Proskauer

2020 Annual Review and Outlook for Hedge Funds, Private Equity Funds and Other Private Funds

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2020 Proskauer Annual Review and 2021 Outlook for Investment Advisers to Hedge Funds, Private Equity Funds and Other Private Funds

The following annual review (Annual Review) is a summary of some of the significant changes and developments that occurred in the past year and certain recommended practices that investment advisers/investment managers (collectively, advisers) to hedge funds, private equity funds and other private funds (collectively, private funds) should consider when preparing for 2021.

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.

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Table of Contents

SEC Examination Update

On December 17, 2020, the Securities and Exchange Commission (SEC) issued a statement regarding the renaming of the agency's fomer Office of Compliance Inspections and Examinations to the Division of Examinations (DoE).

The DoE is now conducting all examinations remotely, and seems to be doing so at an even faster pace than previously. Since the beginning of 2020, we have seen a significant uptick in the number of examinations, in particular of advisers who have not previously been examined.

Other than a handful of exams at large hedge fund managers directed as their use of alternative data, we have not noted any particular focus on the types of advisers examined, as exams have covered hedge fund advisers, private equity fund advisers, other private fund advisers, and advisers of other alternative asset classes. We have also seen numerous examinations of SEC-registered investment advisers based in Europe, Asia and Australia.

For its fiscal year ending September 30, 2019, DoE reported having completed 3,089 exams, roughly equal to the number for the prior year, representing approximately 15% of all SEC registered advisers. DoE also reported that for the same period approximately 150 examinations (or about 5%) resulted in referrals to the SEC's Division of Enforcement. Although this enforcement referral rate is lower than what we have historically seen, this may be explained by the increased number of total exams being completed. Former SEC Chairman Jay Clayton noted in his November 17, 2020 testimony on oversight of the SEC before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, that for fiscal year ending September 30, 2020, DoE conducted nearly 3,000 examinations, again covering approximately 15% of all registered investment advisers, despite significant disruptions caused by the COVID-19 pandemic.

We have not seen any significant changes in the principal areas of focus of DoE examinations. However, as discussed below, DoE very recently published a risk alert on common deficiencies observed in adviser compliance programs. Among the key areas of focus that we have seen in recent examinations, especially examinations of private fund advisers, and which in many cases have been confirmed by DoE's annual statement of examination priorities and public statements of senior DoE staff, are:

- **Material Non-Public Information (MNPI)** – This topic was given particular prominence in DoE's June 2020 Risk Alert relating to private fund managers. In particular, DoE will review:
  - trading records for unusually successful trades, trades that do not match an adviser's stated investment strategy, and trades that take place around the time of public company announcements;
  - meetings, communications and relationships with public company insiders, and the processes used by compliance personnel to monitor such meetings, communications and relationships;
  - positions held by an adviser's personnel on portfolio company boards of directors, creditor committees or other positions providing potential access to non-public information;
  - the use and effectiveness of information barriers;

- relationships with private fund investors who are corporate insiders;
- the use of restricted lists and trading of companies on restricted lists; and
- the use of alternative data, which was newly identified in DoE's 2020 Exam Priorities.

- **Fees and Expenses** – DoE continues as always to focus on issues related to fees and expenses, including the adequacy of disclosure to clients, the accuracy of fee calculations, and the manner of allocating expenses (including in particular broken-deal expenses) among client and affiliate accounts, especially when client and affiliate accounts participate in co-investments on a side-by-side basis.
- **Conflicts of Interest** – This can take many forms, including:
  - allocation of investment and trading opportunities;
  - side-by-side management of different client accounts, or different client accounts and proprietary accounts, using the same or similar strategies;
  - arrangements with or services provided by affiliated entities or service providers;
  - principal transactions, cross transactions and other transactions where the adviser or any other affiliated party may have an interest; and
  - allocation of expenses between the adviser and clients or co-investors.
- **Marketing Materials and Performance Presentations** – DoE typically reviews marketing materials carefully for a variety of issues, including:
  - accuracy of statements in marketing materials, and compliance with stated investment guidelines, restrictions or other representations;
  - accuracy of and back-up support for past performance presentations;
  - potentially misleading uses of selective examples of past investment performance or recommendations; and
  - use of fund credit lines, whether they have been adequately disclosed, and the effect such lines of credit may have on performance or reported IRR.
- **Cybersecurity** – DoE staff members are beginning to ask more detailed questions about advisers' cybersecurity policies and procedures, and in particular whether any incidents have occurred and how they were handled.
- **Valuations** – DoE continues to focus on valuation issues, including in particular valuation of less liquid assets.

DoE Issues Additional Topic-Specific Risk Alerts

In 2020, DoE staff also issued several risk alerts relevant to advisers to private funds.

On June 23, 2020, DoE issued Observations from Examinations of Investment Advisers Managing Private Funds providing an overview of certain compliance issues observed by DoE in examinations of private equity and hedge fund advisers. This risk alert discusses many practices which have been the subject of SEC enforcement actions involving private fund advisers over the past several years, in particular, (1) conflicts of interest, (2) fees and expenses, and (3) policies and procedures relating to MNPI. This risk alert serves as a valuable reminder of some basic steps advisers to private equity and/or

hedge funds can take to reduce and avoid regulatory scrutiny in three crucial areas. For more information, please see our client alert.

On July 10, 2020, DoE issued an alert discussing cybersecurity issues specific to ransomware in response to DoE's observing an apparent increase in the sophistication of ransomware attacks on SEC registrants. This risk alert provided a number of observations on enhancing cybersecurity preparedness and operational resiliency to address ransomware attacks. The risk alert also encouraged firms to monitor the cybersecurity alerts published by the Department of Homeland Security Cybersecurity and Infrastructure Security Agency.

On August 12, 2020, DoE issued an alert addressing select COVID-19 compliance risks and considerations for broker-dealers and investment advisers. DoE has identified a number of COVID-19-related issues, risks, and practices relevant to SEC-registered investment advisers and broker-dealers which fell broadly into the following six categories: (i) protection of investors' assets; (ii) supervision of personnel; (iii) practices relating to fees, expenses, and financial transactions; (iv) investment fraud; (v) business continuity; and (vi) the protection of investor and other sensitive information.

On September 15, 2020, DoE issued an alert focusing on safeguarding client accounts against credential compromise and highlighting "credential stuffing" — a method of cyber-attack that uses compromised client login credentials that can potentially result in the loss of customer assets and unauthorized disclosure of sensitive personal information. This risk alert suggested a number of practices that firms have implemented to help protect client accounts, and encouraged firms to consider reevaluating and potentially limiting their current practices, and exploring whether the firm's staff are properly trained on how they can better secure their accounts.

Finally, on November 19, 2020, an alert was published providing an overview of notable compliance issues identified by DoE related to Rule 206(4)-7 (the Compliance Rule) under the Investment Advisers Act of 1940, as amended (the Advisers Act). This risk alert discussed compliance deficiencies noted where DoE observed advisers that (i) did not devote adequate resources, such as information technology, staff and training, to their compliance programs, (ii) designated chief compliance officers who lacked sufficient authority within the adviser to develop and enforce appropriate policies and procedures for the adviser, (iii) were unable to demonstrate that they performed an annual review or whose annual reviews failed to identify significant existing compliance or regulatory problems, (iv) did not implement or perform actions required by their written policies and procedures, (v) utilized policies and procedures that contained outdated or inaccurate information about the adviser, including off-the-shelf policies that contained unrelated or incomplete information, or (vi) did not maintain written policies and procedures or that failed to establish, implement, or appropriately tailor written policies and procedures that were reasonably designed to prevent violations of the Advisers Act.

SEC Enforcement Update

During this past year, the SEC's Division of Enforcement has continued to face a number of headwinds, somewhat limiting the number of enforcement actions across the board and, in particular, those involving private funds.

- First, as former Division of Enforcement Director Avakian recently noted, DoE has been more actively playing a larger role in addressing misconduct through the exam process with deficiency notices and remediation. While this has resulted in fewer cases being referred to the Division of Enforcement,

DoE is focused on the same issues that have spawned enforcement actions in prior years, particularly on issues that implicate undisclosed conflicts of interest. However, once enforcement actions are initiated, they are no less arduous than in prior years, and the penalties have not materially decreased.

- Second, the coronavirus pandemic disrupted government agencies across all sectors, particularly with respect to initiating new investigations or prosecuting new actions. Division of Enforcement staff are working from home, and investigations (including witness testimony) are being conducted almost entirely remotely, causing additional complications.
- Finally, the Division of Enforcement has continued to deal with the staffing shortages highlighted last year. While the hiring freeze has been lifted, the limited hiring that has taken place has not been sufficient to make up for the years of attrition. The Asset Management Unit, the specialized unit within the Division of Enforcement that focuses on advisers to private funds, remains much smaller today than it was four years ago.

Notwithstanding all of the hurdles that the SEC has faced over the past year, the Division of Enforcement has remained active and aggressive, as evidenced by the number of actions the SEC brought against private fund advisers and the penalties levied in those actions. On November 2, 2020, the Division released its Annual Report for Fiscal Year 2020, and there are a few key takeaways.

- In spite of the headwinds posed by the global COVID-19 pandemic, the SEC brought 715 enforcement actions in FY 2020, representing only a 17% decrease from FY 2019. It also obtained record-breaking monetary remedies with total penalties and disgorgement reaching $4.68 billion, an 8% increase from 2019.
- Adviser cases accounted for 87 standalone actions in the past year. The percentage of cases involving advisers to private funds or investment companies decreased, shrinking to 21% from 36% in 2019, largely due to the conclusion of the Share Class Selection Disclosure Initiative, in which investment advisers failed to make required disclosures relating to their selection of mutual fund share classes that paid the adviser (as a dually-registered broker-dealer) or its related entities or individuals a fee pursuant to Rule 12b-1 of the Investment Company Act of 1940, as amended (the Investment Company Act), when a lower-cost share class for the same fund was available to the client.
- Insider trading cases increased slightly from 6% of the actions filed in 2019 (30 actions) to 8% of the 2020 actions (33 actions).
- The impact of COVID-19 on the SEC was substantial -- by mid-March the entire division had shifted to telework and began conducting all operations remotely. While the enforcement actions brought in 2020 were the fewest Division of Enforcement actions since 2013, when the SEC brought 686 actions, the relatively slight decrease in actions is notable, especially considering that the SEC brought 492 enforcement actions after the transition to telework.
- Relatedly, the SEC received 23,650 TCRs (tips, complaints, and referrals) in 2020, a substantial increase over the 16,850 TCRs received in 2019. The increase seems largely driven by the pandemic, as the number of TCRs received between mid-March and the end of the fiscal year represented a 71% increase from the same time period in 2019. Notably, the SEC opened more inquiries and investigations than it had in 2019.

The Annual Report reiterated the SEC's continued focus on insider trading and other illegal trading activities. In particular, the SEC highlighted the importance of "robust corporate controls and compliance policies around the use and safeguarding of material nonpublic information." We expect the Division of Enforcement to continue to look for MNPI cases involving advisers to private funds, particularly where investment professionals, as part of their employment, come into contact with non-public information.

Division of Enforcement Actions Filed in Fiscal Years 2016 to 2020					
	FY 2020	FY 2019	FY 2018	FY 2017	FY 2016
Standalone Enforcement Actions	405	526	490	446	548
Follow-On Admin. Proceedings	180	210	*210*	196	195
Delinquent Filings	130	126	121	112	125
Total Actions	715	862	821	754	868
Disgorgement and Penalties Ordered (in billions)	$4.68	$4.35	$3.95	$3.79	$4.08

There is continued uncertainty as a result of the current political climate, and the presidential election results may lead to a different SEC composition with different priorities, particularly in the fund space. For example, on May 19, 2020, President Trump signed Executive Order 13924, *Regulatory Relief to Support Economic Recovery*, which laid out a number of "principles and best practices" that federal agencies should consider in rulemaking and enforcement. While the possible interpretations of this order have not yet been tested, and its ongoing existence is uncertain with respect to the incoming Biden administration, several of the provisions may further curtail enforcement actions. For instance, the Order emphasizes that fact-finders in regulatory proceedings must apply the rule of lenity (construing ambiguities against the government), and that agencies should not pursue enforcement actions where "the regulated party attempted in good faith to comply with the law." However, while recent Division of Enforcement activity in the private funds arena has been subdued relative to prior years, the SEC is still focused on similar actions – whether through the Division of Enforcement or DoE.

The bottom line for private fund advisers is that while recent Division of Enforcement activity in the private funds arena has not been quite as active as prior years, the SEC is still focused on similar actions – whether through the Division of Enforcement or DoE. The new administration could easily reallocate its resources, which may result in increased referrals and more enforcement actions over the next year. While there may be a period of rebuilding and the SEC is unlikely to immediately ramp up prosecution to the levels of years past, it will almost certainly begin to bring an increased number of actions against private fund advisers.

Particular SEC Division of Enforcement areas of focus over the past year are noted below.

Principal and Cross Trades

The SEC brought enforcement actions regarding improper principal trades. In February, the SEC settled charges against investment adviser Lone Star Value Management LLC for carrying out a series of cross

trades among a fund in which the CEO had a 35% ownership stake and other Lone Star funds. Lone Star settled the allegations for violations of Sections 206(3) and (4) of the Advisers Act and the Compliance Rule. Please see our March 18, 2020 post for more information.

In a similar vein, the SEC settled with an investment adviser for cross trading securities between approximately forty client accounts that it advised. According to the settlement order, the adviser prearranged buys and sells of the same security in the same amount from one client account to another. The SEC also noted that certain trades were in fact principal transactions and were made without the required disclosures and consent. The order attributes these violations to the lack of adequate policies and procedures in place regarding cross and principal trading. The adviser agreed to violations of Sections 206(3) and (4) of the Advisers Act and the Compliance Rule and a $450,000 civil monetary penalty in settlement of these allegations.

Undisclosed Cash Solicitations

The SEC issued two orders against VALIC Financial Advisors Inc. (VFA) in August 2020, finding that VFA violated Advisers Act Rule 206(4)-3, the "cash solicitation rule," by paying a for-profit company owned by Florida K-12 teachers' unions in exchange for being made a preferred financial services partner for members. The SEC also alleged that VFA provided false or misleading disclosures to its clients about the fees the clients were charged as a result of VFA's directive to third-party advisers in a wrap fee program it sponsored to allocate client assets to higher-cost "no-transaction fee" share classes, when in most cases lower-cost share classes were available. Please see our August 11, 2020 post for more detail.

Fees and Expenses

The SEC remains concerned about undisclosed fees and expenses charged to clients. In April, the SEC settled with a private equity fund adviser for charging the portfolio companies of a private fund it managed for the services of its in-house group of operating partners without fully disclosing this practice and the related conflicts to investors. In particular, the SEC took issue with how the fund adviser emphasized the value added and role played by its Operations Group in generating investment returns, but failed to provide full and fair disclosure that it would separately charge the fund's portfolio companies for those services or the potential associated conflicts. Please see our May 7, 2020 post for more information.

In May, the SEC found that a private fund adviser and its owner misused over $1 million of fund assets. According to the settlement order, the owner routinely purchased two airline tickets for the same trip, but later cancelled the more expensive ticket, submitted it for reimbursement to be paid as a fund expense, and travelled on the less expensive ticket. The SEC also alleged that the owner temporarily borrowed money from the fund account to settle a personal trade. The SEC barred the owner from the investment industry and required both the owner and the fund adviser to pay a $100,000 civil penalty. Please see our May 21, 2020 post for more information.

The SEC also issued an order imposing sanctions against private equity adviser Rialto Capital Management, LLC (Rialto) for violations of the Advisers Act relating to expense allocation. The settlement addressed Rialto's allocation of expenses for certain "third-party tasks" performed by in-house employees, which was allowed under the relevant fund documents with consent of the limited partner advisory committee (LPAC). Yet the SEC took issue with the practice of fully allocating certain expenses to the funds rather than proportionately to co-investors, as well as the manner in which the expenses were disclosed to the LPAC for approval. Please see our August 13, 2020 post for more information.

The SEC settled with a registered investment adviser for material misstatements and omissions to investors related to the annual operating expenses of four money market funds that it managed. According to the settlement order, the adviser caused the funds to reimburse amounts to the adviser which had previously been waived by the adviser, or reimbursed by the adviser to the funds, which resulted in the funds charging expenses that exceeded their contractual limits, causing investors to incur millions of dollars in additional fund expenses. The adviser omitted this from a description of the funds' annual operating expenses in the funds' prospectuses, thereby misstating the expenses investors paid when buying and holding the funds' shares.

Conflicts of Interest

On December 8, 2020, the SEC issued a settled order charging UK-based investment adviser BlueCrest Capital Management Limited (BlueCrest) in connection with the management of a proprietary fund, BSMA Limited (BSMA), that primarily was owned and invested in by senior traders and officers of BlueCrest. The SEC found that BlueCrest made material misstatements and misleading omissions to current and prospective investors regarding its (i) transfer of top-performing traders from its flagship client fund, BlueCrest Capital International (BCI) to BSMA, (ii) replacement of those traders with an underperforming algorithm and (iii) associated conflicts of interest. The SEC also found that BlueCrest failed to disclose certain material facts about the algorithm to BCI's independent directors, whom we represented in connection with the SEC's confidential investigation of BlueCrest. The SEC found that BlueCrest willfully violated non-scienter antifraud provisions of the Securities Act of 1933 and Investment Advisers Act of 1940, as well as the Advisers Act's compliance rule. Without admitting or denying the SEC's findings, BlueCrest agreed to a cease-and-desist order, a censure, and payment of disgorgement and prejudgment interest of $132,714,506 and a civil penalty of $37,285,494, for a total of $170 million, which will be placed into a fair fund to compensate harmed investors.

Valuation

With ongoing economic uncertainty applying pressure, the SEC has continued to focus on valuation issues surrounding portfolio investments. A recent pair of SEC actions demonstrate this trend. In December 2019, the SEC filed a complaint against a private fund adviser, SBB Research Group, LLC, and two of its executives for a multi-year fraud involving the overvaluation of structured notes. The charged executives told prospective investors they used "fair value" in recording investments, but allegedly used their own novel valuation method that inflated investment value, causing SBB to overstate historical performance and overcharge investor fees. Then, on February 26, 2020, the SEC issued a settled order instituting administrative proceedings against SBB's auditor, RSM US LLP, for failing to catch SBB's valuation fraud over years of audits. Please see our April 9, 2020 post for more information.

Similarly, the SEC took issue with the valuation process utilized by Semper Capital Management, LLC, finding that it overvalued certain odd lot positions acquired by a mutual fund it advised (SEMMX) by using round lot pricing. According to the settlement order, Semper should have disclosed that its valuation practices for odd lot positions in bonds were a material contributor to SEMMX's reported performance, and its failure to do so constituted an omission of material information from certain statements to investors that attributed the fund's reported performance to investments rising toward fundamental values. Finally, the SEC noted that Semper failed to adopt policies and procedures that were reasonably designed to address Semper's public disclosures concerning the attribution of SEMMX's reported performance.

Fund administrators have also been the target of the SEC's focus on valuation issues. The SEC recently settled with an independent fund administrator pursuant to Section 203(k) of the Advisers Act for its role in "causing" violations by the fund adviser in connection with funds the administrator serviced pursuant to

a contract with the adviser. The SEC alleged that the fund administrator failed to escalate concerns about what the administrator learned through the due diligence process, namely that the adviser had recorded unauthorized transfers from the funds and fund expenses as receivables, the latter artificially inflating the NAV of the Funds. In addition, once the fund administrator began to provide services, it continued the practice of accounting large withdrawals as receivables, and also, on instructions from the adviser, inflated monthly income by recording a performance "true-up." This resulted in investors receiving monthly statements with materially inflated account balances and returns. The SEC considered the remedial acts taken by the fund administrator, including self-reporting and implementing policies and procedures to address issues surrounding fund accounting and valuation.

Form 13Ds

In September, the SEC settled with Welsh, Carson, Anderson & Stowe for failing to provide appropriate updates in its Form 13Ds for five private funds it managed. The SEC found that Welsh Carson failed to amend its 2016 13D filing once it abandoned plans to take a prosthetics care company private and instead decided to liquidate its entire position. In settlement of these allegations, Welsh Carson agreed to pay $100,000 in civil penalties.

Advertising/Marketing Materials

The SEC settled charges with Old Ironsides Energy, LLC stemming from the inclusion of a "track record" in fund marketing materials that identified a large legacy investment with strong, positive returns as an investment which the adviser had direct management in partnership with project operators, when, as alleged by the SEC, it was actually an investment in a private fund advised by a third party. Though the settlement order observed that the adviser had a policy in place that prohibited the use of false or misleading performance results in fund marketing materials, the SEC found that the adviser had failed to implement it. Please see our April 28, 2020 post for more information.

In May, the SEC obtained the appointment of a receiver over investment adviser TCA Fund Management Group Corp. (TCA), its affiliate TCA Global Credit Fund GP Ltd. (TCA-GP), and several funds managed by TCA to protect investors from a fraudulent scheme allegedly conducted by TCA. The complaint filed by the SEC alleges that TCA improperly recognized revenue by booking loan fees as revenue upon execution of term sheets, and booking investment banking fees for borrowers when an agreement was signed and before they materialized. This, in turn, led to an inflated NAV and false performance results which were included in the promotional materials distributed to investors.

Custody Rule

Continuing to focus on violations of the Custody Rule, the SEC settled with SQN Capital for failing to timely distribute annual audited financial statements prepared in accordance with Generally Accepted Accounting Principles (GAAP) to the investors in one private fund that it advised for each fiscal year from 2012 through 2019, and another private fund that it advised for each fiscal year from 2014 through 2019. The SEC also took issue with SQN Capital's failure to adopt and implement written policies and procedures reasonably designed to prevent such violations.

Similarly, the SEC settled with TSP Capital for failing to timely distribute annual audited financial statements prepared in accordance with GAAP to the investors in the largest private fund that it advised for each fiscal year from 2014 through 2018, or even to retain an auditor for the years after 2015, thus violating Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder.

Policies and Procedures Related to MNPI

The SEC has placed a high-priority on the policies and procedures that investment advisers have in place to protect against the misuse of MNPI. The SEC brought an enforcement action against an adviser for failing to implement written policies and procedures to protect against the misuse of MNPI, especially given that the adviser's business model and trading strategy focused on trading the equity of small market capitalization public companies for which there may have been minimal trading and little or no sell side analyst coverage. The SEC identified several activities that highlighted the importance of MNPI policies: (1) routine communication with insiders; (2) entering into nondisclosure agreements with issuers to gain access to financial information and engage in strategic communications; (3) communicating with investment bankers; (4) participating in confidentially-offered deals, such as secondary offerings and PIPE transactions; and (5) publishing its own research articles on the internet. The SEC found that the policies in place were not reasonably designed to prevent misuse of MNPI because they did not address any business-specific risks and lacked any guidance regarding when trading in securities should be restricted.

The SEC entered into a settlement agreement with another adviser for similar issues related to MNPI policies. In that case, following an investment in a portfolio company, the adviser obtained a seat on the company's board. While the adviser's representative sat on the board and allegedly received information, the adviser purchased the portfolio company's stock during the company's open trading window. According to the SEC's order, the adviser failed to establish appropriate procedures with respect to publically-listed companies in its investment portfolio on whose boards it had an employee-representative. Additionally, the SEC found that the policies and procedures that were in place did not provide specific requirements for compliance staff concerning the identification of relevant parties with whom to inquire regarding possession of potential MNPI and the manner and degree to which the staff should explore MNPI issues with these parties, nor did compliance staff document sufficiently that they had inquired with the relevant parties whether they had received MNPI.

SEC Policy and Rulemaking Updates

The SEC was active on the rulemaking front in 2020, and a number of proposed or adopted rules will affect advisers to private funds. The discussion below does not include a number of interim measures implemented by the SEC or its staff in response to the effects of the ongoing COVID-19 crisis on the financial markets.

Proposed and Adopted Rules

SEC Revises Marketing Rule for Registered Investment Advisers

On December 22, 2020, the SEC announced final rules under the Investment Advisers Act of 1940, as amended "Advisers Act" to govern advertisements by registered investment advisers and payments to solicitors. The amendments create a single marketing rule that draws from and replaces the current advertising and cash solicitation rules, rule 206(4)-1 and rule 206(4)-3, respectively. These amendments reflect market developments and regulatory changes since the advertising rule's adoption in 1961 and the cash solicitation rule's adoption in 1979. The SEC also made related amendments to Form ADV and rule 204-2, the books and records rule.

The SEC received more than 90 comment letters on the proposal[1]. The marketing rule, amended books and records rule, and related Form ADV amendments will be effective 60 days after publication in the Federal Register. The SEC has adopted a compliance date that is 18 months after the effective date to give advisers a transition period to comply with the amendments.

Definition of Advertisement

The amended definition of "advertisement" contains two prongs: one that captures communications traditionally covered by the advertising rule and another that governs solicitation activities previously covered by the cash solicitation rule.

- First, the definition includes any direct or indirect communication that an investment adviser makes that: (i) offers the investment adviser's investment advisory services with regard to securities to prospective clients or private fund investors, or (ii) offers new investment advisory services with regard to securities to current clients or private fund investors. The first prong of the definition excludes most one-on-one communications, provided they do not contain hypothetical performance, and contains certain other exclusions.
- Second, the definition generally includes any endorsement by a current or former client or private fund investor, or any testimonial by any third party (*e.g.*, placement agents) for which an adviser provides cash and non-cash compensation directly or indirectly.

The Adopting Release provided that information included in a private placement memorandum ("PPM") about the material terms, objectives, and risks of a private fund offering is not an advertisement of the adviser. However, whether particular additional information included in a PPM constitutes an advertisement of the adviser depends on the relevant facts and circumstances. For example, if a PPM contained related performance information of separate accounts the adviser manages, that related performance information is likely to constitute an advertisement.

Further, private fund account statements, transaction reports, and other similar materials delivered to existing private fund investors, and presentations to existing clients concerning the performance of private funds they have invested in (for example, at annual meetings of limited partners) also would not be considered advertisements under the marketing rule.

General Prohibitions – The new marketing rule prohibits the following advertising practices:

- making any untrue statement of a material fact, or omitting a material fact necessary to make the statement made, in light of the circumstances under which it was made, not misleading;
- making a material statement of fact that the adviser does not have a reasonable basis for believing it will be able to substantiate upon demand by the SEC;
- including information that would reasonably be likely to cause an untrue or misleading implication or inference to be drawn concerning a material fact relating to the adviser;
- discussing any potential benefits without providing fair and balanced treatment of any associated material risks or limitations;

[1] The Proskauer comment letter was cited 13 times in the Adopting Release, including in connection with some of the key proposals that were not ultimately adopted.

- referencing specific investment advice provided by the adviser that is not presented in a fair and balanced manner;
- including or excluding performance results, or presenting performance time periods, in a manner that is not fair and balanced; and
- including any information that is otherwise materially misleading.

