requires investment advisers (whether or not registered) to submit a report on Schedule 13F with the SEC, within 45 days after the last day of any calendar year and within 45 days after the last day of each of the next three calendar quarters following such calendar year, if on the last day of any month of such calendar year the investment adviser exercised discretion with respect to accounts holding Section 13(f) securities (generally, publicly traded securities) having an aggregate fair market value of at least $100 million.

### Form 13H

An investment adviser that is a "large trader," i.e., it engages in transactions in National Market System securities equal to or in excess of two million shares or $20 million during any calendar day, or 20 million shares or $200 million during any calendar month, must promptly (within 10 days) file an initial Form 13H after effecting aggregate transactions equal to, or greater than, the applicable activity level. Following this initial filing, all large traders must make an amended filing to update any previously-disclosed information that becomes inaccurate no later than promptly (within 10 days) following calendar quarter end and must separately file an annual amendment within 45 days after calendar year-end.

## PRIVACY POLICY NOTICE

Investment advisers and private funds are subject to SEC, CFTC and Federal Trade Commission regulations governing the privacy of certain confidential information. Under such privacy rules, investment advisers and private funds are required to provide notice to individual investors regarding their privacy policies and procedures at the start of the relationship with such individual investor (although they are no longer required to provide an annual privacy notice to such investors unless material changes have been made to the policy).

## FORM D AND BLUE SKY FILINGS

Form D filings for private funds with ongoing offerings lasting longer than one year need to be amended on an annual basis, on or before the first anniversary of the initial Form D filing. Copies of Form D can be obtained by potential investors via the SEC's website. On an annual basis, private fund sponsors should also review their blue sky filings for each state to make sure they meet any renewal requirements. In some states fees apply for late blue sky filings.

## BAD ACTOR RULES

Rule 506(d) of Regulation D under the Securities Act of 1933 prohibits a private fund from relying on the safe harbor private placement exemption contained in Regulation D if the fund, or certain specified persons or entities associated with the fund, are subject to disqualifying events as a result of bad acts. It is imperative for private fund sponsors that intend to rely on Regulation D to identify all persons and entities subject to the rule and conduct appropriate due diligence (including receiving written certifications) to ensure that none are subject to disqualification. In addition, for funds that are engaging in continuous and/or long-term offerings, the diligence should be periodically refreshed.

## STATE LOBBYIST REGISTRATIONS

Private fund sponsors should look at each state in which a public entity or a public employee retirement plan is an investor or a potential investor to determine if the investment adviser or its personnel are required to register as lobbyists. This may require engaging local counsel with knowledge of state and municipal laws and regulations.

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## ANNUAL VCOC/PLAN ASSETS CERTIFICATIONS

Many private equity funds limit “benefit plan investors” to less than 25% of any class of equity interest in a fund (the 25% test) so that such fund’s assets are not deemed “plan assets” subject to the U.S. Employee Retirement Income Security Act of 1974 (ERISA), and some private equity fund sponsors have agreed to provide an annual certification to that effect. Such certification generally can be made at any time during the year, but typically investors wish to have a certification made as of a specified annual date, often as of the end of the year, for convenience. Such certifications must take into account the impact of transfers and withdrawals of fund interests during the applicable period, as well as the impact of different ownership percentages of any alternative investment vehicle, or investments, due to excuse and exclusion.

Other private equity funds operate as “venture capital operating companies” (VCOCs), and may have agreed to deliver an annual certification or opinion as to the fund’s VCOC status. Such certification or opinion will require a determination as to whether at least 50% (based on cost) of the fund’s total investments (excluding cash and other temporary investments) constitute “good” venture capital investments during the 90-day valuation period applicable to the fund. Information regarding the cost of each investment held by the fund on one day during the applicable 90-day period, and confirmation of the management rights required for any “good” investment, should be gathered in preparation for such certification or opinion. Usually the 90-day valuation period is established by the fund in connection with its initial investment. The timing of providing the certification is usually tied to the end of the 90-day period, often 60 days following the end of such period. Fund sponsors should conduct the VCOC or 25% test analysis as applicable and deliver the applicable certification to their limited partners.