Use of Performance Information – The marketing rule prohibits any advertisement that contains:

- gross performance, unless the advertisement also presents net performance;
- any performance results, unless they are provided for specific time periods in most circumstances (although this restriction is not generally applicable to private funds);
- any statement that the SEC has approved or reviewed any calculation or presentation of performance results;
- performance results from fewer than all portfolios with substantially similar investment policies, objectives, and strategies to those being offered in the advertisement, with limited exceptions;
- performance results of a subset of investments extracted from a portfolio, unless the advertisement provides, or offers to provide promptly, the performance results of the total portfolio;
- hypothetical performance, unless the adviser adopts and implements policies and procedures reasonably designed to ensure that the hypothetical performance is relevant to the likely financial situation and investment objectives of the intended audience and the adviser provides certain information underlying the hypothetical performance; and
- predecessor performance, unless there is appropriate similarity with regard to the personnel and accounts at the predecessor adviser and the personnel and accounts at the advertising adviser, and the adviser includes all relevant disclosures clearly and prominently in the advertisement.

Additional Revisions

- *Testimonials and Endorsements* - The marketing rule allows the use of testimonials and endorsements in advertisements, provided the adviser complies with certain disclosure, oversight, and disqualification provisions.
- *Third-Party Ratings* - The marketing rule allows the use of third-party ratings in an advertisement, provided the adviser provides disclosures and satisfies certain criteria pertaining to the preparation of the rating.

As mentioned above, the Adopting Release also makes corresponding amendments to the books and records rule and Form ADV. For additional information and analysis, please see our client alert.

Proposal to Increase the Form 13F Threshold to $3.5 billion

On July 10, 2020, the SEC proposed significantly increasing the reporting threshold requiring the filing of a Form 13F to $3.5 billion, a 35-fold increase from the current threshold. Currently, under Rule 13f-1, advisers that manage at least $100 million worth of equity securities publicly traded in the U.S. (13(f) securities) on the last day of any calendar month are required to file a Form 13F with the SEC. The form includes a table listing all of the U.S.-traded equity securities managed by the adviser, subject to a *de minimis* exception. Confidential treatment can also be requested. The $100 million threshold has not

changed since Congress adopted the requirements in 1975, and the rules were adopted by the SEC in 1978.

The SEC stated that it was proposing the increase to $3.5 billion to provide relief for smaller advisers. According to the SEC, the 13F rules were intended to capture the largest institutional advisers, and increasing the reporting threshold to $3.5 billion is intended to "…account for the changes in the size and structure of the U.S. equities market since 1975."

The SEC requested any comments on this proposal be submitted on or before September 29, 2020. On October 27, 2020, Bloomberg reported that the SEC had received 2,238 letters opposing the changes to 13F requirements and just 24 in favor. Please see our client alert on this rule proposal for more information.

Adoption of Amendments to the Volcker Rule

On June 25, 2020, the Federal Reserve Board, the OCC, the FDIC, the SEC and the CFTC adopted amendments to the regulations implementing section 13 of the Bank Holding Company Act, known as the "Volcker Rule."

The Volcker Rule generally prohibits banking entities (e.g., insured depository institutions and their affiliates) from investing in, sponsoring, or having certain relationships with private equity funds, hedge funds and other entities that are defined under the Volcker Rule as "covered funds," subject to certain exceptions.

Most importantly for advisers, the amendments will expand the types of private funds that banking entities will be able to invest in, sponsor and advise by excluding from the definition of "covered funds" (i) qualifying venture capital funds, (ii) qualifying credit funds, (iii) qualifying family wealth management vehicles, and (iv) qualifying customer facilitation vehicles. In addition, the amendments address certain issues in the current rules related to foreign public funds, limit the extraterritorial impact of the Volcker Rule on certain foreign funds (qualifying foreign excluded funds) and clarify the treatment of parallel investments made by banking entities in the same underlying investments as a sponsored covered fund.

These amendments became effective on October 1, 2020. Please see our client alert on this rule adoption for more information.

Adoption of Amendments to the "Accredited Investor" Definition

On August 26, 2020, the SEC adopted amendments to expand the definition of "accredited investor" found in Rule 215 and Rule 501(a) of Regulation D under the Securities Act of 1933, as amended (Securities Act).

The amendments to the accredited investor definition in Rule 501(a) include:

- adding a new category to the definition that permits natural persons to qualify as accredited investors based on certain professional certifications, designations or credentials or other credentials issued by an accredited educational institution, which the SEC may designate from time to time by order. In conjunction with the adoption of the amendments, the SEC designated by order holders in good standing of the Series 7, Series 65, and Series 82 licenses as qualifying natural persons. This approach provides the SEC with flexibility to reevaluate or add certifications, designations, or credentials in the future. Members of the public may wish to propose for the SEC's consideration additional certifications, designations or credentials that satisfy the attributes set out in the new rule;

- including as accredited investors, with respect to investments in a private fund, natural persons who are "knowledgeable employees" of the fund;
- clarifying that limited liability companies with $5 million in assets may be accredited investors and adding SEC and state-registered investment advisers, exempt reporting advisers, and rural business investment companies to the list of entities that may qualify;
- adding a new category for any entity, including Indian tribes, governmental bodies, funds, and entities organized under the laws of foreign countries, that own "investments," as defined in Rule 2a51-1(b) under the Investment Company Act, in excess of $5 million and that was not formed for the specific purpose of investing in the securities offered;
- adding "family offices" with at least $5 million in assets under management and their "family clients," as each term is defined under the Advisers Act; and
- adding the term "spousal equivalent" to the accredited investor definition, so that spousal equivalents may pool their finances for the purpose of qualifying as accredited investors.

These amendments became effective on December 8, 2020. Please see our client alert on this rule adoption for more information.

Adoption of Amendments to the Auditor Independence Rules

On October 16, 2020, the SEC adopted amendments to certain auditor independence requirements in Rule 2-01 of Regulation S-X. The final amendments reflect updates based on recurring fact patterns that the SEC staff has observed over years of consultations in which certain relationships and services triggered technical independence rule violations without necessarily impairing an auditor's objectivity and impartiality. These relationships either triggered non-substantive rule breaches or required potentially time-consuming audit committee review of non-substantive matters, thereby diverting time, attention, and other resources of audit clients, auditors, and audit committees from other investor protection efforts.

Advisers which are registered with the SEC and which have, or are deemed to have, custody of clients' funds or securities are required to comply with Advisers Act Rule 206(4)-2 (the Custody Rule). Under the Custody Rule, a registered investment adviser managing one or more private funds may either (i) arrange for an annual surprise independent verification of each funds' assets, or (ii) annually distribute each private funds' audited financial statements to all beneficial owners within 120 days of the end of each fund's fiscal year. In each of the foregoing scenarios, the independent verification or the financial statement audits must be completed by an "independent public accountant."

The SEC recognized that relationships within an investment company complex often resulted in a common accounting firm providing both audit and non-audit services to different affiliated entities within the complex (e.g., a private fund and a portfolio company thereof) resulting in the inability of the accounting firm to meet the independence standard required under Rule 2-01 of Regulation S-X. Given the paucity of internationally-recognized accounting firms, difficulties resulted in regulated entities obtaining qualified auditors who were also able to satisfy the independence standard.

The SEC agreed to modify "the proposed amendments to Rule 2-01(f)(4)(ii) to incorporate a dual materiality threshold such that .... [u]nder the final amendments, if either the sister entity or the entity under audit is not material to the controlling entity, then the sister entity will not be deemed an affiliate of the audit client...." The SEC release further noted that "after consideration of the comments received and further evaluation we are persuaded that where the entity under audit is not material to the controlling

entity, an auditor's relationships with or services provided to sister entities would generally not threaten the auditor's objectivity and impartiality."

These amendments will become effective 180 days after publication in the Federal Register.

Policy Updates

On December 11, 2019, the SEC's Division of Investment Management issued a no-action letter concerning Advisers Act Rule 206(4)-2 (the Custody Rule). As required by the Custody Rule, an independent public accountant engaged by a registered adviser in compliance with Custody Rule obligations must be registered with, and subject to regular inspection of, the Public Company Accounting Oversight Board (PCAOB) in accordance with its rules. Absent adoption by the PCAOB of a permanent program for the inspection of auditors, this letter extends prior granted no-action relief until the date that a PCAOB-adopted permanent examination program takes effect.

On October 7, 2020, the SEC voted to propose a conditional exemption from federal broker registration requirements of Section 15(a) of the Securities Exchange Act of 1934 (Exchange Act) for certain "finders" who assist issuers in raising capital in private placements with accredited investors. The proposed exemption, if adopted, could be helpful to private funds and early stage businesses who seek to raise capital without having to engage a registered broker-dealer, but would not preempt analogous state registration requirements. The SEC requested any comments on this proposal be submitted on or before November 12, 2020. Please see our client alert on this proposed conditional exemption for more information.

On September 15, 2020, it was reported that DoE Director, Pete Driscoll, revealed while delivering virtual remarks at the London-based conference *SEC Regulation Outside the U.S.* that the impasse in the SEC's processing of applications of non-U.S.-based advisers that are subject to the General Data Protection Regulation (GDPR) had been reached. The SEC's prior concerns had centered on the GDPR's potentially restricting the agency's ability to access the books and records required to be kept and produced by an adviser registered pursuant to the Advisers Act. It was reported that the solution was reached in part due a letter from the United Kingdom's Information Commission's Office.

Outstanding and Future Matters

As reflected in the SEC's Regulatory Flexibility Agenda, in the spring of 2020, the agency's Division of Investment Management was considering recommending that the SEC propose amendments to existing rules and/or propose new rules under the Advisers Act to improve and modernize the regulations around the custody of funds or investments of clients by investment advisers. More recently, Dalia Blass, former Director of the Division of Investment Management, noted in a public statement on October 22, 2020 that the Division of Investment Management had "taken up" suggestions by the industry to the Custody Rule. Specifically, former Director Blass noted that the Division of Investment Management was exploring "the scope of the rule, the surprise examination requirements, and the appropriate role and requirements for qualified custodians."

CFTC/NFA Updates

The U.S. Commodity Futures Trading Commission (CFTC) has continued to emphasize its enforcement activities, reporting that in its fiscal year ended September 30, 2020 it filed 113 new actions, compared to 69 in the preceding fiscal year. Cases involved allegations of manipulation, spoofing, fraud, misappropriation of confidential information, and illegally offering new products, including digital assets.

The total monetary relief awarded in CFTC enforcement actions increased in the 2020 fiscal year to more than $1.3 billion, a 39% increase over the prior fiscal year.

The NFA reports that its examination program is continuing at its normal pace, but with all examinations taking place remotely.

Coronavirus Relief

In order to accommodate employees working from home during the pandemic, the NFA in January issued no-action relief permitting associated persons (APs) of NFA member firms to temporarily work from home or other remote locations not listed as a branch office and without a branch manager, provided that the NFA member firm implements appropriate supervisory methods to adequately supervise the APs' activities and meet its recordkeeping requirements.

NFA Provides Relief to Permit CTAs to Present Gross Past Performance to ECPs

In April, the NFA amended Compliance Rule 2-9 to permit commodity trading advisors (CTAs) who are also SEC-registered investment advisers to present past performance gross of all fees and expenses to eligible client participants (ECPs) in non-public, one-on-one situations. In order to take advantage of the relief, the CTA must:

- provide the ECP client with written disclosure that the performance results are presented on a gross basis and do not reflect the deduction of fees and expenses, which will reduce the client's returns; and
- offer to provide the ECP client with the performance results net of any fees and expenses agreed upon with the client at or prior to exercising discretion over the client's account.

CFTC Extends Bad Actor Prohibitions to Exempt Advisers

In June, the CFTC adopted a final rule that extends the "bad actor" prohibitions under the Commodity Exchange Act (CEA) to exempt advisers operating a fund under an otherwise applicable exemption, including the limited trading exemption under CFTC Rule 4.13(a)(3). Under the new amended rule, a commodity pool operator (CPO) claiming a registration exemption would be required to certify that neither the CPO nor any of its principals has in its background conduct that would result in automatic statutory disqualification under the CEA.

Other CFTC Rule Changes

On October 6, the CFTC adopted amendments to Form CPO-PQR, required to be filed with the CFTC by registered CPOs.

On October 15, the CFTC adopted a long-awaited final rule establishing position limits for various commodity interests, to become effective in January.

On the same date, the CFTC adopted certain amendments to CFTC Regulation 3.10, which exempts non-U.S. CPOs and CTAs from certain registration obligations with respect to their non-U.S. customers.

Swaps APs Must Take Swaps Exam by January 31, 2021

APs of any NFA member futures commission merchant, introducing broker, CPO or CTA engaged in CFTC regulated swaps activities and who are registered with the NFA as a swap AP must pass the NFA's Swaps Proficiency Requirements by January 31, 2021.

Insider Trading Update

The past year saw two important decisions from the U.S. Court of Appeals for the Second Circuit: One addressing insider trading in breach of a confidentiality agreement and another making clear that the U.S. government can bring criminal charges for insider trading without needing to establish that the tipper of MNPI breached a fiduciary duty or received an improper personal benefit.

Other noteworthy events included (*i*) criminal charges filed against a hedge-fund founder for allegedly misusing confidential information he obtained through his service on the creditors' committee of a bankrupt issuer, (*ii*) the CFTC's continued interest in insider trading, and (*iii*) now-stalled legislative efforts to address insider trading.

Second Circuit Decision on Trading in Breach of Confidentiality Agreement

In September 2020, the Second Circuit affirmed the insider-trading conviction of a doctor who, in breach of a confidentiality agreement, had traded on nonpublic corporate information about a drug trial in which he had been participating. The decision in *United States v. Kosinski*, ___ F.3d ___, 2020 WL 5637600 (2d Cir. Sept. 22, 2020), held that:

- A person can be convicted of insider trading under both the "classical theory" (as a temporary insider) and the "misappropriation theory";
- A contractual agreement to keep information *confidential* can also create liability for *trading* on that information even if the agreement does not expressly prohibit *use* of the information;
- A contractual designation of "independent contractor" status does not preclude a fiduciary relationship, at least where a public policy is at stake (as it is under the securities laws); and
- A fiduciary relationship does not require the fiduciary to have control and dominance over the other party.

Background

The *Kosinski* case involved a doctor who was the principal investigator in a clinical trial for a drug developed by a drug company (Regado Biosciences). Before being retained to participate in the drug trial, the doctor had signed agreements promising both to maintain in "strict confidence" all information with which he would be provided and to file a financial disclosure form "promptly" disclosing to the company if the value of his holdings in company stock exceeded $50,000.

The doctor began purchasing company stock after entering into the agreements, but he never made the required disclosure when the value of his holdings exceeded $50,000. He also sold all of his stock (thereby avoiding a loss) after receiving a confidential email to principal investigators stating that the drug trial had been put on hold because of several patients' allergic reactions. The doctor also bought put options on company stock after receiving another confidential email about a patient's death.

The doctor was convicted of insider trading under § 10(b) of the Exchange Act. The Second Circuit affirmed the conviction.

Liability under the Classical and Misappropriation Theories

The Second Circuit first ruled that the doctor could be convicted under the "classical theory" of insider trading, which recognizes a relationship of trust and confidence between a corporation's shareholders and those insiders who have obtained confidential information through their positions with the company.

The doctor could be deemed a "temporary insider" under this theory, because he entered into a special confidential relationship to help conduct the company's business.

The doctor also could be convicted under the "misappropriation theory" of insider trading, because he used nonpublic corporate information for his own purposes in breach of his contractual duty to the source of that information (the company) to keep the information confidential.

Confidentiality vs. Use

The Second Circuit rejected the doctor's argument that he had agreed only to keep the drug-trial information confidential, not to refrain from using it. The court noted that the agreement covered more than confidentiality; it required the doctor to file disclosure forms about his stock holdings, which he had not submitted. But the court also held that a confidentiality commitment's "absence of an express prohibition on trading is not fatal here." "Whatever merit [the doctor's] argument might have had [the drug company] brought a civil action for breach of contract, it fails in the context of a criminal prosecution for trading on nonpublic inside information that was not available to those upon whom he unloaded his shares without making the requisite disclosure."

Independent-Contractor Status

The Second Circuit also rebuffed the contention that, because the doctor's contract had characterized the doctor as an "independent contractor," he could not be a fiduciary. The court noted that the Supreme Court had previously held that other types of independent contractors could be fiduciaries for insider-trading purposes, but it also declined to "afford the contractual term 'independent contractor' controlling effect where such a term, even in a private contract, implicates significant public policies." The doctor's "actions substantially undermined the policies underlying the Exchange Act relating to insider trading. Accordingly, whether or not the language of the contract would have provided a defense to a private breach of contract action by [the drug company], [the doctor's] designation as an independent contractor cannot control the legality of his trades."

Prerequisites for Fiduciary Status

The Second Circuit devoted significant attention to the doctor's argument that a fiduciary relation can exist only "when confidence is reposed on one side and there is resulting superiority and influence on the other." The court concluded that the doctor's relationship with the drug company was fiduciary even under the doctor's proffered three-part standard, but it also rejected the contention that the *only* appropriate standard for a fiduciary relationship involves "reliance, de facto dominance and control." Instead, the court emphasized that "a fiduciary relationship can arise so long as the party in whom confidence is reposed has entered into a relationship in which he or she acts to serve the interests of the party entrusting him or her with such information, . . . without a showing of 'de facto control and dominance.'"

The *Kosinski* decision does not appear to break new ground on the classical and misappropriation theories of insider trading, but it could undermine arguments that an agreement merely to keep information "confidential" does not include a commitment not to use that information for trading purposes. The Fifth Circuit addressed that issue some years ago, albeit only at the pleading stage, rather than after a trial.

The decision also makes clear that parties cannot insulate themselves from fiduciary status for insider-trading purposes through an "independent contractor" label – and that "de facto control and dominance" are not required for a fiduciary relationship, if the alleged fiduciary agreed to serve the interests of the

party that entrusted him or her with confidential information. The latter holding in particular might expand in some cases the type of relationship that can create fiduciary status for insider-trading purposes.

Criminal Securities-Fraud Liability without Personal Benefits and Fiduciary Breaches

Our annual updates over the past several years have traced the evolution of the "personal benefit" requirement from the Second Circuit's decision in *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014), through the Supreme Court's decision in *Salman v. United States*, 137 S. Ct. 420 (2016), and the Second Circuit's rulings in *United States v. Martoma*, 894 F.3d 64 (2d Cir. 2018). The debate centered on the nature of the "personal benefit" that a tipper of MNPI must obtain to create tipper and tippee liability for trading based on that information.

Insider-trading liability arises under § 10(b) of the Exchange Act only if securities are bought or sold on the basis of MNPI used or obtained in breach of (i) a fiduciary duty, (ii) a duty of trust or (iii) confidence owed to the shareholders of the issuer or to the source of the information. That breach of duty depends on whether the tipper received a personal benefit in exchange for providing the information.

However, as we previously discussed, a criminal fraud statute enacted as part of the Sarbanes-Oxley Act of 2002 – 18 U.S.C. § 1348 – does not require consideration of either fiduciary breaches or personal benefits, and its intent requirement differs from § 10(b)'s. Prosecutors are using § 1348 in insider-trading cases, and the Second Circuit's December 2019 decision in *United States v. Blaszczak*, 947 F.3d 19 (2d Cir. 2019), *cert. filed* (No. 20-306, Sept. 4, 2020), confirms the availability of that alternative theory of liability.

Section 1348 imposes criminal liability on anyone who "knowingly executes, or attempts to execute, a scheme or artifice" either (1) "to defraud any person in connection with" any commodity or any security of a registered issuer or (2) "to obtain, by means of false or fraudulent pretenses, representations, or promises, any money or property in connection with the purchase or sale of" any such commodity or security. The language is derived from the federal mail-fraud and wire-fraud statutes. Because § 1348 is a criminal statute, the SEC cannot use it for civil enforcement actions.

Background

Blaszczak involved prosecutions of four individuals in connection with alleged schemes to obtain nonpublic information from the federal Centers for Medicare and Medicaid Services (the CMS) about reimbursement rates for certain medical treatments. A CMS employee had allegedly given MNPI to a friend (Blaszczak), a former CMS employee who was then working as a consultant; the consultant then passed the information to persons at two hedge funds, who traded on it. The CMS employee allegedly had received benefits from the tippee-consultant in the form of free meals, tickets to sporting events, and an offer to join the consultant's firm.

The government charged all defendants with securities fraud under Title 15, and also with violations of § 1348, and the wire-fraud and conversion statutes. The court's jury instructions on the Title 15 charge addressed all the familiar elements – including whether the tipper (the CMS employee) had owed and breached any duty of trust or confidence to his agency, whether he had received a personal benefit for doing so, and whether the tippee defendants had known of the tipper's breach of duty and receipt of a benefit. The defendants asked the court to include those same elements in its charge under § 1348, but the court denied the request, requiring the jury to find only that the defendants had knowingly and willfully engaged in "an illegal scheme or artifice" by providing confidential CMS information "to another person for the purpose of buying or selling securities on the basis of that information." The charge did not say

anything about the tipper's duty to the agency, his alleged receipt of a personal benefit, or the tippees' knowledge of either of those things.

The jury acquitted the defendants on the Title 15 securities-fraud charges, but convicted them of § 1348 violations (except the CMS employee, who was convicted of wire fraud and conversion of government property). The Second Circuit, in a 2-1 decision, affirmed the convictions.

Second Circuit's Decision

The Second Circuit held that the personal-benefit test required for Title 15 securities fraud does not apply to Title 18 securities fraud under § 1348 (or to wire fraud under 18 U.S.C. § 1343).

The court began by observing that the Title 15 and Title 18 fraud statutes have certain common features: both prohibit schemes to "defraud"; both construe "defrauding" to include embezzlement or misappropriation of confidential information; and neither mentions a "personal benefit" test in the statutory text. But the two statutes differ as to a personal-benefit requirement, because Title 15 securities fraud "depends entirely on the purpose of the Exchange Act," while Title 18 securities fraud derives from the embezzlement theory of fraud.

The court explained that "the personal-benefit test is a judge-made doctrine premised on the Exchange Act's statutory purpose," which is "to protect the free flow of information into the securities markets" while "eliminat[ing] [the] use of inside information for *personal advantage*." Securities fraud under Title 18, in contrast is "derived from the law of theft or embezzlement," where a breach of duty (including receipt of a personal benefit) is not an additional prerequisite. "In the context of embezzlement, there is no additional requirement that an insider breach a duty to the owner of the property, since it is impossible for a person to embezzle the money of another without committing a fraud upon him. Because a breach of duty is thus inherent in . . . embezzlement, there is likewise no additional requirement that the government prove a breach of duty in a specific manner, let alone through evidence that an insider tipped confidential information in exchange for a personal benefit."

The court was not moved by the defendants' argument that eliminating the personal-benefit requirement from Title 18 securities fraud (and wire fraud) would give the government "a different – and broader – enforcement mechanism to address securities fraud than what had previously been provided in the Title 15 fraud provisions." Rather, the court concluded that § 1348 was designed to achieve that result.

The court also held that, "in general, confidential government information may constitute government 'property' for purposes of" the Title 18 securities-fraud and wire-fraud statutes. "[G]overnment agencies have strong interests – both regulatory and economic – in controlling whether, when, and how to disclose confidential information relating to their contemplated rules" (here, CMS's rules about reimbursement rates). In addition, the court upheld the convictions under the statute prohibiting conversion of federal property (18 U.S.C. § 641), ruling that the government's confidential information constituted a "thing of value."

Judge Kearse dissented because she did not consider the agency's pre-decisional regulatory information to be "property" or a "thing of value" under Title 18.

The government's ability to use Title 18 to avoid Title 15's breach-of-duty and personal-benefit requirements could facilitate insider-trading prosecutions where the government cannot prove (or does not want to undertake the burden of proving) that the insider received a personal benefit in exchange for providing MNPI – or, perhaps more importantly, that remote tippees knew about any such benefit. Title

18 will not affect SEC civil proceedings, but the government has been using § 1348 more frequently in recent years, and the *Blaszczak* decision is likely to fuel that trend.

From a compliance point of view, the existence of this alternative prosecutorial route under § 1348 emphasizes the importance of making compliance judgments based on avoiding prosecution in the first place, rather than on framing defenses (such as lack of receipt of a personal benefit or lack of knowledge of any such benefit) if a prosecution arises. If trading decisions do not involve MNPI, the relatively lower prosecutorial burdens under § 1348 should not be cause for concern.

Criminal Charges against Hedge-Fund Founder for Misuse of Role on Committee

In September 2020, the Acting U.S. Attorney for the Southern District of New York announced criminal charges against Daniel Kamensky, the founder and manager of a hedge fund, for securities fraud, wire fraud, extortion, and obstruction of justice. Kamensky, who was co-chair of the Official Committee of Unsecured Creditors (the UCC) in the Neiman Marcus bankruptcy, allegedly had pressured a rival bidder to abandon its higher bid for the debtor's assets so that Kamensky's hedge fund could obtain those assets at a lower price. In so doing, Kamensky allegedly violated the fiduciary duty he owed to all unsecured creditors as a UCC member. Kamensky also allegedly attempted to persuade the rival bidder to cover up the scheme.

During the bankruptcy process, the UCC had negotiated with Neiman Marcus's owners to obtain certain securities known as "MYT Securities," and the UCC ultimately succeeded in reaching a settlement to obtain 140 million shares of MYT Securities for the benefit of certain unsecured creditors. In July 2020, Kamensky was negotiating with the UCC for his hedge fund to offer 20 cents per share to buy MYT Securities from any unsecured creditor who preferred to receive cash, rather than MYT Securities, as part of that settlement.

According to the Government, Kamensky learned on July 31 that an investment bank had informed the UCC of its interest in bidding between 30 and 40 cents per share to buy the MYT Securities from unsecured creditors who wanted cash. That afternoon, Kamensky allegedly sent messages to a trader at the bank telling him not to place a bid for those securities. He then allegedly called other bank employees, told them that his fund should have the exclusive right to buy MYT Securities, and threatened to use his official role as co-chair of the UCC to prevent the bank from acquiring the MYT Securities. He also allegedly stated that his fund had been a client of the bank in the past, but would stop doing business with the bank if the bank proceeded with its bid for the MYT Securities. The bank decided to not make a bid, and it informed the UCC's legal adviser that it had declined to proceed because Kamensky had asked it not to do so.

In an order dated November 4, 2020, United States Magistrate Judge Barbara C. Moses allowed the parties a continuance in the proceedings upon a finding that the parties had been engaged in, and were continuing, discussions concerning a possible settlement of the allegations.

CFTC's Continued Interest in Insider Trading

Our updates in previous annual reviews mentioned the CFTC's new interest in combatting insider trading. That interest continued with the CFTC's August 4, 2020 consent order resolving charges against the New York Mercantile Exchange and two former employees who allegedly had repeatedly disclosed MNPI in violation of the Commodity Exchange Act (the CEA) and CFTC regulations.

The consent order found that, on numerous occasions, the employees had disclosed to a commodities broker "the identities of counterparties to specific options trades, whether a particular counterparty

purchased or sold the option, whether it was a call or a put, the volume of contracts traded, the expiry, the strike price, and the trade price." The order requires the parties to pay $4 million, but caps the individuals' fines at $300,000 and $200,000, respectively. It also imposes a permanent trading ban on the individuals as to commodity interests.

The enforcement action marks the first time the CFTC charged an exchange with employees' violations of the CEA and CFTC regulations' proscriptions against disclosures of MNPI.

Legislation on Insider Trading: Not Much Progress

As we previously reported, several bills have been introduced in Congress in recent years to address insider trading. So far, none of them have become law because of lack of progress in the Senate.

In September 2019, parallel bills were introduced in the House (H.R. 4335) and the Senate (S. 2488) to plug the so-called "8-K trading gap." The bills would require the SEC, within one year after the proposed legislation's enactment, to issue rules requiring issuers to establish policies, controls, and procedures to prevent executive officers and directors from trading the issuers' securities between (*i*) either the date a reportable event occurs (for Form 8-K §§ 1-6) or the date the issuer determines to report that event (for Form 8-K §§ 7-8) and (*ii*) the date the issuer files a Form 8-K or furnishes it to the SEC. The SEC may exempt "automatic" transactions, such as those made pursuant to advance election or trading plans, but not if the trading plans were adopted during the pre-8-K periods described in the preceding sentence. The House passed its bill in January 2020, but the Senate has not acted.

H.R. 2534, a separate insider trading bill, which the House passed in December 2019, would prohibit the purchase or sale of securities while the trader is in possession of MNPI if the purchaser or seller "knows, or recklessly disregards, that such information has been obtained wrongfully, or that such purchase or sale would constitute a wrongful use of such information." Trading would be considered wrongful if the information was obtained (*i*) through theft, bribery, misrepresentation, or espionage, (*ii*) in violation of any federal law "protecting computer data or the intellectual property or privacy of computer users," (*iii*) through "conversion, misappropriation, or other unauthorized and deceptive taking of such information," or (*iv*) in breach of any fiduciary duty, confidentiality, contract, "or any other personal or other relationship of trust and confidence."

H.R. 2534 thus would appear to codify aspects of insider-trading law as we know it. However, unlike current insider-trading law, the bill does *not* require that the discloser of the information to have received a personal benefit in exchange for providing information in breach of a duty. To the contrary, the bill makes clear that the knowledge component does *not* require the trader to know "the specific means by which the information was obtained or communicated, or whether any personal benefit was paid or promised by or to any person in the chain of communication, so long as the person trading while in possession of such information . . . was aware, consciously avoided being aware, or recklessly disregarded that such information was wrongfully obtained or communicated."

H.R. 2534 further states that, except as provided under Exchange Act § 20(a)'s control-person liability provision, no person shall be liable "solely by reason of the fact that such person controls or employs a person who has violated this section, if such controlling person or employer did not participate in, profit from, or directly or indirectly induce the acts constituting the violation of this section." This provision could provide protection to a fund whose employee has gone rogue, as long as the fund itself did not profit from or directly or indirectly induce the alleged misconduct.

H.R. 2534 would also require the SEC to determine within 180 days after enactment whether "automatic trading transactions" should be exempted, and it provides an interim exemption for such transactions.

The bill defines "automatic trading transactions" as those that "occur[] automatically" or are "made pursuant to an advance election." The Senate has not acted on this bill.

FINRA / Broker-Dealer Updates

Private fund sales and marketing activities by employees and other personnel associated with the private fund or its adviser may give rise to broker registration issues.

Under Section 15(a) of the Exchange Act, an individual acting as a "broker" must register with the SEC or be associated with a registered broker-dealer. A broker is defined generally to mean "any person engaged in the business of effecting transactions in securities for others." The SEC staff has advised that a person is "in the business" of being a broker where, for compensation, he or she participates with some regularity in key points in the chain of distribution. Activities typically viewed as brokerage functions include assisting in structuring transactions, identifying potential investors, soliciting or recommending purchases or sales, order taking, and execution or completion of trades. Historically, the staff has considered the receipt of commissions or other transaction-based compensation as *prima facie* evidence of brokerage.

An issuer, including a private fund, generally is not considered a broker with respect to sales of its own interests. However, its paid employees or agents who sell those interests may be brokers unless they can avail themselves of an exemption.

The Rule 3a4-1 "Safe Harbor"

Rule 3a4-1 under the Exchange Act provides a non-exclusive "safe harbor" for individuals associated with issuers or their affiliates that allows them to offer and sell the issuer's securities on a limited basis without being considered brokers. The rule may be relied on by private fund personnel, including principals and employees of the adviser, to sell private fund interests. It has three preliminary requirements:

- The person must not be subject to a statutory disqualification, as defined in Section 3(a)(39) of the Exchange Act;
- He or she may not be compensated in connection with the sale of the private fund interests by the payment of a commission or other remuneration based directly or indirectly on an investment in the private fund; and
- The individual cannot be an associated person of a broker-dealer at the time of the sale.

Other conditions permitting the broadest selling activities provide that the individual (i) must primarily perform other duties for or on behalf of the private fund, (ii) must not participate in selling private fund interests or other securities more than once every 12 months (other than in reliance on another exception), and (iii) cannot have been associated with a broker-dealer within the previous 12 months. (Other exceptions permit sales to banks, broker-dealers and other regulated entities and certain passive activities.)

Circumstances that could cause private fund personnel, including principals and employees of the adviser, to potentially fall outside the safe harbor include:

- Performing private fund marketing or sales activities as a primary function: the Chief Counsel of the SEC's Division of Trading and Markets has said that a dedicated sales staff is indicative of

activities requiring registration. Requests for no-action relief have suggested that less than 50% of the person's time spent on sales functions still may render the person ineligible.

- Compensation tied directly or indirectly to sales, including discretionary bonuses based on considerations or metrics that create a "salesman's stake" in the transactions.
- Sales of multiple private fund products or a single fund product more often than once a year. This factor, subject to further analysis, could prevent reliance on the rule by hedge fund and other fund managers that engage in regular or frequent fundraising efforts.
- Prior employment as a registered representative or other association with a broker-dealer (registered or unregistered, foreign or domestic) within the 12 months prior to engaging in fund marketing activities.

Please refer to our Client Advisory on the Rule 3a4-1 Safe Harbor.

The SEC's Proposed "Finder" Exemption

On October 7, 2020, the SEC proposed a conditional exemption from broker registration for "Finders" who assist issuers, including private funds, in raising capital through private placements with accredited investors. It would create two classes of Finders: Tier I Finders and Tier II Finders.

Tier I Finders could provide contact information of potential investors for one capital raising transaction by a single issuer over a 12-month period, but have no contact with an investor about the issuer.

Tier II Finders could solicit investors, but their activities would be limited to: (i) identifying, screening, and contacting potential investors; (ii) distributing issuer offering materials to them; (iii) discussing information included in the offering materials, *provided* the Tier II Finder does not give advice on valuation or advisability of investing; and (iv) arranging or participating in meetings with the issuer.

Both are subject to the following conditions:

- The issuer is not required to file reports under Section 13 or Section 15(d) of the Exchange Act;
- The issuer relies on an applicable exemption from registration under the Securities Act;
- The Finder does not engage in general solicitation;
- The potential investor is, or reasonably is believed to be, an "accredited investor" as defined in Rule 501 of Regulation D;
- The Finder has a written agreement with the issuer that describes the services provided and related compensation;
- The Finder is not an associated person of a broker-dealer; and
- The Finder is not subject to statutory disqualification.

In both cases, the Finder could not: (i) be involved in structuring the transaction or negotiating the terms of the offering; (ii) handle customer funds or securities or bind the issuer or investor; (iii) participate in the preparation of any sales materials; (iv) perform any independent analysis of the sale; (v) engage in any "due diligence" activities; (vi) assist or provide financing for purchases; or (vii) provide advice as to the valuation or financial advisability of the investment.

A Tier II Finder would have to disclosure its role and compensation prior to or at the time of the solicitation and obtain a dated written acknowledgment of receipt of the disclosure from the investor prior to or at the time of investment.

Tier I and Tier II Finders could receive commissions or other transaction-based compensation. Both would remain subject to the anti-fraud provisions of the federal securities laws. The proposal would not affect state law registration and other requirements.

While the proposal could facilitate the use of outside finders in private fund capital raising, the limitations on the range of communications with investors (less than those permitted by Rule 3a4-1) could limit its utility for personnel of advisers to private funds. For further information, please refer to our full client alert on the Proposed Finder Exemption.

Consequences of Failing to Register or Act within an Exemption

There can be significant consequences for acting as a broker without registration or an exemption, including civil fines and remedies, as well as potential criminal liability. In addition, the SEC may take regulatory action against sales personnel, the adviser and the private fund. Moreover, investors purchasing private fund interests where registration was required may have a right of rescission.

Private funds engaged in regular marketing and sales activities occasionally use affiliated or unaffiliated registered broker-dealers to offer and sell their products. A private fund using an affiliated, limited purpose or full service broker-dealer to sell to individual accredited investors should understand that new Rule 17a-14 of the Exchange Act requires delivery of a relationship summary on Form CRS to the investor prior to any sale, while new Rule 15l-1, Regulation BI (Best Interest), requires additional disclosures and procedures for mitigating conflicts of interest, and would apply where the broker makes recommendations. For more information on Form CRS and Regulation BI, please refer to our Client Advisory on Regulation BI.

For more information on the broker-dealer registration process please see our Client Advisory on Broker-Dealer Registration.

Foreign Corrupt Practices Act Update

In 2020, the SEC and DOJ have continued to focus on investigating and charging corporate actors for FPCA violations, in fact bringing in more money in settlements than any prior year. This year, the SEC and DOJ have brought actions against financial services firms, including consumer lenders and a leading global financial firm. The DOJ has also issued updated guidance on the FCPA and related issues.

In November 2019, the DOJ updated its FCPA Corporate Enforcement Policy to clarify that, in order to obtain credit for voluntary disclosure of misconduct, a company only needed to provide all relevant facts "known to [the company] *at the time of disclosure*," as opposed to all facts, encouraging early disclosure by companies even if they are in the process of investigating all relevant facts, and recognizing that some companies may be hesitant to come forward with incomplete knowledge for fear of later being accused of withholding information. DOJ's FCPA Corporate Enforcement Policy is available here.

Over the summer, the DOJ provided additional updates to its policy on the Evaluation of Corporate Compliance Programs (available here). In its update, the DOJ emphasized its focus on practical questions regarding the development and implementation of compliance programs. In one notable change, it shifted a key evaluative question from asking whether a program was being "implemented"

effectively, to instead asking whether it is "adequately resourced and empowered to function effectively," indicating the DOJ's interest in evaluating additional, lower-level detail as part of its considerations. The changes also direct prosecutors assessing compliance programs to take into greater account the resources and circumstances of a company, such as its "size, industry, geographic footprint, regulatory landscape, and other factors . . . that might impact its compliance program." Finally, the DOJ's changes show increased consideration of how messages are developed and conveyed to employees, adding several provisions regarding data-driven reviews, accessibility of training accompanied by follow-up opportunities for employee questions, and continuous testing, review, and updating of policies. While the DOJ's changes are not sweeping, both the Corporate Enforcement Policy and Evaluation of Corporate Compliance Programs guidance continue to show DOJ's focus on balancing rigorous enforcement with practical investigation that allows good faith actors to follow the law without requiring unachievable standards of compliance and cooperation.

On the SEC side, two FCPA cases this year stand out in particular for their insight into the SEC's approach to financial services cases. Both involved a large, international financial services institution, and illustrate key issues the DOJ considers in making charging decisions. In the first case, brought in April, the SEC filed a civil complaint against an executive of the company for alleged bribes to assist an energy company win a contract to construct a power plant. Although the SEC's complaint alleged that the institution itself had violated the FCPA, it made a point of noting that the institution was not being charged because the individual had taken deliberate steps to prevent the institution and its compliance personnel from discovering his illegal activities. In spite of his efforts, however, the institution's compliance department had sought additional diligence and begun an investigation into the matter, ultimately terminating the institution's involvement in the project. Due to the fact that the compliance department took what the Chief of the SEC's FCPA unit called "appropriate steps to prevent the firm from participating in the transaction," the institution avoided any charges. In the second case, employees of the same institution engaged in a similar alleged bribery scheme, but this time the institution was charged.[2] Several differences separate the two cases, however. In the second case, the magnitude of the fraud was significantly higher, such that an individual resolution would be unlikely to provide the kind of financial penalty demanded by the government. Moreover, although the institution had taken several steps to try and prevent improper activity, ultimately the government alleged that the scheme went forward with the (at least tacit) involvement of the institution itself. Although the institution had strong indicators that its employees' activities may have been improper, it failed to follow up and further investigate. Finally, the conduct charged covered not just a single transaction, but several transactions over a period of years, each of which was approved by a committee, compounding the alleged compliance failures. Cases like these continue to demonstrate the need for vigilant and continuing compliance when potential FCPA issues arise.

[2] The institution's settlement in this case included not only the SEC's charges, but also a deferred prosecution agreement with the DOJ acknowledging responsibility for criminal conduct (available here), and a civil settlement with the Board of Governors of the Federal Reserve System (available here).

Committee on Foreign Investment in the United States Update

On January 13, 2020, the U.S. Department of Treasury issued final regulations (the Final Rules) that implement most of the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA). The Final Rules went into effect on February 13, 2020. The following is noteworthy:

- Adoption of a rule with a nerve center test for the definition of "principal place of business", which is important in determining whether an entity is a "foreign person" under FIRRMA.
- Identification of Australia, Canada and the United Kingdom (including Northern Ireland) as "excepted foreign states." (Investors from these jurisdictions are potentially exempt from certain FIRRMA requirements.)

The instances in which a mandatory CFIUS filing is required are generally limited to foreign person investment in certain critical technologies businesses (discussed below); and certain foreign government "Substantial Interest" transactions in critical technologies; critical infrastructures that are so vital to the U.S. that the incapacity or destruction of such systems or assets would have a debilitating impact on national security; or in businesses that collect sensitive personal data of U.S. citizens that may be exploited in a manner that threatens to harm national security (collectively, "TID U.S. Businesses").

Under the Final Rules, a mandatory CFIUS filing is required if a foreign person investment fund acquires 25% or more of the voting interests of a TID U.S. Business, and, a national or subnational government of a single foreign state (other than an "excepted foreign state") holds 49% or more of the voting interests in the foreign person that is acquiring the voting interests in the TID U.S. Business. This is sometimes applicable in the sovereign wealth fud sole sponsor or fund of one context. When the applicable thresholds are satisfied, the rules refer to the holding as a "Substantial Interest" in such TID U.S. Business. A national or subnational government of a foreign state ("Foreign Government") is deemed to have such Substantial Interest in a foreign person investor only where the Foreign Government holds 49 percent or more of the interests in the general partner, managing member, or equivalent of the entity – without regard to the Foreign Government's equity ownership level. Where a general partner or managing member delegates control over the activities of an investment fund to a third party, the general partner or managing member does not cease to control the investment fund simply by contracting a third party to perform such services.

A "critical infrastructure" investment is generally an investment in a U.S. business that owns, manages, operates, manufactures, supplies, or provides services (referred to as "functions related to critical infrastructure" in the rules) to critical infrastructures, including, certain defense industrial base sectors, telecommunications, energy, transportation, financial services and public water and waste systems. The Final Rules provide an appendix that sets forth the combinations of the twenty-eight categories of "critical infrastructures" and "functions related to critical infrastructure" that potentially constitute TID U.S. Businesses.

A "sensitive personal data" investment is generally an investment in a U.S. business that maintains, collects, or has a demonstrated business objective to collect "identifiable data" (generally, data that can be used to identify a person of a type falling within one of the ten categories set forth below) of more than one million people, or tailors its product to U.S. executive branch or military personnel. The applicable "identifiable data" categories include: (i) data that could be used to determine a person's financial distress, (ii) data contained in a consumer report (unless limited data is obtained from a consumer reporting agency for purposes described in the Fair Credit Reporting Act), (iii) data contained in insurance

applications, (iv) data that relates to a person's physical, mental or psychological well-being (i.e., health information), (v) non-public electronic communications, including, email messaging, or chat communications between or among users of a U.S business' products or services (if the U.S. business is providing communications platforms used by third parties), (vi) geolocation data, (vii) biometric enrollment data (e.g., facial, voice, retina and fingerprints), (viii) data stored and processed for generating state and federal identification cards, (ix) data concerning U.S. government personnel security clearance and (x) data in an application for U.S. government security clearance. However, regardless of the amount of data collected or maintained, who is targeted by the business or if the data falls within one of the ten categories set forth above, data that consists of the results of genetic testing results and genetic sequencing constitute "sensitive personal data." Information that an employer maintains with respect to its own employees (unless the information is about U.S. government contractor security clearances) generally does not constitute sensitive personal data.

The Final Rules also provide a private fund safe harbor. A private fund generally is not a foreign person and therefore does not trigger a filing, despite having foreign limited partner investors, provided:

- the private fund is exclusively managed by a general partner, managing member (or equivalent, such as a board with respect to an entity not structured as a limited partnership or LLC;
- the general partner, managing member (or equivalent such as a board) is not a foreign person or controlled by a foreign person (note that, among other reasons, the general partner could be a foreign person if it is controlled by foreign nationals);
- the private fund's advisory board or committee if it has one does not have the ability to approve, disapprove, or otherwise control investment decisions of the fund or the decisions of the general partner, managing member (or equivalent such as a board);
- the foreign person does not otherwise have the ability to control the investment fund or unilaterally dismiss, prevent the dismissal of, select, or determine the compensation of the general partner, managing member (or equivalent such as a board); and
- the foreign person does not have access to Material Nonpublic Technical Information, defined as information that: "(1) Provides knowledge, know-how, or understanding, in each case not available in the public domain, of the design, location, or operation of covered investment critical infrastructure, including vulnerability information such as that related to physical security or cybersecurity; or (2) Is not available in the public domain and is necessary to design, fabricate, develop, test, produce, or manufacture a critical technology, including processes, techniques, or methods." Material Nonpublic Technical Information does not include financial information regarding the performance of an entity.

On September 15, 2020, the U.S. Department of Treasury issued additional new rules, modifying existing rules that implement FIRRMA. The new rules went into effect on October 15, 2020 and modified the scope of foreign persons' investments in certain critical technologies that are subject to mandatory review by CFIUS. Prior CFIUS regulations required parties to a transaction to notify CFIUS if a foreign person would acquire a U.S. business that produces, designs, tests, manufactures, fabricates, or develops one or more "critical technologies" within one of 27 "covered industries" under the North American Industry Classification System.

Under the new rule, mandatory filings are now required for foreign investments in U.S. critical technology businesses if "U.S. regulatory authorizations" (discussed below) are required to export, reexport, transfer

(in-country), or retransfer the U.S. business's critical technologies to the foreign persons involved in the transaction or certain foreign persons in the ownership chain ("U.S. regulatory authorization"). Under the new rule, the critical technology test is satisfied if U.S. regulatory authorization would apply to a buyer/investor that would control the target business, and also if U.S. regulatory authorization would apply to any persons whose acquisitions of interests in or changes in rights with respect to the U.S. business is a non-control covered transactions or investments ("Export Controlled Investor").

The critical technology mandatory filing requirement is also satisfied where U.S. regulatory authorization would apply to a buyer/investor that holds, individually or in the aggregate with an affiliated group , an interest of 25% or more in the general partner, managing member or equivalent such as a board, of any such Export Controlled Investor.

The term "U.S. regulatory authorization" means a license of authorization under one of four distinct U.S. export regimes:

- The U.S. Department of State's International Traffic in Arms Regulations (the ITAR);
- The U.S. Department of Commerce's Export Administration Regulations (the EAR);
- The U.S. Department of Energy's regulations governing assistance to certain foreign atomic-energy activities; and
- The Nuclear Regulatory Commission's regulations governing the export and import of certain nuclear equipment and material.

As the export control laws are generally not applied agnostically with respect to the destination of the export, the change is likely to have a disparate impact on investors depending on their nationality. The Final Rules also introduced a new definition for what constitutes voting interests for purposes of critical technology mandatory declarations. Under the Final Rules, in the case of an entity whose activities are primarily directed, controlled, or coordinated by or on behalf of a general partner, managing member, or equivalent, a person will be considered to have a voting interest for purposes of critical technology mandatory declarations in such entity only if it holds 25 percent or more of the interest in the general partner, managing member, or equivalent of the entity.

Employing the U.S. regulatory authorization concept in the scope of transactions subject to mandatory review aligns CFIUS's mandatory review of foreign investments involving critical technologies with U.S. export control regulations, and potentially significantly broadening the scope of transactions that will be subject to mandatory review. Going forward, transactions involving foreign investment into U.S. businesses will require significantly modified diligence practices to assess the scope of potentially covered critical technology as it applies to the specific investor or investors in the transaction.

Updates to the Hart–Scott–Rodino Antitrust Improvements Act of 1976 (HSR)

Several proposed rule changes relating to HSR reporting are noteworthy. Under a proposed rulemaking published December 1, 2020, the U.S. Federal Trade Commission (FTC) would expand reporting requirements in several significant ways and potentially implement a new exemption addressing certain minority investments. The changes include the following:

The new proposed rules would require disclosure of additional information from investment firms as it relates to firm-wide investments. "Associate" reporting in the parlance of the HSR rules is currently limited to instances where a related private fund under common management has an investment of more than 5% in a portfolio company that competes with the target investment. The new rule would expand

this requirement to require financial statements, revenue reporting and information related to prior acquisitions for certain controlled portfolio companies of the firm – even when not housed within the private fund that is making the acquisition or filing, and would aggregate holdings among commonly managed private funds for purposes of assessing reporting obligations and disclosure requirements. Beyond expanded disclosures, the proposed rule change to how a "Person" is defined to include its associated private funds is also likely to trigger additional reporting for transactions that may be exempt under the current rules – primarily for new private funds and newly formed entities that may not meet the size-of-person thresholds under the current rules.

Second, the agency has proposed an exemption with respect to acquisitions of 10 percent or less of a company in cases where the investor does not have a "competitively significant relationship" with the target company. The limited exemption would apply where the investor would hold 10 percent or less of the target company; does not hold an interest of more than 1 percent in a competitor of the target company; does not have board representation with respect to the target company or any of its competitors; and, with limited exceptions, the parties are not in an existing vendor-vendee relationship. The rule, while welcomed by some active investors ineligible for the traditional passive investor exemption, may have limited application, for instance for sector private funds that deploy their expertise within a particular industry.

The FTC has also issued an Advance Notice of Public Rulemaking to gather information on additional topics that may be the subject of amendments to the HSR rules and interpretations. The FTC is reviewing potentially making changes to how the size-of-transaction threshold is calculated for analysis of reporting obligations; treatment of real estate investment trusts, which presently enjoy a fairly broad set of exemptions; treatment of "non-corporate" entities such as limited partnerships and limited liability companies, which also enjoy a broad set of exemptions under the current rules; potential additional exemptions relating to minority or de minimis acquisitions; treatment of non-voting interests; devices for avoidance; and potential changes to the filing process. The agency is in the early stages of reviewing potential changes in these areas, and final rules may not be seen for some time.

Separately, the agency has clarified its position with respect to certain transactions that may be viewed as devices for avoidance under the rules. Without a change to the existing avoidance rule, which provides that transactions employing devices for avoidance can be construed as reportable, the agency has updated its prior guidance on the use of special dividends. Under prior guidance, the use of special dividends in advance of closing to reduce a transaction's value to below the reporting threshold was not considered as an avoidance device. The agency will no longer take that view, and has said that it will conduct a "more holistic" review of special dividends and other features of the transaction when evaluating whether the transaction was structured to avoid or delay an HSR filing.

Anti-Money Laundering and Sanctions Enforcement Updates

Important Guidance from the Office of Foreign Assets Control

In May 2019, Treasury's Office of Foreign Assets Control (OFAC) released "A Framework for OFAC Compliance Commitments," suggesting for the first time that companies have an affirmative obligation to

maintain an effective sanctions compliance program.[3] Advisers to private funds should note this development, as all U.S. persons are required to comply with OFAC sanctions.

While failing to implement a sanctions compliance program is not itself a violation of OFAC's regulations, maintaining a sanctions compliance program has always been a mitigating factor in the assessment of monetary penalties in OFAC enforcement actions. However, Treasury's recent pronouncement represents a policy shift. It marks the first time that OFAC has provided explicit guidance on what it considers to be the essential components of a sanctions compliance program, signaling that firms must now comply with OFAC's expectations by taking affirmative steps to understand and effectively address their sanctions risks. A compliance program that falls short of the basic requirements outlined in OFAC's recent guidance may be viewed as a separate aggravating factor leading to increased monetary penalties in the event of a violation.

It is clear from the guidance that OFAC expects to see firms maintain more than just a check-the-box program. The guidance acknowledges that a firm's risk-based compliance program will depend on several factors, including the size and sophistication of firm, the products and services it offers, the nature of its customers and counterparties, and the geographic locations in which the firm operates. At the same time, OFAC identifies five essential components that every compliance program should incorporate: (1) support from senior management; (2) periodic risk assessments; (3) internal controls, including policies and procedures designed to identify, interdict, escalate, report, and maintain records related to activity that is prohibited by OFAC administered sanctions programs; (4) periodic testing and auditing; and (5) periodic training for all appropriate employees. In evaluating these criteria, OFAC appears focused on practical indicia that firms are committed to sanctions compliance, including how resources are allocated and the quality and experience of relevant personnel. Recent enforcement actions in the months following the guidance underscore OFAC's new emphasis on the importance of compliance programs.

In light of OFAC's May 2019 guidance, advisers to private funds should take a hard look at their current sanctions compliance programs. In issuing penalties in 2020, OFAC continued to recognize the presence of an OFAC compliance program in its settlements. Although not required, an OFAC compliance program is clearly a mitigating factor for OFAC penalty awards.

Focusing on internal sanction compliance programs is particularly important as private funds continue to raise money offshore and pursue yield through foreign investments, and as the U.S. sanctions regime becomes more complex. In 2019, we saw changes to the sanctions against Russia, Venezuela, and Iran, which have had a significant impact on private funds. In December 2019, the DOJ revised its policy for business organizations regarding voluntary disclosures of sanctions violations, signaling a continued push towards self-disclosure. In 2020, the United States continued to promulgate new sanctions against Russia, Venezuela, and Iran, among others. OFAC is also increasingly taking the view that private equity firms can be held directly responsible for the OFAC violations of foreign portfolio companies they may own and/or control.