If a “feeder fund” for investors with a particular tax profile was established to invest in a “master fund,” it is possible that the feeder fund might be designed to hold plan assets of ERISA investors. In such case, it may be necessary to update any mandatory disclosure pursuant to Section 408(b)(2) of ERISA (if applicable) regarding direct and indirect compensation for services, if any, relating to the feeder fund. In the case of a new master fund that intends to operate as a VCOC but has not yet made its first investment, updated disclosure to comply with Section 408(b)(2) of ERISA (and possibly other reporting requirements applicable to ERISA investors) may be required, particularly if expenses or management fees were paid by any ERISA investors before the first investment has been made. The circumstances pertaining to each master and feeder fund differ, and counsel should be consulted regarding compliance with any applicable disclosure requirements.

## DEPARTMENT OF LABOR FIDUCIARY RULE

Department of Labor fiduciary rules became applicable in part in June 2017. Because of the rules’ expansive definition of “investment advice”, they affect firms managing pools of assets that include ERISA-subject retirement savings, including private equity sponsors and hedge fund managers. In particular, the rules affect the relationship between sponsors/managers and potential ERISA-subject investors during the fundraising process. An exception to the rules, known as the “Independent Fiduciary Exception,” may be available to sponsors/managers and ERISA-subject investors, provided that the conditions to the exception are complied with. To take advantage of the Independent Fiduciary Exception, sponsors and managers should review their investor communications material, as well as offering documentation and subscription documentation to update if necessary to include the relevant elements of the Independent Fiduciary Exception.

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## TIC REPORTING

U.S. private fund sponsors (and non-U.S. private fund sponsors that manage U.S.-domiciled funds) that have portfolio investments in foreign issuers, have issued interests in their funds to foreign residents or have claims on or liabilities to foreign residents may be required to report those transactions to the Federal Reserve Bank of New York on the Treasury International Capital (TIC) system.

TIC Form SLT generally requires U.S. resident entities to report investments in foreign long-term securities (i.e., securities with a maturity of more than one year) and long-term securities issued by such U.S. resident entities to foreign persons equal to $1 billion or more. A private fund adviser is required to consolidate its reportable long-term securities across all funds to determine whether it meets the reporting threshold. The acquisition of 10% or more of the voting securities of an entity is considered a “direct investment” under the form and is excluded for purposes of determining the $1 billion threshold. Form SLT must be filed monthly. Note that sales of U.S.-domiciled fund interests to foreign investors, and sales of foreign-domiciled fund interests to U.S. investors, may count towards the $1 billion reporting threshold.

TIC Form B generally requires (subject to certain thresholds) the reporting of information on certain claims and liabilities (including loans and short-term debt instruments) of U.S. financial institutions with non-U.S. persons. Filing obligations generally may result from private funds that invest directly in non-U.S. debt instruments, provide credit to non-U.S. entities, directly hold non-U.S. short-term securities, or maintain credit facilities with non-U.S. financial institutions. However, any claims or liabilities that are serviced by a U.S. entity, or any claims or liabilities for which a U.S. custodian or U.S. sub-custodian is used, do not need to be reported by the private fund adviser. Form B must be filed monthly, with a separate quarterly filing.

TIC Form S generally requires U.S. resident entities to report purchases and sales of long-term securities with foreign entities if, during any month, such transactions equaled $350 million or more in the aggregate. A private fund adviser is required to consolidate its reportable long-term securities transactions across all funds to determine whether it meets or exceeds the reporting threshold. Once the reporting threshold is met in a given month, Form S must be filed monthly for the remainder of the calendar year. Note that sales of U.S.-domiciled fund interests to foreign investors, and sales of foreign-domiciled fund interests to U.S. investors, may count towards the $350 million reporting threshold.

## FORM BE-13

The Bureau of Economic Analysis (BEA) requires a U.S. entity, including a private fund domiciled in the U.S., to make a filing on Form BE-13 if a non-U.S. person acquires ownership of 10% or more of its voting securities and the cost of acquiring such securities is more than $3 million.[x] The BEA generally does not consider limited partner interests or non-managing member limited liability company interests to be voting securities, so most U.S. funds with foreign investors would not have to file. However, general partner/managing member interests generally are considered voting securities for purposes of the BE-13. Therefore, a fund domiciled in the U.S. that has a general partner domiciled outside the U.S. generally would be required to file. In addition, if a non-U.S. fund owns 10% or more of the voting securities of a U.S.-domiciled portfolio company, the portfolio company generally would have to file. Reports are required to be filed within 45 days of a reportable transaction. After an initial BE-13 filing is made, the BEA requires quarterly, annual, and five-year benchmark filings. A U.S. person must file a BE-13 for a reportable transaction even if not directly requested to do so by the BEA.