Finally, on December 31, 2019, a federal court in Texas issued a decision vacating a $2 million OFAC penalty against ExxonMobil, on the grounds that the company lacked fair notice that its conduct was prohibited. ExxonMobil's suit was one of the first such challenges to the agency's penalties based on the argument that the applicable regulation was unclear. Although this case is now on appeal, the Texas

[3] For an in-depth discussion of OFAC's new compliance guidelines, see *Navigating the Complex Relationship Between Voluntary Self-Disclosure and Enforcement* by Seetha Ramachandran and Lucas Kowalczyk, in the International Comparative Legal Guide to Sanctions (2019).

court's holding for ExxonMobil suggests that we might see an increase in litigation challenging OFAC penalties and a corresponding shift in some of OFAC's enforcement strategies.

SEC Examinations for Funds with an Affiliated Broker-Dealer or Investment Company

AML issues should also be top of mind for advisers to private funds that have an affiliated broker-dealer or investment company. In January 2020, DoE announced its 2020 examination priorities. Just as it did in 2019, DoE stated it intends to "continue to prioritize examining broker-dealers and investment companies for compliance with their AML obligations." In particular, DoE intends to focus on whether broker-dealers are filing suspicious activity reports with Treasury's Financial Crimes Enforcement Network (FinCEN), as appropriate, and whether they have implemented all elements of their AML programs. During examinations, DoE also intends to focus on whether broker-dealers have conducted independent tests of their AML program on a timely basis. According to DoE, "[t]he goal of these examinations is to ensure that broker-dealers and investment companies have policies and procedures in place that are reasonably designed to identify suspicious activity and illegal money laundering activities." The SEC's continued focus on AML affects even those private funds that are not subject to a mandatory AML program rule, due to enhanced scrutiny facing fund affiliates, counterparties, and institutions that custody funds.

Potential areas for examination could include compliance with new beneficial ownership requirements, books and records requirements, and suspicious activity reporting. For example, in *SEC v. Alpine Securities Corp.*, the Southern District of New York suggested that the SEC's books-and-records authority under Exchange Act rule 17a-8, allows the SEC to bring enforcement actions based on the reporting of potentially suspicious transactions under the Bank Secrecy Act, expanding the SEC's jurisdiction over AML cases.

Over the last five years, the total amount of AML penalties imposed globally has been steadily rising, to more than $8 billion in 2019. In contrast to prior years, less than half of those fines were levied against banks, signaling that AML enforcement is expanding to other types of financial services firms. On November 19, 2020 Arachnys Information Services Ltd. reported that the 2020 global total to that date had stood at close to $9 billion.

The Financial Crimes Enforcement Network Updates Regulations Concerning the Bank Secrecy Act

2020 was an active year for FinCEN, which issued several key announcements clarifying and amending various regulations under the Bank Secrecy Act. On August 18, 2020, FinCEN issued a rare statement clarifying when it will choose to bring enforcement actions for violations of the Bank Secrecy Act. FinCEN shared the factors it reviews when deciding whether to bring an action, including the seriousness of the violations, the harm caused by the violations on FinCEN's mission to protect the financial system, and the pervasiveness of wrongdoing within the accused entity.

On September 16, 2020, FinCEN issued an Advance Notice of Proposed Rulemaking (ANPRM) to solicit public comment on a wide range of questions relating to potential regulatory amendments under the BSA. The ANPRM sought comment on what an "effective and reasonably designed" AML program is. It also sought comment on proposals to impose an explicit requirement for a risk assessment process and for the agency to issue a list of national AML priorities, to be called FinCEN's *Strategic Anti-Money Laundering Priorities* every two years.

On October 1, 2020, FinCEN issued an advisory in response to increased sophistication in Ransomware attacks in recent years. The advisory flags indicators to help detect and prevent suspicious activity, while

also reminding financial institutions of their obligations to file Suspicious Activity Reports (SARs) upon learning of any transactions attempted to evade regulations under the Bank Secrecy Act. In fact, to prevent further expansion of Ransomware, OFAC has made clear that strict liability will apply to any Ransomware payments to sanctioned entities. OFAC's advisory states that it may impose civil penalties based on strict liability, "meaning that a person subject to U.S. jurisdiction may be held civilly liable even if it did not know or have reason to know it was engaging in a transaction with a person that is prohibited under sanctions laws and regulations administered by OFAC."

On October 23, 2020, FinCEN and the Federal Reserve Board invited comment on a proposed rule amending the recordkeeping and travel rule regulations under the Bank Secrecy Act. Currently, financial institutions must collect and provide information related to transmittals of funds over $3,000. The proposed rule lowers the applicable threshold from $3,000 to $250 for international transactions, but leaves the threshold for domestic transactions unchanged at $3,000. The proposed rule also expands the definition of "money" and extends the application of these regulations to cover transactions involving convertible virtual currencies as well as digital assets.

Cayman Anti-Money Laundering Developments

Advisers to Cayman-based funds should confirm that they are in compliance with Cayman AML regulations that went into effect in 2018. The 2018 regulations altered the regulatory environment for Cayman-based funds, including those that are unregistered. One of the major changes in the Cayman AML regulations is a new requirement that Cayman funds designate natural persons employed at a managerial level to serve as AML officers. Specifically, Cayman funds are now required to designate an AML Compliance Officer, a Money Laundering Reporting Officer, and a Deputy Money Laundering Reporting Officer. The new Cayman AML regulations also significantly expand the kinds of AML procedures that funds are expected to maintain. The deadline for Cayman-based funds to comply with the new requirements was December 31, 2018.

Cybersecurity and Privacy Law Updates

U.S. Department of Justice Releases Guidance on Legal Considerations when Gathering Online Cyber Threat Intelligence and Purchasing Data from Illicit Sources (February 2020)

In February 2020 the U.S. Department of Justice (USDOJ) issued a white paper providing guidance to private organizations about the legality of specific cybersecurity measures. *See U.S. Dep't of Justice*, Legal Consideration When Gathering Online Cyber Threat Intelligence And Purchasing Data From Illicit Sources 1–15 (U.S. Dep't of Justice Cybersecurity Unit ed., 2020). In particular, the guidance focuses on information security practitioners' cyber threat intelligence-gathering efforts that involve online forums in which computer crimes are discussed and planned, and stolen data is bought and sold. The guidance contemplates situations in which private actors attempt, amongst other things, to purchase their own stolen data belonging to others with the data owners' authorization – in Dark Markets.[4]

[4] Dark Markets are found on the TOR (the Onion Router) network, which is a collection of computers designed to obfuscate the origin of online communications. The TOR network encrypts and routes communications through a series of relays around the world to thwart efforts to trace their origin. TOR hidden services, also called the "Dark Web," are sites that may only be accessed using a TOR browser. Because the location of sites operating as TOR hidden services is concealed and difficult to trace, TOR hidden services are a preferred technique for hosting sites associated with illegal activities. *See* U.S. Dep't of Justice, Legal Consideration When Gathering Online Cyber Threat Intelligence And Purchasing Data From Illicit Sources 1 (U.S. Dep't of Justice Cybersecurity Unit ed., 2020).

The guidance assumes that security practitioners within private organizations obtain information from Dark Markets solely so that it can be used and shared for legitimate cybersecurity purposes (e.g., to help others identify and defend against cybersecurity threats) and with no criminal or malicious intent or motive. In addition to discussion of the legal risks, the guidance provides best practices for private organizations engaged in retrieving stolen data. Selected practices include:

- Creating "Rules of Engagement": Organizations involved in activities to retrieve stolen data should prepare compliance protocols that outline acceptable conduct for its personnel or contractors who interact with criminals and criminal organizations.
- Being Prepared To Be Investigated: Because federal investigators may not be able to readily distinguish between criminals and innocent parties engaged in intelligence gathering, organizations may become the subject of criminal investigation. Therefore, it is beneficial to build an ongoing relationship with the local FBI field office or Cyber Task Force and the local U.S. Secret Service Electronic Crimes Task Force. This helps avoid misunderstandings about intelligence-gathering activities.
- Practicing Good Cybersecurity: There is no such thing as being "too suspicious" when engaging with cyber criminals. Always practice good cybersecurity by using secured systems.

Additionally, the USDOJ identified three scenarios where the line between gathering threat intelligence and engaging in criminal activity are hard to discern, and provided discussion to assist organizations plan to conduct their intelligence gathering activities in a manner that reduces the potential of violating federal criminal law. The guidance discusses three levels of engagement and the likelihood such activity may result in criminal or civil liability:

First, if a practitioner reads and collects communications posted openly on the forums but does not respond to forum communications or otherwise communicate with others on or through the forums, there is practically no risk of federal criminal liability. In general, posing as a fictitious person or using a pseudonym to gain entry to and communicate on forums does not violate federal criminal law. However, practitioners may not assume the identity of an actual person without their permission, or they may face other criminal or civil liability.

Second, if a practitioner decides to more aggressively gather intelligence by posting inquiries on the forum seeking information about illegal activities, the practitioner's actions will increase the risk of becoming the subject of a criminal investigation. While posing questions does not inherently constitute a federal crime, law enforcement investigations are sensitive to questions in forums as an indication that criminal conduct is occurring.

Third, if a practitioner becomes an active member of a forum and exchanges information or communicates directly with forum members, the organization is quickly put at risk of becoming involved in illegal conduct. For example, the furnishing of information, services or tools in order to build trust with another forum member which could be used to commit crimes may result in violating federal criminal law, but this depends on the practitioner's actions and intent.

The USDOJ guidance ends with a discussion of the legal risks faced by private organizations engaged in merely attempting to purchase their own stolen data (or, in the case of a cybersecurity firm, the data of a party that authorizes the purchase of its stolen data). Three factors bear on the legality of engaging Dark Markets to purchase the stolen data of company customers:

- **Whether the purchaser is the legitimate owner of the data**. Buying one's own data is typically not a crime, but purchasing data through actors in the Dark Market risks purchasing data that has been commingled from other data breaches. If the purchaser has no reason to know that data it does not own is also purchased, then there is little risk of criminal liability. However, purchasing another party's stolen information without permission or authority will raise questions about the purchaser's intent which in turn invites investigative scrutiny to determine the purchaser's motive.
- **The type of data being sold**. Organizations attempting to purchase their stolen data on Dark Markets are unlikely to be prosecuted under statutes which only apply if there is intent to further another crime. However, practitioners will still risk violating other federal statutes (such as trade secrets laws) by receiving or possessing data if they know such data was stolen, and if other elements of the statute are met.
- **The identity of the seller**. Practitioners must be wary of engaging with actors with whom transactions automatically violate federal law. This includes groups designated as foreign terrorist organizations. While criminal liability is unlikely given the intent requirement, civil liability may be imposed under the International Emergency Economic Powers Act (IEEPA). Companies should make every effort to ensure they are not dealing with such actors.

Russian Intelligence Indicted in Globe's Most Damaging Cyberattack (Oct. 2020)

The increasing focus within the Department of Justice on cyber-enabled security threats, as demonstrated by the *Guidance On Legal Considerations When Gathering Online Cyber Threat Intelligence And Purchasing Data From Illicit Sources* is perhaps best captured by the far-reaching indictment in response to the Russian-perpetrated global cyberattacks that occurred throughout 2020.

On October 15, 2020, the U.S. Department of Justice (USDOJ) indicted six computer hackers, all of whom were residents and nationals of the Russian Federation (Russia) and officers in Unit 74455 of the Russian Main Intelligence Directorate (GRU), a military intelligence agency of the General Staff of the Armed Forces. *United States v. Andrienko et al.*, Case No. 20-cv-00316-RJC (W.D. Penn. Oct. 15, 2020). The object of the conspiracy was to deploy destructive malware and take other disruptive actions, for the strategic benefit of Russia, through unauthorized access (hacking) of victim computers.

In particular, Russian operatives launched an attack employing destructive malware against the Heritage Valley Health System in Pennsylvania, a FedEx Corporation subsidiary (TNT Express B.V.) and a large U.S. pharmaceutical manufacturer, causing nearly $1 billion in losses to the companies. Furthermore, the hackers caused organizations such as Heritage Valley Health System to expend more than $2 million responding to, and recovering from, the attack. However, the financial losses only constituted part of the harm: "NotPetya," the destructive malware that was used against Heritage, impaired the provision of critical medical services by causing the unavailability of patient lists, patient history, physical examination files and laboratory records.

The indictment alleged the conspirators designed its malware to masquerade as ransomware, which is a type of malware that encrypts and blocks access to a victim's computer system and/or files until the victim pays a ransom. Unlike previous iterations of the malware, NotPetya operated such that, even if victims paid the required ransom, the "[C]onspirators would not be able to decrypt and recover the victims' computer files." No defendants were arrested, nor did USDOJ charge any of the victim companies for any efforts taken to protect itself from any of the cyberattacks.

Defendants were charged on seven counts: (i) conspiracy to conduct computer fraud and abuse, (ii) conspiracy to commit wire fraud, (iii) two counts of wire fraud, (iv) damaging protected computers, and (v)

two counts of aggravated identity theft. While the USDOJ rightfully did not charge victims with any crime in this case, note that its February 2020 guidance focuses squarely on situations where private organizations could be implicated in conspiracies to commit identity theft crimes. A conspiracy under federal law requires the government to prove: (i) an agreement between two or more persons to achieve a common objective, (ii) that the agreement is illegal, (iii) knowing and voluntary participation, and (iv) commission of an overt act in furtherance of the illegal objective. Conspiracy to commit a computer fraud and abuse carries a maximum sentence of five years in prison, while conspiracy to commit wire fraud carries a maximum sentence of twenty years in prison. Indeed, aggravated identity theft carries a mandatory minimum sentence of four years in prison.

Therefore, private organizations would behoove themselves to ensure that security practitioners, whether internal or third party, do not engage in Dark Market activity which may implicate them in conspiracies at the levels set out in USDOJ guidance, especially for crimes involving the unlawful exchange of identity information which may be precisely the object of a security practitioners motives for engaging Dark Market forum actors in the first instance.

New Federal Case Precedent out of California's Northern District Arms Data Breach Defendants to Steer Future Litigation into Friendlier Venues (March 2020)

On March 18, 2020, Judge Edward M. Chen of the U.S. District Court for the Northern District of California granted Mediant Communications' (Mediant) motion to dismiss a putative nationwide class action brought by representative plaintiffs Phillip Toretto (Toretto) and Daniel C. King (King) stemming from a data breach that occurred in April 2019. In the breach, hackers accessed Mediant's business email accounts and stole the personal information of thousands of shareholders, including individuals' names, genders, physical addresses, email addresses, phone numbers, Social Security Numbers, tax identification numbers, account numbers, and various other types of information. *Toretto, et al. v. Mediant Commc'n., Inc.*, 2020 WL 1288478, *1 (N.D. Cal. March 18, 2020).

The complaint alleged that after hackers obtained unauthorized access to Mediant's business email accounts and exfiltrated the personal information of its customers' investors, the company "disconnected the affected server from the company's system" and "commenced an investigation into the breach." *Id.* After Mediant notified state attorneys general, it sent notices to its customers' investors whose information had been stolen, and represented "that none of the companies who provided investor information had systems involved in the incident or were otherwise at fault in the incident." *Id.* The complaint further alleged that Mediant recommended affected shareholders "closely monitor financial accounts, statements, credit reports and other financial information for any evidence of unusual activity, fraudulent charges or signs of identity theft." *Id.* As a result, plaintiffs "expended time and effort regularly monitoring" their financial accounts in order to mitigate against potential harm and alleged injury under the California Customer Records Acts, which requires notifications of data breaches to describe what occurred and include "the types of Personal Information that were or are reasonably believed to have been the subject of the breach." *Id. See also* Cal. Civ. Code § 1798.82. Toretto also alleged injury under California's Unfair Competition Law due to Mediant's failure "to implement and maintain reasonable security measures." Compl. ¶ 152.

The Court only addressed Mediant's 12(b)(2) motion to dismiss for lack of personal jurisdiction. Because Mediant was headquartered in New York and incorporated in Delaware, Toretto could not establish that California had general jurisdiction, thus the question was whether specific personal jurisdiction existed. *Toretto et al.*, at *3. In the Ninth Circuit, courts employ a three-part test to assess whether a defendant has sufficient contacts with the forum state to be subject to specific personal jurisdiction: (i) whether the

non-resident purposefully directs his activities to the forum state or purposefully avails himself of the privilege of conducting activities in the forum; (ii) whether the claim arises out of or relates to the defendant's forum-related activities, and (iii) whether the exercise of jurisdiction is reasonable. *Id.* Toretto did not rely on the purposeful direction prong, yet also failed to demonstrate any indicia for purposeful availment. *Id.* at *3. In particular, there was no contract between the parties, and Toretto was not a Mediant client, or even – in some cases – one of Mediant's client's clients. *Id.* Additionally, Mediant did not negotiate with any fund adviser in California, and nothing else in the record suggested Mediant sought business specifically in California, including the fact that California law was not made the governing law of any Mediant agreement. *Id.* at *3–4.

Judge Chen decided, in short, that nothing in the record indicated any targeting of, or relationship to, any California residents by Mediant that would distinguish California from any other state. *Id.* at *4. That Mediant was aware it did business with California residents was irrelevant since the same was true of many other states. *Id.* Toretto argued the data breach had a "disparate impact" on California residents, but failed to establish so. *Id.* Indeed, the Court took notice of census data to emphasize that while California makes up 12% of the U.S. population, only about 10% of shareholders affected by the data breach resided in California, and that in any case such disparate impact would not confer jurisdiction over Mediant since foreseeability of harm alone is insufficient to establish personal jurisdiction. *Id.* Mediant contracted with fund advisers and not the funds themselves, so Judge Chen found the fact that seven of the fifteen companies whose shareholders' personal information was compromised were headquartered in California immaterial, reemphasizing that Mediant had no direct contractual relationship with any of the seven breach-affected companies in California, and was only connected through an intermediary company in Illinois. *Id.* Therefore, since Mediant was "not created with the purpose of providing services to entities (or shareholders) in California," but rather "was to service funds and managers on a national basis," the company's indirect relationship to some California companies was merely "a matter of happenstance" and Toretto failed to establish Mediant purposefully availed itself of the laws and benefits of California. *Id.* at *5.

Next, Judge Chen addressed the second prong of the jurisdictional analysis evaluating whether the plaintiff's claims arise out of or are related to the defendant's forum-related activities. The critical question for the second prong is "*but for* Defendants' contacts with California, would Plaintiff's claims have arisen?" *Id.* Toretto contended a "but-for" causal relationship. *Id.* However, the Court disagreed and determined it was not at all evident that, absent Mediant's contractual agreements to provide services to California entities, Toretto's claims would not have arisen. *Id.* Judge Chen noted that Mediant is often hired through intermediary companies by a number of public companies and mutual funds as their proxy agent, not all of which are located in California. *Id.* Put differently, even if Mediant had no contracts with California business entities, Toretto could still have been affected by the data breach if he owned stock in mutual funds or public companies that hired Mediant via an adviser outside of California. *Id.* Therefore, Toretto failed to satisfy the second prong of the personal jurisdiction analysis since his claims had no causal or proximate relationship to Mediant's indirect contracts with California companies. *Id.* at *6. Judge Chen finally noted that although the "purposeful direction" prong of the Ninth Circuit's personal jurisdiction analysis applies only to intentional torts, the prong would not be satisfied were it applicable to Toretto's suit since no evidence suggested that Mediant "expressly aimed any intentional act at California, and "[m]ere untargeted negligence is not enough." *Id.*

The Northern District of California decision will give companies sued after suffering data breaches more control over where those lawsuits are heard. According to *Toretto, et al.*, a company may have clients in

a different state, but that does not necessarily mean that it engaged in any business operations or marketing in that jurisdiction.

Attorney General's Cyber-Digital Task Force Updates Cryptocurrency Enforcement Framework (Oct. 2020)

In October 2020, the Attorney General's Office released a report outlaying a threat assessment and enforcement framework with respect to cryptocurrency use. Specifically, the report gives an overview of the threats posed by increased cryptocurrency use and distinguished legitimate uses from illicit uses. The report provides an overview of the domestic and international legal and regulatory frameworks governing organizations' engagement with cryptocurrency use. Finally, the report ends with a discussion of ongoing challenges and future strategies, particularly focusing on business models and activities that may facilitate criminal activity alongside department of justice response strategies.

I. Threat Overview

Virtual currency is a digital representation of value that, like traditional coin and paper currency, functions as a medium of exchange – i.e., it can be digitally traded or transferred, and can be used for payment or investment purposes.

a. Legitimate Uses

Advocates for increased use of cryptocurrency point out its ability to significantly reduce transaction costs, corruption and fraud by eliminating the need for financial intermediaries. In addition, cryptocurrency advocates maintain that the system enables "micro-payments," which provides enterprises with the opportunity to sell low-cost goods and services that may not be profitable enough with traditional credit and debit due to higher transaction costs. Finally, while the privacy functions associated with cryptocurrency may challenge law enforcement agencies, greater anonymity will likely also reduce the risk of account or identity theft associated with use of traditional credit systems.

b. *Illicit Uses*

Criminal enterprises and individuals are increasingly leveraging cryptocurrency's features to engage in financial transactions associated with the commission of crimes. The report identifies a number of illicit uses:

Using Cryptocurrency Directly to Commit Crimes or to Support Terrorism	> Buying and selling illegal things > Buying and selling tools to commit crimes or to support terrorism > Ransom, blackmail and extortion > Raising funds for criminal and/or terrorist activity
Using Cryptocurrency to Hide Financial Activity	> Money laundering > Operating unlicensed, unregistered or non-compliant exchanges > Evading taxes > Avoiding sanctions

	> Theft and fraud
Committing Crimes within the Cryptocurrency Marketplace Itself	> "Cryptojacking" (unauthorized use of someone else's computer to generate cryptocurrency)

c. Role of Dark Markets

USDOJ notes that many cryptocurrency-related crimes are enabled by the operation of Dark Markets offering the opportunity to buy and sell illegal tools for committing crimes. The infamous online black market called "Silk Road" was an example of such an exchange prior to being dismantled by law enforcement in 2013.

II. Current Legal and Regulatory Framework

A wide range of criminal activity is implicated by cryptocurrency use, and the Department of Justice uses available tools to prosecute such unlawful activity. Key partners in its pursuit to prosecute illicit cyber activity are criminal code authorities, as well as domestic and international regulatory frameworks.

a. Criminal Code Authorities

A variety of federal charges are applicable to conduct involving use of cryptocurrency as the method of payment for the distribution of illegal goods and services. These include, for example, wire fraud, 18 U.S.C. § 1343, Mail fraud, 18 U.S.C. § 1341, Securities fraud, 15 U.S.C. §§ 78j, 78ff, Access device fraud, 18 U.S.C. § 1029, Identity theft and fraud, 18 U.S.C. § 1028, Fraud and intrusions in connection with computers, 18 U.S.C. § 1030, Possession and distribution of counterfeit items, 18 U.S.C. § 2320, Money laundering, 18 U.S.C. § 1956 *et seq.*, Transactions involving proceeds of illegal activity, 18 U.S.C. § 1957, Operation of an unlicensed money transmitting business, 18 U.S.C. § 1960, Failure to comply with Bank Secrecy Act requirements, 31 U.S.C. § 5331 *et seq.*, Criminal forfeiture, 18 U.S.C. § 982, 21 U.S.C. § 853, and Civil forfeiture, 18 U.S.C. § 981.

b. *Domestic Regulatory Authorities*

Statutory prohibitions related to cryptocurrency are promulgated by regulatory agencies, and the USDOJ report focuses on regulatory activity around money services businesses and virtual asset service providers:

- The Financial Crimes Enforcement Network and the Bank Secrecy Act (regulating cryptocurrency exchanges);
- Office of Foreign Assets Control (OFAC) (administering and enforcing economic and trade sanctions against targeted foreign countries and regimes, terrorist groups, international narcotics traffickers and those engaged in malicious cyber activities);
- Office of the Comptroller of the Currency (OCC) (independent agency regulating and supervising national banks and federal savings associations);
- The SEC (regulating securities exchange in order to protect investors, to maintain fair, orderly and efficient markets, and to facilitate capital formation. The SEC is particularly interested in the rapid growth of the "initial coin offerings" (ICOs) market.);
- The CFTC (overseeing futures, options and swaps that involve a commodity, including certain virtual currencies where it is the underlying asset in a derivatives contract, or if there is fraud or manipulation involving a virtual currency traded in interstate commerce.);

- The Internal Revenue Service and Tax Enforcement (IRS) (administering U.S. tax code; treating virtual currency as property for U.S. federal tax purposes); and
- State Authorities (protecting the investing public in their respective states through licensure restrictions, registration requirements, audits and enforcement.).

c. *International Regulation*

The Financial Action Task Force (FATF) is the global standard-setter for anti-money laundering and combating the financing of terrorism (AML/CFT) standards applicable to virtual asset entities. It released recommendations to assist obligated entities with preventing the misuse of virtual assets for money laundering, terrorist financing, and proliferation.

III. Department of Justice Response Strategies

USDOJ commits to aggressively prosecuting malicious actors in the cryptocurrency space using the broad range of legal and regulatory authorities at its disposal. USDOJ also has broad authority to prosecute virtual asset service providers even when they are not located inside the United States. Where virtual asset transactions touch financial, data storage, or other computer systems within the United States, USDOJ has jurisdiction to prosecute the actors who direct or conduct those transactions. Additionally, USDOJ will continue to foster cooperation with State authorities as well as enhance international cooperation and promote comprehensive and consistent international regulation.

FINRA Information Notice Warns Firms to Take Appropriate Measures in Addressing Increased Vulnerability to Cybersecurity Attacks (March 26, 2020)

FINRA published measures that firms may take in light of the COVID-19 pandemic to protect customer and firm data on firm and home networks, as well as devices. While not an exhaustive list, the alert does provide basic guidance of which smaller firms can take advantage immediately. Due to use of remote offices or telework arrangements, heightened anxiety among associated persons and confusion about the virus, the risk of cyber events has increased during the pandemic. The measures outlined by FINRA are below:

Measures for Associated Persons

Office and Home Networks	> Use a secure network connection to access the firm work environment through company provided Virtual Private Network (VPN) or secure firm or third-party website > Secure Wi-Fi connections using stringent security protocol > Check for and apply any software updates to routers on a timely basis > Change the default user names and passwords on home networking equipment, such as routers
Computers and Mobile Devices	> Check for and apply updates to the operating system or any applications

	> Install and operate anti-virus and anti-malware software
Common Attacks	> Phishing scams related to COVID-19 > Fake, unsolicited "HelpDesk" calls requesting passwords
Incident Response	> Employees must understand their individual roles in the firm's incident response plan and whom to contact in the event of a cybersecurity incident

Measures for Firms

Network Security Controls	> Provide staff with a secure connection to the work environment or sensitive applications (e.g. VPN) > Evaluate privileges to access sensitive systems and data
Training and Awareness	> Train staff on how to connect securely to the office environment remotely and on potential scams > Alert the firm's IT support staff to be diligent in vetting incoming calls, because fraudsters may use the increase in remote work to engage in social engineering schemes, such as making bogus calls requesting password resets or reporting lost phones or equipment
Contract Information	> Provide staff with important IT support staff contact information

U.S. Tax

The U.S. Internal Revenue Service (the "IRS") and the U.S. Department of the Treasury (the "Treasury") have continued working to provide guidance implementing major tax reform legislation enacted in December of 2017, commonly referred to as the Tax Cuts and Jobs Act (the "TCJA"), furthering the Treasury's regulatory goal of completing all TCJA guidance by the end of 2020. Additionally, the IRS and the Treasury have issued substantial guidance implementing and clarifying certain provisions of the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"). The following summary covers the most recent updates to select provisions under the foregoing laws affecting advisers and the private funds industry.

Selected Provisions

Partnership interests held in connection with performance of services; so-called "Carried Interest"

On July 31, 2020, the IRS and the Treasury issued proposed regulations (the "Proposed 1061 Regulations") providing guidance on section 1061 of the Internal Revenue Code of 1986, as amended (the "Code"), as implemented by the TCJA. In general, section 1061 imposes a three-year holding period rule for an investment fund manager's share of gains earned through the fund to be eligible for lower tax rates applicable to long-term capital gain. This is a departure from the one-year holding period that typically results in long-term capital gain treatment. The Proposed 1061 Regulations provide clarification and guidance on the application of section 1061, although many questions remain unanswered, including the extent to which section 1061 would apply to gains that are not attributable to the fund manager's "carried interest" or "incentive allocation" earned from third-party investors.

As background, section 1061 applies to an applicable partnership interest (an "API") held by or transferred to a taxpayer in connection with the performance by that taxpayer (or a related person) of substantial services in an applicable trade or business (an "ATB"). ATB activities include raising or returning capital and developing, investing in and disposing of "specified assets" (generally, stock, securities, commodities, real estate held for rental or investment and certain partnership interests). The activities of private fund managers generally will constitute an ATB, and, therefore, any carried interest or incentive allocation generally will be an API subject to these rules.

The IRS and the Treasury have requested comments on the Proposed 1061 Regulations, which could change significantly prior to finalization.

While the Proposed 1061 Regulations do not address many open questions, they provide some key points of guidance. Notably:

Carry waivers are not explicitly prohibited, but must be carefully implemented.

Fund managers may, in certain cases, desire to waive an allocation of gain from a fund that is treated as short-term capital gain pursuant to section 1061, with the ability to be made whole in the future with an allocation of gain that is treated as long-term capital gain. The IRS and the Treasury indicate that they are aware of the use of these types of waivers being employed by fund managers, and further warn that such arrangements may be subject to challenge on various grounds. The Proposed 1061 Regulations, however, do not provide any further guidance on these waiver strategies other than noting that they need to comply with generally applicable tax laws, including those that also apply to so-called "management fee waivers," which we previously have discussed in a prior alert.

Certain income is not subject to recharacterization under section 1061.

The Proposed 1061 Regulations confirm that section 1061 does not apply to (1) "qualified dividend income," (2) section 1231 gains (generally, gain from the sale of real property and depreciable personal property used in a trade or business and held for over one year, such as machinery or timber), (3) gains characterized as long-term capital gain without regard to the holding period rules defined in section 1222 (which include gains characterized under the mixed straddle rules), and (4) "mark-to-market gains" under section 1256 (generally, gain from certain futures and options contracts). Despite these exceptions, under the statute, the definition of a "specified asset" includes "real estate held for rental or investment," meaning an interest held in a real estate fund would be an API. Capital gain dividends received from regulated investment companies ("RICs"), and real estate investment trusts ("REITs"), are also subject to

section 1061, unless the capital gain dividend is attributable to capital assets held for more than three years, or is attributable to one of the exceptions discussed above.

There are several exceptions to interests that are defined as an "applicable partnership interest."

The Proposed 1061 Regulations, consistent with the statute, confirm that the following are exceptions from the definition of an API: (1) capital interests (e.g., generally, a fund manager's "commitment" to a fund, discussed further below), (2) interests held by certain corporations (discussed further below), (3) interests held by employees of an entity not engaged in an ATB, and (4) gain attributable to assets not held for portfolio investment on behalf of third-party investors. In addition, the Proposed Regulations introduce a new exception from the definition of an API for interests held by unrelated bona fide purchasers at fair market value.

General guidance on the exception for capital interests narrows the scope of the capital interest exception.

Section 1061 provides an exception for gain with respect to "capital interests," which was generally understood to mean gain earned with respect to invested capital. The Proposed 1061 Regulations appear to narrowly define the scope of this exception and adopt an approach that may be unworkable in many closed-end private investment funds. For example, certain special allocations of fees or expenses not borne by a fund manager may be problematic under the Proposed 1061 Regulations' approach (note, however, the Proposed 1061 Regulations do carve out certain management fee breaks or discounts). In addition, the Proposed 1061 Regulations require allocations to be made in accordance with capital account balances to qualify for the capital interest exemption. This requirements raises the question of whether a partnership agreement that uses so-called "target allocations" satisfies that requirement. A general partner interest in a hedge fund may never qualify as a "capital interest" under the Proposed 1061 Regulations because it has different withdrawal and liquidity terms. Without additional guidance, some or all of a fund manager's gains attributable to capital invested in a fund may be subject to the rules of section 1061. The IRS has requested comments on other allocation arrangements that could be appropriately included in the capital interest exception under the Proposed 1061 Regulations.

There is no exception for capital interests funded with loans from or guaranteed by another partner, the partnership or a party related to either. Any loan (including a recourse loan) or other advance made or guaranteed, directly or indirectly, by any partner, the partnership or any person related to another partner or the partnership may cause an interest not to qualify for the capital interest exception, and, therefore, income or gains from such interest may be subject to section 1061 recharacterization.

The exception for APIs held by a corporation does not cover S-corporations and certain PFICs.

While statutorily there is an exception for APIs held by "corporations," the Proposed 1061 Regulations provide that there is no exception for APIs held by S-corporations. This is not unexpected, as the IRS previously announced its intention to more narrowly define "corporation" for purposes of section 1061 in a prior administrative notice. The Proposed 1061 Regulations exclude certain passive foreign investment companies ("PFICs") for which a qualified electing fund ("QEF") election has been made from the definition of "corporation" for purposes of section 1061, further narrowing the exception for corporations.

The S-corporation exclusion would apply to tax years beginning after December 31, 2017, and the PFIC exclusion is effective from the date Proposed 1061 Regulations are published in the Federal Register.

Distributions in-kind are subject to section 1061.

Stock of a portfolio company that a fund distributes to a fund manager continues to be subject to section 1061 following the distribution. The Proposed 1061 Regulations confirm that a fund manager needs to continue to hold such shares following a distribution until the three-year holding period under section 1061 has been met in order to obtain long-term capital gain treatment upon an ultimate sale of such stock.

Certain otherwise tax-free transfers (e.g., gifts) will be taxable.

The Proposed 1061 Regulations provide that certain types of transfers of an API to a "related person" will be taxable. "Related persons" for purposes of this rule include a taxpayer's spouse, children, grandchildren and parents, as well as colleagues. "Transfer" for purposes of this rule is broadly defined, but it remains unclear whether the term includes a transfer at death or a forfeiture of an API. Importantly, the Treasury and the IRS seem to take the position that this part of the Proposed 1061 Regulations is confirming the text of the statute and, therefore, arguably this rule has already been operative and may have impacted transactions effected since December 2017. However, transfers to entities that are disregarded as separate from their owners under any provision of the Code or the Treasury Regulations, including grantor trusts and qualified subchapter S subsidiaries, would not be treated as transfers to related persons for purposes of section 1061.

The Proposed 1061 Regulations are silent on the "family office exception".

Section 1061 does not apply to "income or gain attributable to any asset not held for portfolio investment on behalf of third-party investors." Although the preamble to the Proposed 1061 Regulations states that many comments suggested that this exception was intended to exclude family offices, and that the Treasury and the IRS generally agree with this position, the Proposed 1061 Regulations do not mention a family office exception, and it is not clear whether the capital interest exception will exempt most, or all, family office structures. Hopefully, this exception will be clarified when the regulations are finalized.

Installment sales are evaluated at the time of sale.

Finally, the Proposed 1061 Regulations confirm that when applying section 1061 to gain recognized under the installment sale method (generally, a sale of property where one or more payments is received in a year that begins after the year the sale is concluded), the relevant inquiry is the holding period of the property at the time of the sale.

For further discussion of the Proposed 1061 Regulations, please see our August 6, 2020, client alert.

On January 7, 2021, the IRS and the Treasury issued final regulations under section 1061. On January 7, 2021, the IRS and the Treasury issued final regulations under section 1061. These final regulations, which modify the proposed rules discussed above, will generally apply for taxable years beginning on or after January 19, 2021. For a summary and analysis of the final regulations, please our January 14, 2021 blog post.

CARES Act Provisions

On March 27, 2020, the President signed into law the CARES Act, which includes a number of tax related provisions. The following discussion briefly summarizes certain key provisions affecting businesses and individuals.

Economic stabilization investments are treated as debt, not ownership.

The CARES Act authorizes the Treasury to make or guarantee up to $500 billion in debt and equity investments in businesses, states and municipalities affected by COVID-19. The CARES Act directs the IRS to issue guidance providing that the acquisition of warrants, stock options, common or preferred stock or other equity under the program does not result in an ownership change for purposes of section 382. While the CARES Act does not by its terms prevent investments from contributing to a section 382 ownership change, it appears consistent with the intent of the legislation for the IRS to entirely disregard such investments for purposes of determining whether a taxpayer has experienced a section 382 ownership change. Any loans made or guaranteed by the Treasury under the program are treated for tax purposes as debt issued at par, and stated interest on these loans is treated as qualified stated interest. As a result, loans issued or guaranteed under the program are not treated as issued with an original issue discount for tax purposes, and cash basis taxpayers are not permitted to deduct interest on the loans until that interest is paid.

Downward attribution is not repealed.

An earlier version of the CARES Act contained a provision that would have restored section 958(b)(4). As discussed in detail below, before its removal as part of the TCJA, section 958(b)(4) prevented a United States person from being treated as owning the stock owned by its foreign owner. As a result of that removal, many investments by funds in non-U.S. corporations became "controlled foreign corporations", the tax consequences of the ownership of which can be adverse to U.S investors. This provision of the CARES Act was removed from the final version.

Net operating losses and excess business losses are easier to use.

The CARES Act allows a corporation's losses from 2018, 2019 and 2020 to be carried back for five years. The five-year carryback provision could allow a taxpayer to obtain permanent tax savings by generating a refund from losses arising in the pre-TCJA period when the corporate tax rate was as high as 35% compared with the current 21% rate. It also allows corporate net operating losses ("NOLs") to fully reduce taxable income for taxable years beginning after December 31, 2017 through 2020 (rather than only 80% of taxable income under current law). A REIT is not permitted to carry back losses. These provisions temporarily reverse certain changes made by the TCJA. However, the CARES Act effectively prevents the use of NOL carrybacks to offset income includible under section 965 (the deemed repatriation provision enacted in the TCJA). The CARES Act allows corporate taxpayers to make certain important elections, including the election to forego the carryback. Additionally, NOLs that arose in a tax year that straddled December 31, 2017 are eligible for the two year carryback period as a result of the technical correction to the effective date language in the TCJA (which originally applied the prohibition on carrybacks to taxable years ending after December 31, 2017).

The CARES Act also retroactively suspends the excess business loss provision of section 461(l)(1) (which disallows business losses in excess of $250,000 for a single taxpayer and $500,000 for a married couple filing jointly) for 2018, 2019 and 2020.

The section 163(j) limitation on business interest expense deduction increases from 30% to 50%.

The CARES Act retroactively increases the section 163(j) limitation on business interest expense deductions, discussed below, from 30% to 50% for tax years 2019 and 2020. Taxpayers may elect to use their 2019 adjusted taxable income for purposes of calculating their section 163(j) limitation for 2020. Taxpayers may also elect out of the increase (for example, to defer the deduction and avoid generating or

increasing a net operating loss, which will again be usable only to the extent of 80% of taxable income beginning in 2021, or to minimize the amount of interest subject to the base erosion and anti-abuse tax or the "BEAT"). The CARES Act also provides that the increase in the limitation applies to partners in partnerships only in 2020 (and not in 2019) but, for partners that do not elect out of the provision, 50% of the excess business interest of a partner that is accrued in 2019 is deemed to accrue in 2020 and is not subject to any limitation in 2020.

50% Employee Retention Tax Credit ("ERTC") for employers closed due to COVID-19.

The CARES Act provides an eligible employer with a refundable payroll tax credit equal to 50% of certain "qualified wages" (including certain health plan expenses) paid to its employees beginning March 13, 2020 through December 31, 2020 if the employer is engaged in a trade or business in 2020, and the wages are paid (i) while operation of that trade or business is fully or partially suspended due to a governmental order related to COVID-19 or (ii) during the period beginning in the first quarter in which gross receipts for that trade or business are less than 50% of gross receipts for the same calendar quarter of 2019 and ending at the end of the first subsequent quarter in which gross receipts are more than 80% for the same calendar quarter of 2019. The ERTC can be used to offset all federal payroll taxes, including federal withholding tax, and the employer's and employee's share of social security tax and Medicare, but not the federal unemployment tax.

However, before the Consolidated Appropriations Act (the "Act") was passed in late December, as discussed below, an "employer" could not claim an ERTC if it, or any of its affiliates with whom it is treated as a "single employer" had received a Paycheck Protection Program (the "PPP") loan (unless the PPP loan was repaid prior to May 18, 2020). For purposes of the PPP, applicants and entities are considered to be affiliates when one controls or has the power to control the other or such entities are under common control. Control is broadly defined, and encompasses affirmative and negative control rights, as well as equity-based and contractual control rights (including affiliation based on a management agreement). Common control could include, for example, two separate portfolio companies owned by the same private equity fund.

Under the CARES Act, if a company received a PPP loan, the other entities with which it was deemed a "single employer" became ineligible for ERTCs going forward, and potentially forfeited any ERTCs already received (i.e., such ERTCs would be recaptured). As a result of how "single employer" status is set out in the CARES Act, the possibility was raised that the addition of new affiliates as the result of a transaction would similarly cause existing ERTCs to be forfeited (i.e., recaptured) and the utilization of ERTCs going forward to be blocked.

The IRS issued FAQs that discussed the interaction of ERTCs and the rules under the PPP in the M&A context. While those rules provided helpful relief, they were not binding guidance. For a discussion of these FAQs, please see our December 7, 2020 blog post.

On December 27, 2020, the Act was signed into law, enhancing and expanding certain provisions of the CARES Act. Notably, the Act strikes the provision of the CARES Act that prohibited an employer that received a PPP loan from qualifying for the ERTC. Under the Act, an employer that receives a PPP loan may also be eligible for the ERTC. However, qualified wages that an employer takes into account in determining the ERTC may not be included in payroll costs for purposes of obtaining PPP loan forgiveness. These provisions take effect as if included in the CARES Act. Accordingly, employers that received PPP loans may be eligible for the ERTC for the 2020 calendar year despite having received a

PPP loan. Additionally, the Act makes certain other changes to the ERTC and added a provision which provides that expenses related to PPP loan forgiveness are deductible

For further discussion of these changes including a summary of the tax provisions of the Act, please see our December 29, 2020 blog post.

The 10% early withdrawal penalty for distributions of up to $100,000 from retirement funds for affected individuals is waived.

The CARES Act allows an individual to withdraw up to $100,000 from a qualified retirement account without incurring the 10% penalty for early withdrawals if (1) he or she is diagnosed with COVID-19, (2) his or her spouse or dependent is diagnosed with COVID-19, or (3) he or she experiences adverse financial consequences as a result of being quarantined, furloughed, laid off, having work hours reduced, being unable to work due to lack of child care due to COVID-19, closing or reducing hours of a business owned or operated by the individual due to COVID-19 or other factors as determined by the IRS. This provision applies to distributions from January 1, 2020 (rather than the date of enactment of the CARES Act) through December 31, 2020. Income attributable to the withdrawal will be taxable over three years (unless the taxpayer elects otherwise), and the taxpayer may recontribute the amount within three years without regard to the cap on contributions. The CARES Act also increases the maximum amount that an individual may borrow from a qualified plan from $50,000 to $100,000, allows an individual to borrow up to the present value of his or her non-forfeitable accrued benefit (rather than merely one-half of that amount, as under current law), and if the loan matures between the date of enactment and December 31, 2020, allows up to an additional year to repay the loan.

Deductibility of charitable contributions expanded.

The CARES Act allows a permanent "above the line" charitable contribution deduction for up to $300 of cash contributions to certain section 501(c)(3) public charities beginning in 2020, even if the individual takes the standard deduction. The CARES Act also suspends the 50% adjusted gross income limitation for charitable contributions by an individual in 2020 (so that an individual can receive a charitable contribution deduction for up to 100% of his or her 2020 adjusted gross income), and increases the 10% taxable income limitation on charitable contribution deductions for corporations to 25%. Finally, the CARES Act temporarily increases the cap on deductions for charitable contributions of food inventory in 2020 from 15% to 25% of taxable income (in the case of a C-corporation) or aggregate net income for all relevant trades or businesses (in the case of an individual).

Costs associated with improving qualified improvement property can be immediately expensed.

The CARES Act corrects an error in the TCJA that prevented businesses from expensing certain costs for improvements to "qualified improvement property", and which required the costs to be depreciated over the 39-year life of a building. Qualified improvement property is any improvement to the interior of a nonresidential building that is placed into service after the building is first placed into service. Qualified improvement property does not include improvements that are attributable to the enlargement of the building, elevators or escalators, or the internal structural framework of the building. The change is retroactive to the date of enactment of the TCJA.

Alternative Minimum Tax (AMT) credits are accelerated.

The TCJA repealed the corporate AMT and allowed corporations to claim corporate AMT credits over several years until 2021. The CARES Act allows corporations with outstanding AMT credits to claim their credits immediately.

For further discussion of the tax provisions of the CARES Act, please see our May 4, 2020 blog post.

Limitation on Business Interest Deductions - the New Section 163(j) Final and Proposed Regulations

As currently in effect, section 163(j) limits the deductibility of business interest to 30% of adjusted taxable income ("ATI"), as specifically adjusted to approximate earnings before interest, tax, depreciation and amortization ("EBITDA") for tax years through 2021(however, as mentioned above, the CARES Act raises the limit to 50% for tax years 2019 and 2020). Beginning in 2022, taxable income adjustments will exclude depreciation and amortization. Section 163(j) does not apply to "investment interest" and also provides exclusions for certain real estate trades or businesses and an exclusion for businesses with adjusted gross receipts of $25 million or less.

In November 2018, the IRS and the Treasury issued proposed regulations with respect to the section 163(j) rules (the "Old Proposed 163(j) Regulations"). For a discussion of the Old Proposed 163(j) Regulations, please see our December 5, 2018, blog post.

On July 28, 2020, the IRS and the Treasury issued final regulations (the "Final 163(j) Regulations") and new proposed regulations (the "New Proposed 163(j) Regulations"), to provide further guidance on the business interest expense deductibility limitation under section 163(j), and the specific impact of such rules on particular groups of taxpayers. The Old Proposed 163(j) Regulations now have been superseded by the Final 163(j) Regulations and the New Proposed 163(j) Regulations.

Definition of Interest – Final Regulations

The Final 163(j) Regulations significantly narrow the definition of "interest" set forth in the Old Proposed 163(j) Regulations by providing exceptions to or otherwise removing items from the definition of interest for purposes of section 163(j). In addition, the Final 163(j) Regulations modify the Old Proposed 163(j) Regulations in several important respects. First, while the Final 163(j) Regulations continue to treat swaps with significant non-periodic payments as on-market, level payment swaps and loans (the "embedded loan rule"), the Final 163(j) Regulations exempt cleared swaps and non-cleared swaps that require the parties to meet the margin or collateral requirements of a federal regulator (or requirements that are substantially similar) from the embedded loan rule. Second, the Final 163(j) Regulations continue to treat substitute interest payments (described in Treasury Regulations Section 1.861-2(a)(7)) in connection with sale-repurchase or securities lending transactions as interest expense to the payor and interest income to the recipient, but provide that such amounts will only be interest expense and interest income to the extent such sale-repurchase or securities lending transactions are not in the ordinary course of business of the payor and recipient, respectively. Third, although the Old Proposed 163(j) Regulations treated fees in respect of a lender commitment to provide financing as interest to the extent financing was provided, the Final 163(j) Regulations do not include such commitment fees in the definition of interest, but note their treatment will be addressed in future guidance.

The Final 163(j) Regulations also exclude debt issuance costs, guaranteed payments for the use of capital, and hedging income and expense from the definition of interest. However, the Final 163(j) Regulations retain, with important changes, an anti-avoidance rule with respect to the definition of interest that was set forth in the Proposed 163(j) Regulations. The anti-avoidance rule generally will require any expense or loss to be treated as interest expense for section 163(j) purposes if (a) the expense or loss is "economically equivalent" to interest and (b) if a principal purpose of structuring the transaction is to reduce a taxpayer's interest expense. The Final 163(j) Regulations provide five examples to illustrate the anti-avoidance rule, which is intended to apply broadly. The examples address certain kinds of payments

excluded from the definition of interest, including treatment of guaranteed payments and hedging transactions.

Impact on Trading Partnerships – New Proposed Regulations

The Old Proposed 163(j) Regulations provided that section 163(j) applied to a partnership engaged in the trade or business of trading personal property (including marketable securities) for the account of owners of interests in the activity (a "Trading Partnership"). This rule applied without regard to whether that interest was also subject to limitation under section 163(d) in the hands of the taxpayer partner.

Under section 163(d), taxpayers may only deduct investment interest expense to the extent of investment interest income. Generally, investment interest is "interest allowable as a deduction . . . which is paid or accrued on indebtedness properly allocable to property held for investment." Thus, interest expense of a partnership engaged in a trade or business would potentially have been subject to a section 163 limitation at two levels: a first limitation under section 163(j) at the partnership level; and a second limitation under section 163(d) at the partner level.

In response to comments on this seemingly inequitable result, the New Proposed 163(j) Regulations would bifurcate the business interest expense between partners that are passive investors and those who materially participate, subjecting only the portion allocable to those who materially participate to the section 163(j) limitation at the partnership level. Although it mitigates the double-limitation result of the Old Proposed 163(j) Regulations, the bifurcation approach requires a Trading Partnership to similarly bifurcate all other items of income, gain, loss and deduction from its trading activities between passive investors and those who materially participate in such trading activities, resulting in an increased administrative burden on the Trading Partnership to track its partners and make appropriate allocations between them based on their level of involvement in trading activities.

The New Proposed 163(j) Regulations acknowledge that bifurcation of interest expense requires a Trading Partnership to know whether each partner is a passive investor or an investor who materially participates in trading activities. To the extent a partner who seems to be a passive investor has grouped activities of the Trading Partnership with other activities of the partner outside of the Trading Partnership, it is possible that such partner would be deemed to be materially participating without the Trading Partnership's knowledge.

To avoid this result, the New Proposed 163(j) Regulations would provide that for purposes of testing material participation, any non-passive partnership trade or business activity in which a partner does not materially participate (whether or not related to a Trading Partnership) may not be grouped with any other activity of the partner. This raises many questions, including, whether a general partner should be permitted to group the activities of two or more of the Trading Partnerships that it manages. The New Proposed 163(j) Regulations invite comments on this fact pattern, and ask whether some sort of reporting regime (requiring all partners to annually certify or report to the Trading Partnership whether they are material participants in the trading activity) would be preferable.

On January 5, 2021, the IRS and the Treasury issued additional final regulations under section 163(j). These final regulations, which modify the New Proposed 163(j) Regulations discussed above, will generally become effective on the date they are filed for public inspection in the Federal Register.

Changes to the Determination of Controlled Foreign Corporation Status

Under current law, a foreign corporation is classified as a controlled foreign corporation (a "CFC") if U.S. persons that each own at least 10% of the voting power or the value of the foreign corporation ("U.S.

Shareholders") own in aggregate more than 50% of the voting power or value of the foreign corporation. By contrast, prior to the TCJA, only U.S. persons owning at least 10% of the voting power of the foreign corporation were included in the 50% vote or value calculation. Furthermore, U.S. Shareholders had to own more than 50% of the foreign corporation for 30 continuous days during the year for the corporation to be classified as a CFC. The TCJA repealed the 30-day safe harbor and now CFC status is tested every day of the year.

Prior to the TCJA, section 958(b)(4) contained a limitation on inbound attribution of stock for purposes of determining whether a foreign corporation is a CFC. Effective retroactively to a foreign corporation's last taxable year beginning before January 1, 2018, and each subsequent taxable year, the limitation on inbound attribution has been repealed and now downward attribution from a non-U.S. person applies. This broader attribution rule also applies to taxable years of U.S. Shareholders in which or with which the taxable years of those foreign corporations end.

Apart from significantly increasing the number of foreign corporations that will now be CFCs, this change may cause some inbound financing structures (often used in real estate and other fund structures utilizing "blocker" corporations) to fail to qualify for the portfolio interest exemption from withholding on interest because interest payments received by a CFC from a related person are excluded from the portfolio interest exemption.

On October 1, 2019, the IRS and the Treasury released a revenue procedure, **Rev. Proc. 2019-40** (the "Rev. Proc."), and **proposed regulations** (the "Proposed 958 Regulations") relating to the repeal of the inbound attribution limitation.

The Rev. Proc. provides certain safe harbors for a U.S. Shareholder of a "foreign-controlled CFC," which is a foreign corporation that would not be a CFC if the determination were made without applying the downward attribution rule so as to consider a U.S. person to own stock which is owned by a foreign person (i.e., the foreign corporation would not be a CFC but for the repeal of the attribution limitation). The Rev. Proc. also provides safe harbors for certain persons to use alternative information to determine their taxable income with respect to foreign corporations that are CFCs solely as a result of the repeal of section 958(b)(4) if they are unable to obtain information to report these amounts with greater accuracy.

Under the Rev. Proc., the IRS will accept a U.S. person's determination that a foreign corporation does not meet the section 957 ownership requirements and, therefore, that the foreign corporation is not a CFC with respect to the U.S. person if the U.S. person does not have actual knowledge, statements received and/or reliable publicly available information sufficient for the U.S. person to determine that the section 957 ownership requirements are met. For this purpose, actual knowledge, statements received and/or reliable publicly available information as of a given date will be treated as true for all subsequent dates unless subsequent information rebuts the original information. If the U.S. person directly owns stock of, or an interest in, a foreign entity ("top-tier entity"), in order to apply the safe harbor, the U.S. person must inquire of the top-tier entity whether it meets the section 957 ownership requirements, whether, how and to what extent such top-tier entity directly or indirectly owns stock of one or more foreign corporations and whether, how and to what extent such top-tier entity owns directly or indirectly stock of, or an interest in, one or more domestic entities.