## FORM BE-12

The BEA's five-year benchmark survey on Form BE-12 regarding foreign direct investment in the United States is due May 31, 2018. The survey is required for U.S. entities in which a foreign person holds, directly or indirectly, 10% or more of its voting securities at any time during 2017. A U.S. entity that has such foreign ownership must complete the survey whether or not it is contacted by the BEA. As with the BE-13, if a non-U.S. fund owns 10% or more of the voting securities of a U.S.-domiciled portfolio company, the portfolio company generally would have to file. The BE-12 should be submitted on a consolidated basis, meaning all U.S. entities sharing common ownership that are required to file should complete one survey.

## EUROPEAN UNION REGULATION OF THE PRIVATE EQUITY INDUSTRY

The Directive on Alternative Investment Fund Managers (the AIFM Directive) has now been implemented into the national laws of all key European Economic Area (EEA) member states and the transitional rules terminated in July 2014. Managers bringing funds to the market in the EEA since such date have to comply with the AIFM Directive and its varied implementation across the EEA. The AIFM Directive subjects EEA private fund sponsors and private fund sponsors using EEA fund vehicles to certain operational and organizational requirements.

The AIFM Directive also impacts U.S. (and other non-EEA) private fund managers that market fund interests to investors in the EEA by imposing a subset of the full AIFM Directive rules upon them. In particular, such managers become subject to certain ongoing compliance requirements including disclosure and reporting obligations, restrictions on extracting capital from EEA portfolio companies and other measures designed to improve transparency when acquiring EEA portfolio companies. In each jurisdiction which has implemented the AIFM Directive there is a separate private placement regime which governs the registration requirements for that particular jurisdiction - some require a straightforward notification, while others require an application to be submitted, with approvals from regulators being necessary prior to marketing to investors in the relevant jurisdiction. Some EEA jurisdictions have supplemented the AIFM Directive's minimum requirements for non-EEA private fund sponsors with additional obligations such as, in the case of Denmark and Germany, the appointment of a depositary to oversee the fund's investments and cash flows. In the case of Austria and France, workable private placement regimes have not been implemented and therefore the only way for U.S. (and other non-EEA) private fund managers to admit investors from such jurisdictions is following a genuine reverse solicitation fact pattern. Private fund sponsors will have to carefully plan their marketing campaigns and register for marketing (by way of notification or application, as applicable) in any relevant EEA jurisdictions in good time. For those jurisdictions where an approval is required, the applications should be submitted well in advance of anticipated marketing efforts commencing since regulators in some EEA jurisdictions have been taking several months to approve marketing, although in many jurisdictions the process takes a matter of days or weeks. In addition, fund managers will be required to carry out a short form compliance process to ensure they are ready to meet the European reporting requirements. We are currently assisting a significant number of U.S.-based and global private fund managers in making applications to EEA regulators for approval under the AIFM Directive's private placement regimes in a variety of EEA jurisdictions.

We are seeing an increasing interest from U.S. (and other non-EEA) private fund managers and their investors in establishing parallel fund structures based in the EEA and able to access the AIFM Directive's single market passporting regime. We would be happy to discuss options with you on a case by case basis in due course.