The Proposed 958 Regulations "turned off" certain special rules that arise solely as a result of the repeal of the inbound attribution limitation. However, the Proposed 958 Regulations did not provide relief that would (i) prevent foreign corporations from being treated as CFCs as a result of the repeal of section 958(b)(4), (ii) limit the Subpart F or GILTI income required to be reported as a result of the repeal of

section 958(b)(4), or (iii) reinstate the portfolio interest exemption for foreign corporations affected by the repeal of section 958(b)(4). For further discussion of the Proposed 958 Regulations and section 958(b)(4), please see our related blog post.

On September 22, 2020, the IRS and the Treasury issued new proposed regulations and released final regulations which largely adopt the proposed regulations released in October 2019. Although the IRS and the Treasury received comments requesting relief with respect to the three exclusions mentioned above, they declined to include these exclusions in the final regulations. Additionally, these final regulations do not adopt a provision of the proposed regulations which provides that section 958(b)(4) does not apply with respect to certain PFIC determination rules applicable to foreign corporations that are both CFCs and not publicly traded. The preamble to the final regulations states that this provision will be finalized as part of regulations finalizing proposed PFIC regulations issued last year. On December 4, 2020, the IRS and the Treasury issued these regulations, finalizing the provision.

The new proposed regulations would modify the ownership attribution rules applicable to outbound transfers of stock or securities of a domestic corporation under section 367(a), which generally requires a domestic corporation to satisfy certain reporting requirements to obtain non-recognition treatment on outbound transfers of its stock or securities, and would narrow the scope of foreign corporations that are treated as CFCs for purposes of the look-through rule under section 954(c)(6), which generally provides that dividends, interest, rents and royalties received or accrued by a CFC from another related CFC are not treated as foreign personal holding company income to the extent attributable to, or properly allocable to, income of the related CFC that is neither Subpart F income nor income treated as effectively connected income ("ECI"). These regulations affect U.S. persons that transfer stock or securities of a domestic corporation to a foreign corporation that are subject to section 367(a) and U.S. shareholders of foreign corporations, and would apply to transfers made after September 21, 2020.

Global Intangible Low-Taxed Income ("GILTI") and Subpart F Final and Proposed Regulations

On July 20, 2020, the IRS and the Treasury issued final regulations along with new proposed regulations under section 954(b)(4) related to high-taxed subpart F income. The final regulations follow the proposed GILTI regulations that the IRS and the Treasury had issued in June of 2019. Notably, the final regulations expand the high-tax exclusion, allowing the exclusion to apply electively to all tested gross income subject to a minimum effective tax rate. Under the final regulations, shareholders of a CFC may elect to exclude from gross tested income amounts that have been subject to foreign tax at an effective rate that exceeds 90 percent of the U.S. federal income tax rate (currently, 18.9%).

The proposed GILTI regulations had been thought to provide less flexibility than the high-tax exception available for subpart F income. Some taxpayers and practitioners were critical of this distinction and requested the GILTI high-tax exclusion be changed to apply the exclusion to all open years, permit the determination to be made on a CFC-by-CFC basis rather than qualified business unit by qualified business unit, and permit the election to be made annually. The final regulations eliminate the disparity between the elections and attempt to avoid any incentive taxpayers may have had to plan into using the subpart F exception, and do allow taxpayers to make an annual election. Although the final regulations move away from the qualified business unit by qualified business unit determination, the final regulations do not adopt a CFC-by-CFC determination.

The final regulations provide for a single election under section 954(b)(4) for both subpart F income and tested income and are applicable to tax years beginning after July 23, 2020.

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

Enacted as part of the TCJA, section 1446(f) generally requires a transferee, in connection with a disposition of a partnership interest by a non-U.S. person, to withhold and remit 10 percent of the "amount realized" by the transferor, if any portion of any gain realized by the transferor would be treated as effectively connected with the conduct of a trade or business in the United States under the substantive sourcing rule of section 864(c)(8).

On October 7, 2020, the IRS released final regulations providing guidance on the rules imposing withholding and reporting requirements under the Code on dispositions of certain partnership interests by non-U.S. persons (the "Final 1446(f) Regulations"). Prior to issuing the Final 1446(f) Regulations, the IRS issued Notice 2018-08, Notice 2018-29, and, on May 13, 2019, proposed regulations (the "Proposed 1446(f) Regulations") to provide interim guidance with respect to these withholding and information reporting requirements. For a discussion of this previous guidance, please see our related blog post on the Notices and related blog post on the Proposed 1446(f) Regulations.

The Final 1446(f) Regulations adopt many of the rules set forth in the Proposed 1446(f) Regulations, with certain modifications, and include some taxpayer friendly provisions and clarifications, such as (i) allowing new partnership certifications to satisfy exceptions to withholding; (ii) clarifying whether exceptions look to gross income instead of net income; (iii) allowing transferring non-U.S. partnerships to reduce or avoid withholding if there are non-U.S. partners in the partnership that can apply tax treaty benefits; (iv) allowing transferees to directly claim refunds for excess secondary withholding by a partnership; and (v) clarifying that if an exception to withholding applies to a transfer, subsequent earnout payments will also be exempt from such withholding.

Some provisions clarify ambiguities in the Proposed 1446(f) Regulations, such as: (i) indicating that section 1446(f) withholding applies to all transfers of partnership interests that both (a) do not have proper documentation for an exception and (b) cannot confirm that the interest does not give rise to effectively connected income ("ECI"); and (ii) clarifying that partnerships have affirmative secondary withholding obligations, and are not required to rely on certifications provided by the transferee.

The Final 1446(f) Regulations were published in the Federal Register on November 30, 2020. Most of the Final 1446(f) Regulations will apply to transfers occurring on or after January 29, 2021, although secondary withholding obligations imposed on partnerships to backstop the general section 1446(f) withholding rules will only apply to transfers occurring on or after January 1, 2022. For further discussion, including details regarding exceptions from withholding under the Final 1446(f) Regulations, please see our October 15, 2020 blog post.

Determining Gain or Loss of Foreign Persons from Sale or Exchange of Certain Partnership Interests

Shortly before releasing the Final 1446(f) Regulations, the IRS and the Treasury released final regulations under section 864(c)(8) (the "Final 864(c)(8) Regulations"), which as mentioned above, generally treats gain or loss of a foreign partner from the sale, exchange, or other disposition of an interest in a partnership that is engaged in a trade or business within the United States is treated as ECI. The Final 864(c)(8) Regulations generally adopt the framework of previously proposed regulations and provide several clarifications, including clarifying that a foreign partner's distributive share of deemed sale gain or loss does not include any amount that is excluded from the foreign partner's gross income or otherwise exempt from tax by reason of an applicable provision of the Code.

The Final 864(c)(8) Regulations also provide a coordination rule for nonrecognition transfers where the partnership owns one or more U.S. real property interests. In such instances, section 897(g) will apply with respect to the unrecognized gain or loss, overriding the nonrecognition rule in the Final 864(c)(8) Regulations, potentially causing recognition of gain to the extent of the FMV of the U.S. real property interests.

Qualified Opportunity Zone Program

On December 19, 2019, the IRS and the Treasury issued final regulations (the "Final OZ Regulations") under section 1400Z-2 of the Code regarding the opportunity zone program, which was enacted as part of the TCJA. The opportunity zone program is designed to encourage investment in distressed communities designated as "qualified opportunity zones" ("opportunity zones") by providing tax incentives to invest in "qualified opportunity funds" ("QOFs") that, in turn, invest directly or indirectly in the opportunity zones.

The opportunity zone statute left many uncertainties regarding the fundamental operations of the opportunity zone program. The IRS and the Treasury issued two sets of proposed regulations under section 1400Z-2 in October 2018 and April 2019 (the "Proposed OZ Regulations"). The Proposed OZ Regulations were discussed in two of our earlier blog posts, found here and here. The Final OZ Regulations address the many comments received in response to the Proposed OZ Regulations, and retain the basic approach and structure set forth in the Proposed OZ Regulations, but include clarifications and modifications to the Proposed Regulations. The Final OZ Regulations are generally taxpayer-favorable, and incorporate many of the provisions requested by commentators. However, there are certain provisions that are worse for taxpayers than under the Proposed OZ Regulations.

For further discussion of the Final OZ Regulations and links to our previous discussions of the Proposed OZ Regulations and the opportunity zone program generally, please see our January 22, 2020, blog post.

Section 871(m) Regulations

On September 17, 2015, the IRS and the Treasury issued final, temporary and proposed regulations under section 871(m) (collectively, the "2015 Regulations") 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 entered into 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 issued new final, temporary and proposed regulations (the "2017 Regulations"), which are substantially similar to the 2015 Regulations and provide clarification of certain aspects. In August 2017, the IRS issued Notice 2017-42, which extends the phase-in application of section 871(m) to certain transactions.

Notice 2018-72 describes the extension of (i) the phased-in application of the regulations to delta-one and non-delta-one transactions, (ii) the extension of the simplified standard for determining whether transactions are combined transactions, and (iii) the extension of phased-in relief for qualified derivatives dealers. The guidance also provides that withholding agents may apply some of these transition rules for payments made in 2020.

On October 23, 2019, an IRS official stated that the IRS is working to finalize temporary regulations on section 871(m) before they sunset, and those regulations will provide an extension of the transition period. Accordingly, on December 16, 2019, the IRS and Treasury issued final regulations under section 871(m) (the "Final 871(m) Regulations") concurrently with Notice 2020-2, which further extends the phased-in application of the Final 871(m) Regulations to delta-one and non-delta-one transactions.

Notice 2020-2 is substantially similar to Notice 2018-72, again providing extensions to areas related to section 871(m) described above. The Final 871(m) Regulations finalize the temporary regulations, but do not make substantial changes to the rules.

Final Section 385 Regulations

Since their release in October 2016, the final and temporary regulations under section 385 (the "385 Regulations") have been controversial. The intent of section 385 and the 385 Regulations generally was to prevent erosion of the U.S. tax base through placement of debt owed by a U.S. corporation in a foreign affiliate, which was a typical post-inversion planning technique. As issued in 2016, the 385 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.

On November 4, 2019, the IRS finalized proposed regulations removing certain final and temporary 385 Regulations that had set forth minimum documentation requirements in order for certain financial arrangements among expanded groups to be treated as debt for U.S. federal income tax purposes. However, the IRS noted that it was still considering the issues addressed by the removed regulations and could propose modified regulations that would simplify and streamline the requirements to minimize taxpayer burdens, while ensuring the collection of information needed for tax administration purposes.

Concurrently, the IRS issued notice of its intention to issue proposed regulations (the "Proposed 385 Regulations") which would be a substantially modified version of temporary 385 Regulations that expired in October 2019. Like the temporary 385 Regulations, the Proposed 385 Regulations treated as stock certain debt that is issued by a corporation to a controlling shareholder in a distribution or in another related-party transaction that achieves an economically similar result. Unlike the temporary 385 Regulations, the Proposed 385 Regulations did not treat a debt instrument as funding a distribution or economically similar transaction solely because of its temporal proximity to a distribution.

However, on May 13, 2020, the IRS issued final regulations under section 385 that did not adopt the Proposed 385 Regulations, but are materially the same as the temporary 385 Regulations, which provided exceptions for certain short-term debt instruments and additional rules regarding partnerships and consolidated groups.

IRS Guidance for Transition from LIBOR

On October 9, 2019, the IRS and the Treasury released proposed regulations addressing market concerns regarding the U.S. tax effect of the expected transition from LIBOR and other interbank offered rates on debt instruments (e.g., loans, notes and bonds) and non-debt contracts (e.g., swaps and other derivatives). Please see our October 15, 2019 blog post for a discussion and analysis of the proposed regulations.

One year later, on October 9, 2020, the IRS issued Rev. Proc. 2020-44 to provide additional guidance to taxpayers that are affected by the phase-out of LIBOR and other interbank offered rates. Guidance in Rev. Proc. 2020-44 provides specific modifications of contracts that are not treated as a taxable transaction under Section 1001 and other provisions. Generally, this includes any contract with terms that reference an IBOR that are modified as described in Section 4.02 of Rev. Proc. 2020-44. A contract subject to Rev Proc. 2020-44 may include a derivative, debt instrument, stock, insurance contract and a lease agreement.

Rev. Proc. 2020-44 is effective for modifications to contracts occurring on or after October 9, 2020, and before January 1, 2023, however, a taxpayer may rely on the guidance for modifications occurring before October 9, 2020.

Final Regulations on UBTI Provide Guidance to Tax-Exempt Organizations Making Fund Investments

On November 19, 2020, the IRS and the Treasury issued final regulations (the "Final UBTI Regulations") under section 512(a)(6), a provision requiring tax-exempt organizations (including individual retirement accounts) to calculate unrelated business taxable income ("UBTI") separately with respect to each of their unrelated trades or businesses, effectively limiting an exempt organization's ability to use losses from one business to offset income or gain from another. Previously, on April 23, 2020, the IRS and the Treasury had issued proposed regulations (the "Proposed UBTI Regulations").

The Proposed UBTI Regulations followed Notice 2018-67, which provided interim guidance on the application of section 512(a)(6). For a discussion of Notice 2018-67 please see our August 30, 2018 blog post.

The Final UBTI Regulations largely follow the rules set forth in the Proposed UBTI Regulations, and like the Proposed UBTI Regulations, the Final UBTI Regulations (i) simplify the manner in which exempt organizations classify their various business activities for purposes of determining their UBTI; and (ii) provide some relief and guidance in applying certain aggregation rules, which will help exempt organizations who generally are minority investors in private funds.

Like the Proposed UBTI Regulations, under the Final UBTI Regulations, all investment activities are treated as a single and separate unrelated trade or business. For this purpose, investment activities are limited to the following three activities only: (i) direct or indirect investments in partnerships designated as "qualifying partnership interests" ("QPIs"), (ii) debt-financed properties, and (iii) qualifying S-corporation interests.

Also consistent with the Proposed UBTI Regulations, the Final UBTI Regulations permit, but do not require, an exempt organization to aggregate UBTI realized from all QPIs as a single trade or business in investments; however, once an exempt organization opts to designate a partnership interest as a QPI, the exempt organization cannot use a NAICS two-digit sector code to identify the partnership's underlying trade or business unless and until the partnership interest is no longer a QPI.

The benefit of this aggregation rule for an exempt organization investing in private funds is that, for its QPIs, it will be able to aggregate gains and losses from UBTI generating activities conducted by those funds without having to identify each and every underlying activity generating those gains and losses. This saves exempt organizations the administrative burden of obtaining information about the underlying activities of a fund in which the organization is invested. As a result, it will be critical for exempt organizations to identify each of their QPIs and ensure that those interests remain QPIs to benefit from the aggregation rule.

For further discussion of the Proposed UBTI Regulations, please see our May 5, 2020 client alert.

One notable change in the Final UBTI Regulations is the treatment of certain partnership interests that do not meet the requirements to be treated as QPIs. Both Notice 2018-67 and the Proposed UBTI Regulations permitted an exempt organization to treat each partnership interest acquired prior to August 21, 2018 as one trade or business (the "Transition Rule"). The Transition Rule applied even if such partnership interest failed to meet the criteria needed to be treated as one trade or business set forth in

Notice 2018-57 or the Proposed UBTI Regulations, and regardless of whether there was more than one trade or business directly or indirectly conducted by such partnership or lower-tier partnerships. While some commentators advocated to make the Transition Rule permanent, effectively making it a grandfathering rule, the IRS and the Treasury declined to take this approach. Under the Final UBTI Regulations, an exempt organization may treat each partnership interest acquired prior to August 21, 2018 that does not meet the requirements to nevertheless be treated as a single trade or business, until the first day of the exempt organization's first taxable year beginning after the date the Final UBTI Regulations are published in the Federal Register.

The Final UBTI Regulations contain two other notable changes. First, the so called "control test" has been renamed as the "participation test" in order to better reflect the intent of the rule, which is to determine whether an exempt organization significantly participates in a partnership (and, by extension, be able to obtain the information needed from the partnership to determine whether a trade or business conducted by the partnership is related or not). Second, the Final UBTI Regulations expand the application of the "look-through rule" by also allowing a tax-exempt partner to apply the rule to indirectly held partnership interests that meet the requirements of the participation test, thus treating such interests as QPIs, even if the tax-exempt partner materially participates in the immediately higher-tier partnership which owns the interest in the qualifying partnership. For purposes of the look-through rule, the participation test will apply tier-by-tier to the exempt organization's indirectly held partnership interests.

Section 274 Regulations on Meal and Entertainment Expense Deductions

Although the TCJA repealed the exception to a general rule disallowing the deduction of expenses incurred for entertainment, amusement or recreation that is directly related to (or, in certain cases, associated with) the active conduct of the taxpayer's trade or business (and the related rule applying a 50% limit to such deduction), taxpayers are still generally permitted to deduct up to 50% of the food and beverage expenses associated with operating their trade or business (e.g., meals consumed by employees during work travel), subject to the limitations under section 274. However, under the Consolidated Appropriations Act, discussed above, taxpayers are allowed to deduct 100% of business meals expenses during 2021 and 2022 as long as such expenses are provided by a restaurant and paid or incurred before January 1, 2023.

On October 3, 2018, the IRS and the Treasury issued Notice 2018-76, which provides guidance for the deductibility of business meals as business expenses. Under Notice 2018-76, business meal expenses continued to be 50% deductible, provided certain conditions are met. Taxpayers may deduct 50% of an otherwise allowable business meal expense so long as: (i) the expense is ordinary, necessary, and paid or incurred in the carrying on of any trade or business during the taxable year; (ii) the expense is not lavish or extravagant under the circumstances; (iii) the taxpayer or its employee is present at the furnishing of the meal; (iv) the meal is provided to a current or potential business customer, client, consultant, or similar business contact; and (v) if provided at an entertainment activity, either (a) the food and beverages are purchased separately from the entertainment or (b) the food and beverages' cost is stated separately from the entertainment costs on the bill, invoice or receipt.

On February 26, 2020, the IRS issued proposed regulations under section 274, which generally adopt the guidance set forth in Notice 2018-76, but add that the itemized costs of separately stated food and beverage items purchased at an entertainment venue must be the usual selling cost at the venue or must approximate the reasonable value of the items.

On September 29, 2020, the IRS and the Treasury released final regulations under section 274, which are materially similar to the proposed regulations. The most significant change in the final regulations relates to certain taxable fringe benefits. Generally, a taxpayer may fully deduct expenses for meals and entertainment that are treated as compensation for employees and other service providers. The proposed regulations would have denied any deduction for such expenses if the value a recipient included in income was less than the amount required to be included under the applicable valuation rules. The final regulations are less harsh in this regard, and allow a deduction, with certain limitations, if the taxpayer treats an improper amount as compensation to the recipient. Under this more limited rule, the taxpayer is subject to a "dollar-for-dollar methodology," which caps the permitted deduction to the dollar amount treated as compensation. The final regulations impose the dollar-for-dollar rule if (i) any portion of an item is excluded from income, or (ii) less than the proper amount was treated as compensation. However, if no amount was treated as compensation, without regard to whether such treatment is proper or improper and without regard to whether this is due to an income exclusion or a reimbursement, no deduction is permitted.

Both Notice 2018-76 and the proposed regulations were widely considered to be very generous, so the final regulations should also be welcome relief for taxpayers.

The final regulations apply for tax years beginning on or after October 9, 2020. Neither the rules nor the preamble to the final regulations provide that taxpayers may apply the regulations before publication. However, since the final regulations are substantially similar to the proposed regulations, this timeline may not be particularly burdensome to taxpayers. [NTD: I don't think we need to add anything here, but let me know if you disagree.]

State and Local Tax Credit for Entity Level Taxes

A provision of the TCJA limited the individual deduction for state and local income taxes and property taxes to $10,000 for taxes that are not incurred in connection with a trade or business. Because the limitation impacted residents in high-tax states most acutely, several states, such as New Jersey and Connecticut, enacted legislation, generally in the form of a tax assessed on pass-through entities accompanied by a corresponding state tax credit, aimed to benefit taxpayers by helping to mitigate the impact of the $10,000 limit. While it had been uncertain whether the IRS would allow these workarounds, on November 9, 2020, the IRS released Notice 2020-75, effectively permitting such entity level tax workarounds.

Notice 2020-75 states that the deduction will be allowed whether the state entity-level tax is mandatory (such as Connecticut), or elective (such as New Jersey). This is welcome news for tax-exempt owners of pass-through entities such as charitable organizations, as a mandatory state tax at the entity-level tax would disadvantage these owners. However, most of the states that have enacted a tax on pass-through entities have made the provision elective. At this time, only the state of Connecticut imposes a mandatory tax on pass through entities.

Notice 2020-75 is effective for taxes paid on or after November 9, 2020. But, the proposed regulations will also permit a deduction for payments made by a partnership or S corporation for tax years ending after December 31, 2017, and before November 9, 2020, if the specified income tax payment is made to satisfy the liability for income tax imposed on a pass-through entity pursuant to a law enacted before November 9, 2020. As a result, pending confirmation when the proposed regulations are published, entity-level taxes previously paid under the entity-level tax laws already enacted by a state with workaround rules should be allowed without regard to the $10,000 state and local tax deduction cap.

ERISA Update

Fiduciary Rule "Investment Advice" Guidance

On June 29, 2020, the U.S. Department of Labor (DOL) issued new guidance applicable to "investment advice" fiduciaries under the U.S. Employee Retirement Income Security Act of 1974, as amended (ERISA), and Section 4975 of the U.S. Internal Revenue Code of 1986, as amended (the Code). Importantly, this guidance generally only impacts advisers that provide investment guidance directly to ERISA-covered plans, individual retirements accounts and annuities (IRAs), and other entities or accounts that are subject to ERISA or Section 4975 of the Code (e.g., private investment funds deemed to be holding ERISA "plan assets) (collectively, "Retirement Plans). It should not impact managers of, or advisers to, plans, vehicles and accounts that are not subject to ERISA or Section 4975 of the Code, such as a non-plan asset private investment fund that is operated under the "ERISA 25% limit" or as a "VCOC" or "REOC."

Reinstatement of the "Five-Part Test"

- Effective immediately, the DOL formally reinstated its "five-part test" for determining whether a person is a "fiduciary" under ERISA and Section 4975 of the Code by reason of providing "***investment advice***" for a fee. (This guidance does not cover fiduciaries that have ***discretionary investment authority***.) In April 2016, the DOL temporarily replaced the "five-part test" with a new fiduciary rule that significantly expanded the type of investment-related information that would be considered "investment advice" which affected certain marketing and other related activities directed at Retirement Plans common to the investment management industry (including the private investment fund industry). However, that rule was vacated by the Fifth Circuit in March 2018. Shortly after that decision, the DOL issued Field Assistance Bulletin 2018-02, which provided that the DOL would not enforce the 2016 fiduciary rule and instead would go back to the "five-part test," so the ERISA industry has generally already been operating as if the "five-part test" was the governing rule. In any event, this new guidance is formal confirmation that the "five-part test" is applicable once again.
- Although the DOL made no changes to the text of the "five-part test," the DOL did provide some additional information on the DOL's current view about key elements of the test. Historically, service providers have often taken the position that certain investment guidance (such as guidance on whether or not to take a distribution from a retirement plan and roll it over to an IRA) was not "investment advice" under the "five-part test" because it was not provided on a "regular basis" and/or pursuant to a "mutual" agreement, arrangement or understanding that the advice would serve as a "primary basis" for the decision – negating several of the required prongs of the "five-part test." In this regard, the DOL noted the following:
  - Although advice provided on an isolated basis may not satisfy the "regular basis" prong, such requirement may be satisfied if the advice is either part of an ongoing advisory relationship or the start of an ongoing advisory relationship (even where no advice was previously provided);
  - Whether advice satisfies the "mutual" understanding requirement will be based on the "***reasonable***" understanding of the parties. Written statements disclaiming a "mutual" understanding are not determinative, but may be considered;
  - Advice does not need to serve as "***the***" primary basis of investment decisions, but rather it only need to serve as "***a***" primary basis; and

- If a recommendation is based on individualized needs or made in accordance with a best interest standard such as the SEC's best interest standard, the parties "typically should reasonably understand that the advice will serve as at least a primary basis for the investment decision."

Key Takeaway: Even with this additional information from the DOL, it seems that general marketing of investment products to Retirement Plans, and providing specific information to Retirement Plan investors or prospective investors concerning investment products that is not based on specific individualized needs of the investor, will continue not to result in the provision of "investment advice" under ERISA.

Proposed Exemption for Conflicted "Investment Advice" and Principal Transactions

- The DOL proposed a new prohibited transaction exemption for "investment advice" fiduciaries (again, which is not applicable to fiduciaries with ***discretionary investment authority***) that would (i) give them more flexibility to provide otherwise "conflicted" advice (including with respect to IRA rollovers) that affects their compensation, and (ii) permit them to enter into and receive compensation from "riskless" and certain other "principal transactions," provided that, in each case, the advice is provided in accordance with "impartial conduct" standards – namely, a best interest standard (which includes duties of prudence and loyalty) – that are intended to be aligned with the standards of conduct for investment advice professionals established and considered by other U.S. federal and state regulators (in particular, the SEC and its Regulation Best Interest). The proposed exemption will not go into effect unless and until it is finalized.

This latest round of "fiduciary rule" guidance undoubtedly will not be the last word on this topic.

For more information on this guidance package, please see here.

DOL Offers Its Views on 401(k) Plans Investing in Private Equity

On June 3, 2020, the DOL published an Information Letter (the Letter) confirming that an investment option under a 401(k) plan (or other defined contribution plan) may include a limited allocation to private equity,[5] but it did not establish any kind of "safe-harbor" for doing so. While this is not a novel concept (in fact, some defined contribution plans have had private equity and other alternative asset allocations within their plan investment options for years, and challenges to the prudence of those investments are actively being litigated), the Letter does confirm that including a small allocation to private equity within an investment option would not violate ERISA if ERISA's fiduciary and prohibited transaction requirements are satisfied.

Notably, the Letter does not discuss whether a 401(k) plan could have an investment fund investing all or substantially all of its assets in private equity or a fund investing in private equity as a direct investment option for plan participants. Rather, the Letter discusses including private equity as a small allocation (DOL suggests in a footnote to the Letter that fiduciaries should consider limiting to 15% or less)[6] within a diversified investment option such as a custom target date fund, target risk fund, or a balanced fund, while indicating that a direct investment in private equity would "present distinct legal and operational issues."

[5] The Letter does not address investments in illiquid asset classes that do not fit directly within the "private equity" heading (e.g., debt or real estate).

[6] As the Letter does not address other illiquid asset classes, it is unclear whether this limit would apply to all illiquid assets.

Recognizing that private equity-based investments may offer greater returns than could be achieved solely in the public market, 401(k) plan participants and fiduciaries have long sought access to such asset class that is often utilized in investing defined benefit plan assets. Given the complex fiduciary and regulatory issues, however, it has been a struggle for plan fiduciaries and private equity asset managers to determine how best to accomplish that goal.

The Letter lists specific issues for 401(k) plan fiduciaries to consider and solve (again, without providing a "safe harbor) before authorizing (or maintaining) an investment option with a private equity allocation. In particular, the Letter notes that any such decision must be made in accordance with ERISA's strict duties of prudence and loyalty and in a manner that avoids prohibited transactions, which requires (among other things) that the fiduciary must evaluate whether the potential upside from the investment justifies the added risk, fees, complexity, and valuation and liquidity issues, arguably creating enhanced risk if such investments underperform their counterparts that do not include an allocation to private equity. Also, the Letter references, and does not resolve, additional issues that might arise under ERISA's prohibited transaction rules, as well as securities, banking, tax, and other laws.

Key Takeaway: While this guidance purports to provide some comfort for private equity asset managers seeking to access the defined contribution plan space, the "comfort" is fairly limited in scope and the issues remain just as complex as ever.

For more information on this DOL guidance, please see here and here.

Proposed ERISA Restrictions on ESG Investing

On June 23, 2020, the DOL issued a proposed rule that would limit when and how fiduciaries of ERISA plans may (i) consider non-pecuniary "environmental, social and corporate governance" (ESG)-type factors when making plan investment decisions, or (ii) offer an ESG-themed investment option under a 401(k)-type plan. This proposal generally only applies to fiduciaries and managers of ERISA-covered plans, entities or accounts, and does not apply to managers of, or advisers to, plans, vehicles and accounts that are not subject to ERISA.

In its commentary, the DOL noted that confusion persists for ERISA plan fiduciaries in regards to its ESG-investing rules, which the DOL acknowledged may be a result of varied statements it has made over the years in past guidance. In short, the proposed rule would codify the DOL's view that the sole focus of ERISA plan fiduciaries must be the financial returns and risk to participants and beneficiaries, and that ERISA plan fiduciaries must not sacrifice investment returns, take on additional investment risk, or pay higher fees to promote non-pecuniary benefits or goals.

Key Takeaway. If finalized, the proposed rule would apply only to the investment of "plan assets" covered by ERISA. In light of the fact that the proposed rule generally would impose additional requirements to demonstrate the prudence of an investment that is an ESG-themed investment or an investment that references ESG factors, the proposed rule could have a chilling effect on the investment of ERISA "plan assets" in any type of investment fund or product that even mentions ESG considerations as part as its investment strategy or process. If this guidance is finalized in a manner consistent with the proposal, ERISA plan fiduciaries may take more of an interest in how fund advisers consider ESG factors in implementing their investment strategy.

For more information on this proposal, please see here.

Proposed Proxy Voting Guidance for ERISA Fiduciaries

On September 4, 2020, the DOL published a proposed rule (the Proposed Proxy Voting Rule) that would confirm its position that ERISA's fiduciary duties of prudence and loyalty apply to an ERISA plan fiduciary's exercise of shareholder rights, including proxy voting, proxy voting policies and guidelines, and the selection and monitoring of proxy advisory firms.

The Proposed Proxy Voting Rule reflects the DOL's attempt at clarifying its prior proxy voting guidance that "may have led to some confusion or misunderstandings." In particular, the DOL acknowledged that there is a view among some that ERISA plan fiduciaries are required to vote ***all*** proxies – the Proposed Proxy Voting Rule makes clear that is ***not*** the case. The Proposed Proxy Voting Rule instead provides that an ERISA plan fiduciary is permitted to vote proxies only when it prudently determines that the matter being voted upon would have an ***economic impact*** on the plan after the costs of research and voting are taken into account, and that a fiduciary is prohibited from voting proxies otherwise. The DOL expressly states in the preamble that there is no presumption that abstaining from voting proxies is a per se fiduciary breach; rather, fiduciaries are required to vote proxies in a manner that is in the best interests of the plan, which requires a consideration of the likely impact on the plan's investment performance in light of the size of the plan's holdings in the issuer relative to the total investment assets of the plan, the plan's percentage ownership in the issuer, and the costs involved.

Consistent with the DOL's ESG guidance relating to the investment of plan assets (summarized above), the Proposed Proxy Voting Rule would provide that, when exercising a plan's shareholder rights (including proxy voting), an ERISA plan fiduciary is prohibited from subordinating the financial interests of the plan to any non-pecuniary objective or from sacrificing investment returns or taking on additional risks in order to promote non-financial goals. In addition, the Proposed Proxy Voting Rule would require a plan fiduciary to:

- investigate material facts that form the basis for exercising such shareholder rights;
- maintain records on exercises of shareholder rights, including records that demonstrate the basis for such decisions; and
- exercise prudence and diligence in the selection and monitoring of persons selected to advise or otherwise assist with exercises of shareholder rights (and where the authority to vote proxies or exercise other shareholder rights has been delegated to an investment adviser or proxy advisory firm, a responsible plan fiduciary shall require such adviser or firm to document the rationale for proxy voting decisions or recommendations sufficient to demonstrate that the action was "based on expected economic benefit to the plan).

The Proposed Proxy Voting Rule specifically provides that:

- a plan fiduciary "must vote" any proxy where the fiduciary prudently determines that the matter being voted on would have an economic impact on the plan after considering the factors described above and costs involved in voting; and
- a plan fiduciary "must not vote" any proxy unless it prudently determines that the matter would have an economic impact on the plan after considering such factors and costs.

However, recognizing that determining whether or not to vote proxies may be resource-intensive and often will exceed the potential economic benefits to the plan, the DOL also proposed examples of permitted policies that fiduciaries may adopt that are intended to reduce the need for fiduciaries to consider proxy votes that are unlikely to have an economic impact on the plan.

Key Takeaway: In the meantime, ERISA plan fiduciaries should carefully review their proxy voting policies and practices – including those applicable to investment advisers and proxy advisory firms that exercise these rights on behalf of the plan – and be prepared to make any necessary changes in the event the Proposed Proxy Voting Rule is finalized.

For more information on this proposal, please see here.

State Regulation / Blue-Sky Updates

Compliance with Rule 506 is very important in connection 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 with Rule 506, there is no pre-emption and, 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 for the offering as well as other aspects of the offering. If a filing is incomplete or late or a state finds any other issue with it, they may require that the issuer make a rescission offer to the investors and possibly pay fines.

Provided that an offering is made in compliance with Rule 506, the blue sky laws of many states currently require that a hard copy of Form D, along with the state's required filing fee, be filed with the relevant state authority within 15 days following the initial sale of securities in that jurisdiction (as stated above, that would be the date on which the first investor in the jurisdiction is irrevocably contractually committed to invest). Some states' blue sky laws require that copies of amended SEC filings also be filed with the state, and a few 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, "The NASAA Electronic Filing Depository" usually referred to as the "EFD," which is currently required to be used for filings in about 15 states, and may 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 use 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. A handful of states also occasionally request to see copies of the offering materials provided in connection with the offering.

Employment Law Update

Harassment and Discrimination
California

On October 10, 2019, California Governor Gavin Newsom signed AB 9 into law. The law, which took effect on January 1, 2020, extends the statute of limitations period for employees to file claims of discrimination, harassment, and/or retaliation with the California Department of Fair Employment and Housing (the DFEH) from one to three years. Once an employee receives a right-to-sue letter from the DFEH, that employee will then have one more year to file a civil action in court. As a result of this new law, employers may find themselves defending against lawsuits filed several years after the underlying conduct occurred.

For more information, please refer to our October 14, 2019 post.

Connecticut

The Connecticut Commission on Human Rights and Opportunities (the CHRO) published Frequently Asked Questions (FAQs), a model notice poster, and other written materials regarding sexual harassment to assist employers in complying with the Time's Up Act's (the Act) sexual harassment training and notice requirements. These materials include a free online training and education video which employers may use to satisfy their obligation to provide employees with sexual harassment training. Additionally, the FAQs clarify that the Act applies to any employer with at least one employee based in Connecticut. The FAQs also note that employers need not provide live sexual harassment training. Rather, the training may be done via a recorded video or online. Notwithstanding this, the training must be provided in a format that allows participants to ask questions and receive answers.

Although an employer may prepare its own training materials that meet or exceed the minimum standards set forth under the Act, the CHRO's model training materials are sufficient for employers to discharge their duty to provide sexual harassment training. The training materials provided by the CHRO are divided into various segments and incorporate interactive quizzes for employees to complete. Employees who complete the training will receive certificates of completion. Although these certificates are not required to prove that an employee has completed the training, employers may wish to use these certificates to internally track compliance with the law.

Please refer to our November 8, 2019 post for more information.

New York

On November 8, 2019, New York Governor Andrew Cuomo signed into law a bill which amends the New York Labor Law to prohibit discrimination based on an employee's or dependent's reproductive health decision making. Under the new law, which took effect upon signing, an employer may not access an employee's or their dependent's reproductive health without prior consent. Specifically, this prohibition prevents an employer from "accessing an employee's personal information regarding the employee's or the employee's dependent's reproductive health decision making, including but not limited to, the decision to use or access a particular drug, device or medical service without the employee's prior informed affirmative written consent." In addition, employers cannot require employees to sign waivers or other documents that purport to deny an employee the right to make their own reproductive health care decisions, including the use of a particular drug, device, or medical service.

The law also includes an anti-discrimination and anti-retaliation provision which prohibits reprisals against employees based on their or their dependents' reproductive health decision making. Employees who believe they have been discriminated against by their employer in violation of this law may file a civil action seeking back pay, benefits, reasonable attorneys' fees, and costs. The law also provides for other remedies, such as injunctive relief, reinstatement, and liquidated damages equal to 100% of the award for damages, unless the employer proves a good faith basis to believe that its actions were in compliance with the law. Likewise, employers who discriminate against employees in violation of the law may also be subject to separate civil penalties. Finally, employers who utilize employee handbooks are required to include in their handbook a notice of employee rights and remedies under this law.

For more information, please refer to our November 18, 2019 post on Proskauer's Law and the Workplace blog.

New York City

On January 11, 2020, an amendment to the New York City Human Rights Law (the NYCHRL) took effect which expanded the law's protections to freelancers and independent contractors. As a result of the amendment, freelancers and independent contractors enjoy the same protections against discrimination, harassment, and retaliation under the NYCHRL as employees. This means that contractors and freelancers have the right to request and receive reasonable accommodations for needs related to disability, pregnancy, lactation, religious observances, and status as victims of domestic violence, sexual offenses, or stalking in the same manner as such accommodations are available to employees.

Likewise, the expansion imposes new requirements on employers to ensure that independent contractors and freelancers receive sexual harassment prevention training. As is required with regular employees, independent contractors and freelancers who work: (i) more than 80 hours in a calendar year, and (ii) for at least 90 days (which need not be consecutive) must complete the annual training. However, independent contractors and freelancers do not need to undergo sexual harassment prevention training at each workplace where they meet these requirements. Rather, an independent contractor or freelancer can provide proof of completion of one such training to multiple workplaces.

For more information, please refer to our original January 14, 2020 post.

Virginia

On April 11, 2020, Virginia Governor Ralph Northam signed the Virginia Values Act into law which brought extensive changes to the Virginia Human Rights Act (VHRA). Some of the notable changes to the VHRA include:

- An expansion to the protected characteristics under the VHRA to include sexual orientation, gender identity, and veteran status. This expansion took effect on July 1, 2020, and made Virginia the first southern state to prohibit discrimination on the basis of sexual orientation and gender identity;
- Prior to these amendments, the VHRA applied only to employers with more than five and fewer than 15 employees. Following the amendments, however, the law's prohibition on unlawful employment practices now applies to all employers with 15 or more employees. As it concerns cases of "unlawful discharge" on the basis of a protected characteristic (except for age), the VHRA will apply to employers with five or more employees.
- Given the expansion to which employers were covered by the VHRA, a much broader group of employers is now subject to the law's private right of action. Where the VHRA previously

provided a private right of action only in cases involving discharge, the new amendments expand the right of action to provide a claim for any unlawful employment practice under the law.

- The remedies available to employees who bring claims under the amended VHRA have also been greatly expanded. Previously, the VHRA capped back pay at 12 months and prohibited compensatory, punitive or other damages, as well as reinstatement. Additionally, the prior version of the VHRA provided that attorneys' fees available to prevailing employees were limited to "attorney fees from the amount recovered, not to exceed 25 percent of the back pay awarded." The amendments, however, now permit recovery of compensatory and punitive damages, reasonable attorneys' fees, and other equitable relief, without caps.

In addition to the above, Governor Northam also signed House Bill 827/Senate Bill 712 into law which, among other things, requires employers with five or more employees to "make reasonable accommodation to the known limitations of a person related to pregnancy, childbirth, or related medical conditions, unless the employer can demonstrate that the accommodation would impose an undue hardship on the employer."

For more information regarding these new requirements, please refer to our April 24, 2020 post.

Sexual Orientation and Gender Identity as Protected Characteristics

On June 15, 2020, in a 6-3 decision, the United States Supreme Court in *Bostock v. Clayton County*, No. 17-1618 (590 U.S. __ (2020)), held that Title VII's prohibition on sex discrimination includes discrimination on the basis of sexual orientation and gender identity. The decision settled a growing circuit split among federal courts. While the Second and Sixth Circuits previously held that Title VII's protections extended to discrimination on the basis of sexual orientation and gender identity, the Eleventh Circuit held that such discrimination was not prohibited. While the decision will have little impact on employers operating in states that already prohibited discrimination based on these characteristics, the Supreme Court's decision extends federal anti-discrimination protections to approximately 25 states that did not previously offer protections against discrimination on the basis of sexual orientation and gender identity.

For more information, please refer to our June 15, 2020 post analyzing the Supreme Court's decision.

Hairstyle Discrimination

Over the past year, Colorado, Maryland, New Jersey, and Virginia have amended their state anti-discrimination laws to prohibit discrimination on the basis of hairstyle. These states join California and New York which have also enacted laws prohibiting discrimination on the basis of hairstyle and appearance. The Maryland, New Jersey, and Virginia laws are discussed in more detail below.

Maryland

Maryland's Fair Employment Practices Act was amended, effective October 1, 2020, to include in its prohibition against discrimination on the basis of race, discrimination based on traits historically associated with race, "including hair texture, afro hairstyles and protective hairstyles." The amendment also defines "protective hairstyle" to include braids, twists, and locks.

For more information, please refer to our May 26, 2020 post.

New Jersey

New Jersey Governor Phil Murphy signed the Create a Respectful and Open Workspace for Natural Hair Act (the CROWN Act) into law on December 19, 2019. The CROWN Act, which took effect upon its

signing, amends the New Jersey Law Against Discrimination to define "race" as inclusive of "traits historically associated with race" such as hair texture and protective hairstyles. The CROWN Act also expressly includes braids, locks, and twists as examples that would be considered "protective hairstyles." In addition to applying to employers, the CROWN Act also applies to housing and public accommodation.

Please refer to our December 23, 2019 post for more information.

Virginia

Governor Northam signed HB 1514 into law on March 3, 2020. The law amends the Virginia Human Rights Act by including discrimination "because of or on the basis of traits historically associated with race, including texture, hair type, and protective hairstyles such as braids, locks and twists" as part of the law's prohibition on race discrimination.

For more information, please refer to our March 4, 2020 post.

Diversity and Representation

California

On September 30, 2020, California Governor Gavin Newsom signed Assembly Bill 979 (AB 979) into law. The law, which aims to increase representation from communities of color and the LGBT community on the boards of publicly traded companies, requires covered corporations to have at least one director from an "underrepresented community" on their board by the close of 2021. AB 979 defines a "director from an underrepresented community" as a director who self-identifies as "Black, African American, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian, or Alaska Native, or who self-identifies as gay, lesbian, bisexual, or transgender."

Additionally, by the end of 2022, corporations with more than 4 but fewer than 9 directors are required to have a minimum of 2 directors from underrepresented communities. Conversely, covered corporations with 9 or more directors are required to have a minimum of 3 directors from underrepresented communities. Failure to comply with the law may result in hefty fines ranging from $100,000 to $300,000. Judicial Watch, Inc., a Washington, D.C.-based conservative legal group, filed a constitutional challenge to the law in Los Angeles Superior Court on the same day the law was signed.

For more information, please refer to our October 5, 2020 post.

Safe and Sick Leave Laws

The COVID-19 pandemic has prompted several states to pass new sick and medical leave laws or amend their already-existing laws to provide additional leave to employees. The federal government also passed its own legislative package in response to the pandemic which includes amendments to the Family and Medical Leave Act, and also provides sick leave for certain employees. Below are just a few of this past year's developments.

Families First Coronavirus Response Act

On March 18, 2020, President Trump signed the Families First Coronavirus Response Act (FFCRA) into law. Among the FFCRA's provisions aimed at providing emergency relief during the pandemic was a new sick leave law, the Emergency Paid Sick Leave Act (the Act). The Act, effective April 1, 2020, requires employers with fewer than 500 employees to provide up to two weeks of paid sick leave to all employees for certain covered purposes relating to the pandemic.

Under the Act, employers are required to provide full-time employees with up to 80 hours of paid leave and part-time employees with a number of hours of paid leave equivalent to the hours that such employee works, on average, over a 2-week period. Covered employees may use emergency paid sick leave if:

- They are subject to a federal, state, or local quarantine or isolation order related to the coronavirus;
- They have been advised by a health care provider to self-quarantine due to concerns related to the coronavirus;
- They are experiencing symptoms of the coronavirus and are seeking a medical diagnosis;
- They are caring for an individual who is subject to a federal, state, or local quarantine or isolation order related to the coronavirus, or who has been advised by a heath care provider to self-quarantine due to concerns related to the coronavirus;
- The employee is caring for their son or daughter if the school or place of care of the son or daughter has been closed, or their child care provider is unavailable, due to coronavirus precautions; and/or
- They are experiencing any other substantially similar condition specified by the Secretary of Health and Human Services in consultation with the Secretary of the Treasury and the Secretary of Labor.

Notably, in many instances, the two-week period of paid leave will run concurrently with leave under the Emergency Family and Medical Leave Expansion Act discussed below. For more information on the Act's provisions, please refer to our March 18, 2020, March 30, 2020, and April 14, 2020 blog posts.

Colorado

On July 14, 2020, Colorado Governor Jared Polis signed the Healthy Families and Workplaces Act (the Act) into law. Effective immediately upon its enactment through December 31, 2020, the Act extended leave available under the FFCRA to all employees in the state, regardless of employer size.

Beginning January 1, 2021, employers with 15 or more employees must permit employees to accrue 1 hour of paid sick leave for every 30 hours worked, up to 48 hours. As an alternative, employers may also choose to frontload the full annual allotment of paid sick leave to an employee at the beginning of each year. Although employees may carryover unused paid sick leave from one year to the next, an employer may cap the number of paid sick leave hours used in any given year to 48. In addition, the Act requires employers to provide up to an additional two weeks of paid sick leave during a public health emergency, even where an employee's sick leave has been exhausted. Please see our July 21, 2020 post on Proskauer's Law and the Workplace Blog for more information regarding the Act's requirements.

New York – COVID-19 Sick Leave

On March 18, 2020, in response to the pandemic, New York Governor Andrew Cuomo signed into law the COVID-19 Paid Sick Leave Law. Under the law, which took effect immediately, employees who are subject to a qualifying quarantine or isolation order and who are unable to telework during the period of the order may take job-protected leave. Employees who take such leave are entitled to compensation through a combination of sick leave and, in some cases, disability and paid family leave benefits. The benefits are available as follows:

- Employers with 10 or fewer employees and a net income of less than $1 million in the previous tax year must provide eligible employees with unpaid, job-protected sick leave through the termination date of a qualifying order.
- Employers with 10 or fewer employees as of January 1, 2020 with revenue of more than $1 million in 2019 and employers with between 11 and 99 employees as of January 1, 2020 must provide eligible employees with paid sick leave during a 5 day period.
- Employers with 100 or more employees as of January 1, 2020 must provide eligible employees with paid sick leave for a 14 day period paid at the employee's regular rate of pay during a qualifying quarantine or isolation order period. All covered public employers, regardless of size, also must provide paid sick leave for 14 days during a qualifying order period.

This quarantine-related sick leave must be provided in addition to any sick leave an employee has already accrued. Employers are also required to return employees to the positions they held prior to their leave at the same rate of pay and other terms and conditions of employment. Retaliation or discrimination against employees for taking such leave is prohibited. Employees who are not provided with the required number of sick days or not properly paid for sick days for COVID-19 quarantine leave may file a complaint with the New York Department of Labor.

For more information, please see our March 18, 2020 and March 27, 2020 blog posts.

New York – Statewide Paid Sick Leave

In addition to the COVID-19 Paid Sick Leave Law, on April 3, 2020, Governor Cuomo signed the fiscal year 2021 New York State budget, which included a new statewide paid sick leave requirement. Under the new leave provisions, which took effect on September 30, 2020, employees must accrue at least 1 hour of sick leave for every 30 hours worked. Alternatively, employers may frontload the full amount of sick leave an employee is entitled to at the beginning of each year.

Employers with 4 or fewer employees and a net income of less than $1 million in the prior tax year must provide employees with up to 40 hours of unpaid sick leave. Employers with between 5 and 99 employees and employers with 4 or fewer employees with a net income greater than $1 million in the prior tax year must provide each employee with up to 40 hours of paid sick leave each year. Finally, employers with 100 or more employees are required to provide up to 56 hours of paid sick leave per year.

Please see our April 8, 2020 post for more information.

New York City

In an effort to align the New York City Earned Safe and Sick Time Act (the ESSTA) with the New York State Paid Sick Leave Law, the New York City Council passed a bill that would largely reconcile differences between the bills. The ESSTA provided employees up to 40 hours of paid or unpaid sick and safe leave, depending on the number of employees. Among other things, the bill amends the ESSTA to impose identical sick and safe leave requirements to the state law. In addition, the bill eliminates the need for a newly hired employee to wait 120 days prior to utilizing accrued leave. The bill was signed into law by New York City Mayor Bill de Blasio on September 28, 2020, and took effect on September 30, 2020.

Please see our September 28, 2020 post for more information.

Washington D.C.

On May 27, 2020, and July 7, 2020, Washington D.C. Mayor Muriel Bowser signed the D.C. COVID-19 Support Emergency Amendment Act and the Coronavirus Support Clarification Emergency Amendment Act of 2020 (collectively, the "CSEA). The package amended the D.C. Accrued Sick and Safe Leave Act, and requires employers with between 50 and 499 employees to provide employees up to a maximum of 80 hours of paid "public health emergency leave" for any of the reasons paid leave is available under the Families First Coronavirus Response Act. This leave must be used "concurrently with or after exhausting any other paid leave to which the employee may be entitled for covered reasons under federal or District law or an employer's policies."

For more information, please refer to our July 28, 2020 post.

Family and Medical Leave Developments

Family and Medical Leave Act

The Emergency Family and Medical Leave Expansion Act (the Act) was passed as one of several of the FFCRA's provisions. The Act amended the Family and Medical Leave Act (FMLA) to include a new type of public health emergency leave for eligible employees of employers with fewer than 500 employees.

Effective April 1, 2020, an employee who is unable to work (including telework) due to a need for leave to care for their minor child if the child's school or place of care has been closed or where their child care provider is unavailable due to a public health emergency with respect to COVID-19 declared by a federal, state, or local authority is able to take up to 12 weeks of leave under the Act. Unlike the FMLA's leave provisions for other covered reasons which require an employee to have been employed by the employer for at least 12 months, an employee seeking leave under this new provision must be employed by the employer for only 30 calendar days prior to taking such leave. Notably, this new category of leave does not alter the total available amount of leave an employee may take under the FMLA, which remains at 12 weeks over a 12-month period.

In addition, while employers are not required to pay employees for the first 10 days of public health emergency FMLA leave, they are required to provide paid leave amounting to two-thirds of an employee's regular rate of pay. This payment, however, is capped at $200 per day and $10,000 in the aggregate. The Act also prohibits employers from firing, disciplining, or otherwise discriminating against employees because they take leave under the FFCRA. For more information on the Act's provisions, please refer to our March 18, 2020, March 30, 2020, and April 14, 2020, blog posts.

Washington D.C.

The COVID-19 Support Emergency Amendment Act and the Coronavirus Support Clarification Emergency Amendment Act of 2020 expanded leave under the D.C. Family and Medical Leave Act (DCFMLA). Specifically, the CSEA created a new temporary category of DCFMLA leave to permit employees who have worked for an employer of any size in Washington D.C. for at least 30 days to take up to 16 weeks of COVID-19 leave. This leave is available to employees unable to work due to:

- A recommendation from a healthcare provider to quarantine or isolate, including because the employee or an employee's household member is high risk for serious illness from coronavirus;

- A need to care for a family member, or a member or an individual with whom the employee shares a household who is under a government or health care provider's order to quarantine or isolate; or
- A need to care for a child whose school or place of care is closed, or whose childcare provider is unavailable to the employee.

This new temporary category of leave under the DCFMLA is currently set to expire on December 31, 2020, but may be extended by an order from Mayor Bowser. For more information, please refer to our July 28, 2020 and September 23, 2020 blog posts.

COVID-19 Anti-Retaliation Measures

Over the past several months, several jurisdictions including California, Chicago, Michigan, New Jersey, New York, and Washington have issued emergency orders or taken other measures aimed at prohibiting employers from retaliating against employees for obeying public health orders requiring them to remain at home as a result of the pandemic. A few of these measures are described below.

Illinois – Chicago

On May 20, 2020, the Chicago City Council passed the Chicago Anti-Retaliation Ordinance (the Ordinance). The Ordinance, which took effect immediately, prohibits an employer from demoting or terminating an employee for obeying an order issued by the Mayor, the Governor of Illinois, or the Chicago Department of Public Health requiring the employee to:

- Stay at home to minimize the transmission of coronavirus;
- Remain at home while experiencing coronavirus symptoms or sick with coronavirus;
- Obey a quarantine order issued to the employee;
- Obey an isolation order issued to the employee; or
- Obey an order issued by the Commissioner of Health regarding the duties of hospitals and other congregate facilities.

Likewise, the Ordinance also prohibits an employer from retaliating against an employee for obeying an order issued by the employee's treating healthcare provider to remain at home while experiencing coronavirus symptoms, while sick with coronavirus, or to remain in quarantine or isolation. The anti-retaliation prohibition also extends to employees caring for an individual who is obeying an order to stay at home to minimize the spread of coronavirus, to remain at home while experiencing coronavirus symptoms or sick with coronavirus, or to obey a quarantine order.