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| Annual Compliance Obligations | |
|---|---|
| Due Date | Regulatory Filing |
| February 14, 2018 | Annual amendment to Form 13H<br>Form 13F |
| March 1, 2018 | Annual CFTC exemption affirmation due for commodity pool operators and commodity trading advisors |
| April 2, 2018 | Form ADV annual amendment |
| April 30, 2018 | As required by the Custody Rule, distribute audited financial statements to investors |
| April 30, 2018 | Distribute updated Form ADV Part 2A to clients |
| April 30, 2018 | Annual update to Form PF due for registered investment advisers to private equity funds with more than $150 million of assets under management attributable to private funds |

| Other Compliance Obligations | |
|---|---|
| TIC Form SLT | Due on 23rd day following last business day of preceding month |
| TIC Form B | Due on 15th day following month-end and 20th day following quarter-end |
| TIC Form S | Due on 15th day following last business day of preceding month |
| Form 13H initial filing | Due prompty (within 10 days) after the first effecting transactions equal to or greater than the threshold activity level |
| Other than annual amendment to Form 13H | Due promptly (within 10 days) following quarter-end in which information became inaccurate |
| Form 13F | Due within 45 days of the last day of the calendar year and within 45 days after the last day of each of the first three calendar quarters of the subsequent calendar year |
| Form BE-12 | Due May 31, 2018. The BEA anticipates releasing the Form and instructions thereto in the first few months of 2018. |
| Form BE-13 | Due on 45th day after the transaction is completed |
| Other than annual amendment to Form ADV | Due promptly after information becomes materially inaccurate (or, for certain items, after information becomes inaccurate in any way) |
| Review of compliance policies and procedures | Annually |
| Employee training | Annually |
| Notice of changes to privacy prolicies, if any | Annually |
| Update of “bad actor” representations | Annually during the fundraising process and as appropriate with respect to placement agents |
| Lobbying registration and compliance obligations | Prior to marketing to pension funds and in accordance with compliance obligations of the particular jurisdiction |

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ENDNOTES

[i] This Private Equity Alert is not intended to provide a complete list of an investment adviser's compliance obligations or to serve as legal advice and, accordingly, has not been tailored to the specific needs of a particular investment adviser's business.

[ii] The full publication is available here.

[iii] The Advertising Rule, Rule 206(4)-1 under the Investment Advisers Act of 1940, generally prohibits registered investment advisers from publishing, circulating or distributing any advertisement that contains any untrue statement of material fact or that is otherwise false or misleading. While the Advertising Rule does not technically apply to exempt reporting advisers, we would urge such advisers to comply with its principles as a best practice.

[iv] The full publication is available here.

[v] For more information please see our October 2017 Private Equity Alert available here.

[vi] Certain deadlines are calculated based on the assumption that the adviser has a fiscal year-end of December 31.

[vii] In addition, an investment adviser must update its Form ADV promptly if certain information becomes inaccurate as indicated in the instructions to Form ADV.

[viii] Please note that certain large "hedge fund" advisers and "liquidity fund" advisers are subject to more frequent and extensive reporting requirements and shorter deadlines.

[ix] For more information on the *de minimis* exemption and the changes made to the Commodity Exchange Act and the CFTC Rules by the Dodd-Frank Act, please see our September 2012 Private Equity Alert *Changes to CFTC Regulations Affecting Private Funds* available here.

[x] If the 10% threshold, but not the $3 million threshold, is crossed, a BE-13 Claim for Exemption must be filed.

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**Private Equity Alert** is published by the Private Equity practice group of Weil, Gotshal & Manges LLP, 767 Fifth Avenue, New York, NY 10153, +1 212 310 8000, www.weil.com.

The Private Equity group's practice includes the formation of private equity funds and the execution of domestic and cross-border acquisition and investment transactions. Our fund formation practice includes the representation of private equity fund sponsors in organizing a wide variety of private equity funds, including buyout, venture capital, distressed debt, and real estate opportunity funds, and the representation of large institutional investors making investments in those funds. Our transaction execution practice includes the representation of private equity fund sponsors and their portfolio companies in a broad range of transactions, including leveraged buyouts, merger and acquisition transactions, strategic investments, recapitalizations, minority equity investments, distressed investments, venture capital investments, and restructurings.

If you have questions concerning the contents of this issue, or would like more information about Weil's Private Equity practice group, please speak to your regular contact at Weil or to authors:

**Authors**


| | | | |
|---|---|---|---|
| David Wohl (NY) | View Bio | david.wohl@weil.com | +1 212 310 8933 |
| Venera Ziegler (NY) | View Bio | venera.ziegler@weil.com | +1 212 310 8769 |
| Gregory Denis (NY) | View Bio | gregory.denis@weil.com | +1 212 310 8505 |


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