An employee who believes they have been retaliated against may initiate a civil action seeking: (i) reinstatement; (ii) damages equal to three times the amount of wages they would have been owed had the retaliatory action not taken place; (iii) actual damages caused by the retaliatory action; and (iv) costs and reasonable attorneys' fees.

Please refer to our April 27, 2020 and May 28, 2020 posts for more information.

Michigan

In response to the pandemic, Michigan has moved to prohibit employers from discharging, disciplining, or otherwise retaliating against employees who stay home from work because they have tested positive for COVID-19, they display the principal symptoms of COVID-19, or they have been in close contact with an

individual who tested positive for COVID-19 or displayed a principal system of the disease. According to the latest executive order issued by Governor Gretchen Whitmer, Executive Order 2020-172, the "principal symptoms of COVID-19" include (i) any of the following that are not explained by a known medical or physical condition: "fever, an uncontrolled cough, shortness of breath," or (ii) "at least two of the following not explained by a known medical or physical condition: loss of taste or smell, muscle aches (myalgia), sore throat, severe headache, diarrhea, vomiting, abdominal pain." "Close contact" is defined by the order as "being within six feet of an individual for fifteen minutes."

Employers are required to treat employees who take such leave as though they are on medical leave under the Michigan Paid Medical Leave Act. Notably, however, such leave is unpaid. Further, an employer may debit any hours that an employee stays home from work from that employee's accrued leave. An employee who tested positive for COVID-19 or who has displayed principal symptoms of the disease may take job-protected leave until "24 hours have passed since the resolution of fever without the use of fever-reducing medications; 10 days have passed since their symptoms first appeared or since they were swabbed for the test that yielded the positive result; and other symptoms have improved." Conversely, an employee who has been in close contact with someone who tested positive for COVID-19 or suffered from one of its principal symptoms may take leave until "14 days have passed since the last close contact with the sick or symptomatic individual; or the individual displaying COVID-19 symptoms receives a negative COVID-19 test."

New Jersey

New Jersey Governor Phil Murphy signed Assembly Bill No. A3848 into law on March 20, 2020. The law, which took effect immediately, prohibits employers from terminating or otherwise penalizing an employee who requests or takes time off from work based on a recommendation from a New Jersey medical professional that the employee "take that time off for a specified period of time because the employee has, or is likely to have, an infectious disease . . . which may infect others at the employee's workplace." The law also expressly prohibits an employer from failing or refusing to reinstate an employee to the position they held prior to the leave without reduction in seniority, status, benefits, pay, or any other terms and conditions of employment. Finally, an employee who believes their employer has violated the law may file a complaint with the Department of Labor and Workforce Development or file a lawsuit seeking reinstatement.

Mini-WARN

The Worker Adjustment and Retraining Notification Act (WARN), and its state analogues (mini-WARN) require employers to provide employees with advance notice in the event of a mass layoff. While the federal WARN Act provides exceptions to its 60-day notice requirement in the event of unforeseen business circumstances and natural disasters, not all state analogues provide this exception. In light of the unprecedented strain the pandemic has imposed on employers nationwide, states have adjusted their mini-WARN acts to create exceptions for layoffs prompted by the pandemic.

California

On March 18, 2020, Governor Newsom issued an executive order permitting California employers conducting layoffs caused by the COVID-19 pandemic to use a newly-created "unforeseen business circumstances" exception to the state's WARN Act requirements. Under the executive order, employers who conduct mass layoffs, relocations, or closures under the "unforeseen business circumstances" exception must still provide notice in accordance with the California WARN Act as soon as practicable, even if less than 60 days. In addition to including the information already required by the California

WARN Act, the notice must also note that the layoff, relocation, or termination/closure is caused by COVID-19-related "business circumstances that were not reasonably foreseeable as of the time that notice would have been required." The notice must also state that "If you have lost your job or been laid off temporarily, you may be eligible for Unemployment Insurance (UI). More information on UI and other resources available for workers is available at labor.ca.gov/coronavirus2019."

For more information, please refer to our original March 18, 2020 post.

New Jersey

Governor Murphy signed two amendments to the New Jersey WARN Act into law on April 14, 2020. Prior to the amendments, New Jersey did not have an exception to its WARN Act's 60-day notice requirement for mass layoffs. Accordingly, the new amendments redefine "mass layoff" to exclude layoffs due to national emergencies, among other events (e.g., fire, flood, natural disaster). The amendment, which took effect immediately and operated retroactively to March 9, 2020 (the date Governor Murphy declared a state of emergency), ensures that mass layoffs triggered by the pandemic do not implicate the New Jersey WARN Act's notice requirements. Prior to the pandemic, New Jersey passed several amendments to its WARN Act which would have imposed more onerous burdens on employers in terms of compliance. These amendments were set to take effect on July 19, 2020. This effective date, however, was delayed by the April amendments.

Please refer to our original April 16, 2020 post for more information.

Artificial Intelligence

Over the last several years, employers have increasingly adopted algorithms and other artificial intelligence tools to assist with hiring and other employment decisions. These tools can perform a range of functions, including resume screening and video interview analysis. The COVID-19 pandemic has prompted employers to embrace these technologies at increasing rates as hiring procedures have gone virtual. Some commentators, however, have raised questions about whether the use of artificial intelligence eliminates or perpetuates bias in employment. Accordingly, some states and local municipalities have moved to regulate the use of algorithms in employment. Below are measures Illinois and Maryland have recently enacted.

Illinois

Illinois' Artificial Intelligence Video Interview Act (the Act) went into effect on January 1, 2020. The Act requires employers to receive an applicant's consent prior to using artificial intelligence (AI) tools to analyze video interviews. Additionally, employers must notify applicants beforehand that AI tools may analyze their video interview and employers must explain how the AI works and what types of characteristics it uses to evaluate applicants. The Act prohibits employers from sharing an applicant's video interview "except with persons whose expertise or technology is necessary in order to evaluate an applicant's fitness for a position." Employers must also delete all copies of the videos within 30 days of receiving such a request from the applicant.

For more information, please refer to our original January 3, 2020 post.

Maryland

On October 1, 2020, H.B. 1202 took effect. The new law prohibits employers from using a "facial recognition service for the purpose of creating a facial template during an applicant's interview for employment," absent the applicant's consent. The law defines a "facial template" as the "machine-

interpretable pattern of facial features that is extracted from one or more images of an individual by a facial recognition service." To use facial recognition technology to analyze an interview, an employer must secure an applicant's consent through a waiver that contains the following: (1) "the applicant's name"; (2) "the date of the interview"; (3) "that the applicant consents to the use of facial recognition during the interview"; and (4) "whether the applicant consented to the waiver."

For more information, please refer to our original May 26, 2020 post.

Executive Compensation Update

Compensation Cost Savings

During these turbulent economic times caused by the COVID 19 pandemic, many employers have been exploring ways to significantly reduce cash outlay and operating costs. Employers in hard hit industries such as retail, travel and entertainment have utilized layoffs and reductions in force to relieve the economic effects of the pandemic. Employers implementing layoffs and closures need to be ready to navigate through their potentially complex contractual and statutory obligations, including the requirements of the federal Worker Adjustment and Retraining Notification (WARN) Act and related state statutes.

Many employers looking to conserve cash have also utilized alternatives to layoffs, such as reductions in pay, temporary furloughs and work share programs. Employers utilizing these alternatives should be mindful of federal, state and local wage and hour and labor laws, consent and notice requirements under contractual agreements with individual employees or groups of employees (including unions), tax implications, impact on employee benefit plan participation, governance considerations, and disclosure requirements for public companies.

Portfolio companies in extreme financial hardship with significant compensation and benefits liabilities may find that a bankruptcy filing helps facilitate a resolution of the liabilities that would not otherwise be possible outside of the bankruptcy process. Companies looking to restructure and streamline costs in the bankruptcy process often look to executive compensation and employee benefit plans as one area for change. In connection with a bankruptcy, an employer may examine whether to continue or terminate its compensation programs and employee benefit plans as part of the restructuring.

Proskauer can help identify appropriate compensation cost savings solutions for individual employers and assist in navigating the contractual and statutory implications of implementation.

Compensation Challenge of Performance Awards

Even as salary levels for many employers have returned to pre-pandemic levels, compensation committees struggle with how to adjust performance metrics, re-price "underwater" awards and establish new programs to attract and retain senior management.

The worlds of Private Equity and Private Credit face the same compensation challenges. Their management teams received significant equity-based incentive grants in their portfolio companies based on underlying valuations and business plans established pre-pandemic. Now these awards may be significantly "underwater" at the current valuation, and the underlying performance goals may be unattainable, reducing their retention and incentive value and adversely impacting morale and productivity. Left with little or no value in their equity interests, management team members may be more inclined to look for other opportunities outside of the company group. Because these are not public

companies, this issue has not gotten as much public attention, but it is on the minds of Private Equity sponsors and their management teams.

The “compensation challenge” for Private Equity and Private Credit is how to revise, restructure or replace outstanding incentive awards. This involves complicated tax, executive compensation, securities and corporate issues. Proskauer has the experience and expertise to meet this challenge.

Accelerating Taxes on Compensation to Avoid Major Increases

The employment tax/wage withholding regulations require that Federal Insurance Contributions Act (FICA) taxes be paid on deferred compensation as it vests rather than when it is paid. Although no one likes to pay taxes on amounts before they are paid, paying FICA taxes on vesting typically benefits executives for two reasons. First, once the executive’s current compensation is above the social security wage base, only the Medicare tax (1.45% for the employer and 2.35% for the employee) is owed. In contrast, if FICA taxes are deferred and paid in a future year before their compensation exceeds the social security wage base, both the employer and employee will pay the 6.2% social security tax total annual compensation up to $140,000 or so. Second, FICA is owed only on the present value of future payments. Subsequent earnings are typically exempt from FICA tax.

The employment tax/wage withholding regulations allow, but do not require, FICA taxes to be deferred until the amount of the benefit is “reasonably ascertainable.” If taxes are deferred, the amount due will be determined based on rates in effect when the tax is paid.

Some democratic lawmakers have proposed increasing FICA tax rates and imposing social security taxes on amounts above the social security wage base. These changes would dramatically increase FICA liability for annual compensation payable to highly compensation senior management, portfolio managers and investment professionals with deferred compensation or phantom carry. The impact could be mitigated by paying FICA taxes on deferred compensation amounts before the amounts become reasonably ascertainable.

Similarly, in anticipation of potential increases to income tax rates, it might become advantageous to accelerate payment of deferred compensation; but care must be taken to avoid triggering penalty taxes under Section 409A of the Internal Revenue Code.

Proskauer can help to identify potential strategies for particular arrangements.

SEC Continues to Scrutinize Disclosure of Perks and Personal Benefits

Since August 2020, the SEC has imposed civil penalties in the hundreds of thousands of dollars against multiple publicly traded corporations in connection with their failure to disclosure certain perquisites and personal benefits provided to senior executive officers, including travel, lodging and entertainment fringes and expenses.

These enforcement actions are the latest indication that the SEC is closely reviewing disclosure of perks and personal benefits with a focus on companies identified as noncompliant through the SEC’s use of risk-based analytics. Under SEC proxy disclosure regulations for executive compensation under Item 402 of Regulation S-K under the Securities Act of 1933 (Item 402), any item that provides a direct or indirect benefit that has a personal aspect is considered to be a perk, unless that benefit is “integrally and directly related to the performance of the [individual’s] duties,” or the benefit is provided to all employees on a non-discriminatory basis. Item 402 requires disclosure of perks in excess of $10,000 in the aggregate. Any individual perk exceeding the greater of $25,000 or 10% of the total amount of perks must be quantified and disclosed in a footnote to the summary compensation table.

In addition to the securities disclosure and enforcement considerations, employers should note that their ability to deduct the costs associated with providing certain fringe benefits related to transportation, moving expenses, employer-provided meals, entertainment and achievement awards has been limited by the Tax Cuts and Jobs Act (the TCJA) through year-end 2025.

In order to simplify their reporting obligations, avoid the heightened perquisite disclosure required by Item 402 and maximize deductibility of executive pay, employers may choose to eliminate company-provided perquisites and increase regular cash compensation, such as salary or wages. For tax purposes, cash generally will be taxable to the employee as ordinary income and would be deductible by the employer as an ordinary and necessary business expense, as long as that compensation is reasonable. Nonetheless, corporations may be required to discuss any shift from perquisites to cash in its narrative disclosures, including its Compensation Discussion and Analysis, or "CD&A." In addition, employers should make sure to consider the effect any proposed salary increase may have on other compensation components – for example, annual bonuses, incentive awards and severance that are based on a multiple or percentage of salary – as well as for purposes of employer contributions to and discrimination testing with respect to 401(k) plans.

Reorganization and Chapter 11 Updates

Over the past year, important decisions have been rendered by federal courts (i) excusing commercial renters from payment of postpetition rent obligations in light of governmental restrictions imposed to address the COVID-19 pandemic, and (ii) permitting a cramdown Chapter 11 plan to allocate a portion of distributable proceeds against the strict terms of a subordination agreement.

Excusing Payment of Rent Obligations Due to COVID-19 Government Restrictions

As the United States saw COVID-19 infection rates increase in early 2020, many states issued mandatory shutdown orders closing or limiting business operations. With businesses finding it difficult to continue satisfying lease obligations during the crisis, some have filed bankruptcy to seek rent relief, even though the Bankruptcy Code requires debtors to pay postpetition rent obligations.

Specifically, Bankruptcy Code Section 365(d)(3) requires the debtor to "timely perform all the obligations of the debtor . . . arising from and after [the petition date] under any unexpired lease of nonresidential real property, until such lease is assumed or rejected . . . ." This section was intended to relieve the financial burden on commercial landlords pending a debtor's decision to assume or reject a lease. However, courts have disagreed on the application of this section. For example, whether the obligations "arising from and after [the petition date]" means (i) all obligations that become due and payable postpetition, or (ii) all obligations *accruing* postpetition.

The In re Hitz Restaurant Group Decision

The U.S. Bankruptcy Court for the Northern District of Illinois recently held, in *In re Hitz Restaurant Group*, 616 B.R. 374 (N.D. Ill. 2020), that pandemic restrictions partially excused the tenant-debtors' (*Hitz*) nonpayment of postpetition rent under a force majeure clause in a commercial lease.

On March 16, 2020, Illinois Governor J.B. Pritzker issued an executive order addressing the COVID-19 pandemic in Illinois. Among other things, the order required all restaurants in the state to "suspend service for . . . on-premises consumption." *Hitz* had not paid rent since before July 2019, and filed for Chapter 11 protection to avoid eviction. After *Hitz* failed to pay postpetition rent, the landlord sought relief

to evict *Hitz* from the premises unless it paid outstanding and future postpetition rent required under Section 365(d)(3).

In light of the challenges posed by the executive order, *Hitz* argued that its obligation to pay postpetition rent was excused by the force majeure clause in the commercial lease, which excused performance in the event of novel "laws, governmental action or inaction, [or] orders of government" that hindered or prevented *Hitz's* fulfillment of its obligations under the lease.

In reaching its conclusion, the court explained that the terms of the lease must govern the application of Section 365(d)(3), and that the governor's executive order triggered the lease's force majeure clause. However, *Hitz* was not entirely relieved of its obligation under Section 365(d)(3) to pay postpetition rent. The court explained that, while the executive order suspended certain restaurant operations, it specifically permitted and encouraged restaurants to continue various take-out, curbside, and delivery services. The court therefore held that *Hitz's* obligation to pay postpetition rent should be reduced in proportion to "its reduced ability to generate revenue due to the executive order." As the landlord was silent on the issue, the court determined preliminarily that approximately 75% of the leased space was unusable by the executive order, and ordered *Hitz* to pay its landlord 25% of postpetition rent, pending an evidentiary hearing to determine the use of the premises.

Implications of the In re Hitz Restaurant Group Decision

In the wake of the COVID-19 pandemic and resulting economic hardships, many commercial tenants and landlords will encounter disputes similar to the ones raised in this case. While not binding in other jurisdictions, this case will likely serve as a blueprint for other courts to fashion equitable outcomes given the exigencies of the COVID-19 pandemic. Results, however, will depend on the specific lease language and particular circumstances. Notably, in *Hitz*, the governor's executive order triggered the force majeure clause, which specifically included "governmental action" and "orders of government" as force majeure events.

Limitations on Strict Enforcement of Subordination Agreements in Cramdown Plans

Bankruptcy Code Section 510(a) provides for the enforceability of subordination agreements in bankruptcy. Congress intended this provision to honor creditors' prepetition expectations within bankruptcy. However, Bankruptcy Code Section 1129(b)(1) limits the applicability of Section 510(a), providing that a non-consensual Chapter 11 plan may be confirmed, "notwithstanding Section 510(a)." The U.S. Court of Appeals for the Third Circuit's decision in *In re Tribune Co.*, 972 F.3d 228 (3d Cir. 2020), demonstrates the limits of subordination agreements in context of confirming a cramdown plan.

The Tribune Decision

The Tribune Company (Tribune) was the largest media conglomerate in the country prior to its bankruptcy, which followed its failed leveraged buyout (the LBO). Prior to the LBO, Tribune issued unsecured notes of various priorities to fund its enterprise. First, the Tribune issued the "Senior Notes" under an indenture that provided that such notes would be paid prior to any other debt incurred by Tribune. Later, Tribune also issued unsecured "PHONES Notes", which were subordinate to "Senior Indebtedness." Finally, Tribune (a) issued, as part of the LBO, unsecured "EGI Notes" subordinate to repayment of "Senior Obligations," (b) incurred "Swap Claims" through the cancellation of an interest rate swap agreement, and (c) incurred certain Retiree Claims and Trade Claims over time.

Tribune's cramdown plan classified the Senior Notes separately from the Swap Claims, Retiree Claims, and Trade Claims, but paid both classes a pro-rata recovery of 33.6% on account of their claims. The

Senior Noteholders argued that this pro-rata distribution allocated approximately $30 million of their recovery from the subordinated PHONES and EGI Notes to the payment of Swap Claims, Retiree Claims, and Trade Claims, who should not qualify as "Senior Obligations," and thus not benefit from such subordination.

The Third Circuit held that subordination agreements do not need to be strictly enforced, and that creditor interests in cramdown plans are instead protected through an evaluation of whether the plan discriminates unfairly and is fair and equitable in its treatment of the dissenting class. Thus, the question remained whether re-allocation of the subordinated amounts from the Senior Noteholders to the remaining unsecured creditors unfairly discriminated against the Senior Noteholders, in light of their rights under the subordination agreement. Namely, the Senior Noteholders argued that they were being unfairly discriminated against because they would receive less under the cramdown plan than they would if the subordination agreement were strictly enforced.

The Third Circuit disagreed and explained that unfair discrimination is determined from the perspective of the dissenting class, and that court may, in certain circumstances, such as where a class-to-class comparison is difficult, consider the difference between what the dissenting class argues it is entitled to recover and what it actually received under the plan. While the allocation of the subordinated amounts to the Retiree Claims and Trade Claims discriminated against the Senior Noteholders, the minimal reduction by 0.9% of the Senior Noteholder claims was not material, and thus not presumptively unfair. Therefore, the plan may be confirmed over their objection.

Implications of the Tribune Decision

Subordination agreements are respected in bankruptcy proceedings, but the Bankruptcy Code is flexible and provides debtors an opportunity to "negotiate a confirmable plan even when decades of accumulated debt and private ordering of payment priority have led to a complex web of intercreditor rights." While this decision provides debtors increased flexibility in crafting a plan of reorganization, it leaves beneficiaries of subordination agreements with a higher burden of proof to argue not only that the plan violates their contractual rights, but that it does so unfairly and materially.

European Union

Brexit: UK withdrawal from the EU and the end of the Transitional Period

In March 2017, 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 were expected to be agreed. Whilst it was anticipated that the UK would leave the EU on 29 March 2019, this date was subsequently extended twice. On 31 January 2020 the UK formally left the EU (an event informally known as "Brexit") and entered into a transitional period until 31 December 2020 under which most EU legislation continued to apply in the UK in the same way as it did prior to Brexit. Prior to the end of the transitional period, the UK and the EU agreed and signed a free trade agreement (the "FTA"). The UK subsequently left the EU Customs Union and Single Market on 31 December 2020 following the end of the transitional period agreed between the UK and EU and, on 1 January 2021, the FTA agreed between the UK and EU came into force.

Despite the FTA being agreed, there is still a great deal of uncertainty concerning many aspects of the UK's legal and economic relationship with the EU, including in relation to the provision of cross-border

services. From a financial services perspective, the outcome is a 'hard' or no deal Brexit scenario, as the FTA does not provide for a continuation of cross-border financial services. Accordingly, the UK firms which previously benefitted from the EU financial services "passport" (as detailed below) are no longer able to access this. However, this does not impact US fund managers in the same way as they do not have access to such "passports" and so would need to continue to market their funds *via* the national private placement regime ("NPPR") of the relevant countries, where it is feasible to do so.

Impact of Brexit - Loss of the Financial Services Cross-Border "Passport" for the UKs

From a financial services perspective, until 31 December 2020 firms authorized in the UK were able to use 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 allowed such firms to carry out cross-border activities, whether through the provision of services or the establishment of a branch in other EU Member States. After the end of the transitional period, the UK became a "third country" (*i.e.*, a non-EU country) and the provisions applicable to third countries are now applicable to UK firms. This has resulted in a curtailment of the freedoms UK firms previously enjoyed. For example, UK alternative investment fund managers ("AIFMs") are no longer able to use the cross-border marketing passport when marketing their alternative investment funds across the EU. Instead they need to market in other EU Member States by making NPPR notifications in each Member State into which they wish to market. It is possible that UK firms may be given a special status in future which would allow UK firms to continue to have access to the EU market on an "equivalent basis", but there is no clarity around this and this currently looks unlikely.

As the UK has retained the AIFMD regime as it is currently implemented into its domestic law for the foreseeable future, U.S. managers would continue to need to submit NPPR notifications to the UK Financial Conduct Authority ("FCA") prior to marketing their funds in the UK. Any further future developments 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.

New Rules Relating to the Pre-Marketing of Funds will come into force from August 2021

In June 2019, the EU published the legislative package (being made up of Directive (EU) 2019/1160 and Regulation (EU) 2019/1156) aimed at reducing the regulatory barriers for the cross-border distribution of funds in the EU (the "CBDF Package"). Specifically the CBDF Package is designed to address certain issues in the AIFMD and UCITS Directive relating to the marketing of funds under the AIFMD or UCITS marketing passports. Even though EU Member States are required to implement the CBDF Package into their national law by 2 August 2021, managers should be preparing now to ensure their fundraises in 2021 will be compliant with the new rules.

Under the CBDF Package, there will be a new harmonised definition of "pre-marketing" of funds. At the moment, the interlinked concepts of "pre-marketing" and "marketing" are interpreted differently between Member States. Currently some EU Member States take a more restrictive view as to what activities can be carried on as "pre-marketing" (e.g. only allowing for high level discussions about the fund manager and its track record, with no reference to the relevant fund). Should a fund manager or its agents seek to provide more information on the fund to investors in such EU Member States, then approval for the marketing of the fund must be obtained from that Member State's regulator. In other EU Member States, there is currently a wide interpretation of pre-marketing which allows for a significant amount of fund specific information and documentation to be provided to a potential investor ahead of needing marketing approval.

The new harmonised 'pre-marketing' definition in the CBDF Package would allow for fund specific information, including draft PPMs or offering documents, to be provided to potential investors and for this to still fall within the scope of pre-marketing, as long as it does not amount to "an offer or placement" to an investor, which would trigger a formal marketing notification requirements.

Pre-marketing activity will not need to be notified to EU Member State regulators in advance, but fund managers will need to send a letter to their local home state regulator within two weeks of beginning their pre-marketing. This letter will need to specify where and for which periods the pre-marketing is taking or has taken place, with a brief description of the pre-marketing (including information on the investment strategies presented and the AIF(s) covered). However, it remains to be seen how the requirement to provide this pre-marketing letter will work in practice.

Under the CBDF Package there is also a requirement for any third party carrying out premarketing on behalf of a fund manager to be authorised as an investment firm under MiFID, a CRD IV credit institution, a UCITS management company or an AIFM under AIFMD, or act as a tied agent in accordance with MiFID. In addition, the agent will be directly subject to the pre-marketing rules in the CBDF Package. Placement agents and fund distributors will need to make sure that they are prepared for this change, which could include having to set-up an EU based firm with the appropriate authorisations.

Furthermore, the new regime attempts to provide further clarity regarding the use of "reverse solicitation" as a fundraising strategy. Any subscription by professional investors in the relevant EU Member State within 18 months of the EU AIFM having begun pre-marketing will be deemed to have taken place as a result of active "marketing" (triggering the requirement to make a formal marketing notification). However, it is unclear as to whether this would apply on a "per investor" or "per jurisdiction" basis. Should regulators interpret this on a "per jurisdiction" basis, this would mean that "marketing" and the associated requirements would be triggered upon any investor being pre-marketed to in that EU Member State. It is hoped that further guidance will be provided on this point ahead of it coming into force.

The CBDF Package also creates new de-notification requirements, which include that EU AIFMs must notify their home Member State regulator when intending to cease marketing of an AIF. This would mean that the EU AIFM will not be able to carry out pre-marketing in relation to the AIF and a "similar investment strategy" or "investment ideas" for 36 months after the de-notification. There is no further guidance as to how these terms should be interpreted, but this could potentially be problematic should it extend to a restriction on pre-marketing further AIFs by a particular AIFM albeit that the default solution in such circumstances would be to not de-notify.

It is important to note that the requirements of the CBDF Package apply to EU AIFMs. The requirements do not apply to non-EU AIFMs (including US managers) marketing funds under the NPPRs nor do they apply to EU AIFMs marketing non-EU AIFs under the NPPRs. However, the CBDF Package does contain a provision prohibiting EU Member States from adopting laws and regulations that are more advantageous for non-EU AIFMs than for EU AIFMs and, therefore, it is likely that Member States will adopt similar rules for non-EU AIFMs seeking to market under the NPPRs. However, it remains an open question as to how similar these rules will be and so any developments in this area should be closely monitored by non-EU fund managers.

It is expected that the UK will implement requirements in its domestic regime equivalent to those in the CBDF Package, so this development should be followed closely.

New Prudential Rules for EU Investment Firms will come into force in June 2021

A new EU prudential regime for investment firms will apply from 26 June 2021. The Investment Firm Regulation ("IFR") and Directive ("IFD") comprising a set of legal rules amending the existing prudential framework applicable to investment firms in the EU authorised under MiFID. The new regime will provide certain changes to the risk management, regulatory capital and remuneration requirements applicable to such EU firms.

The new IFR/IFD rules will impact (for example) investment advisers, portfolio managers and corporate finance advisers, amongst others. Currently, EU firms that are authorised under MiFID are subject to varying regulatory capital requirements depending on the investment services and activities for which they are authorised and their ability to hold client money or assets. Different firms, therefore, are currently subject to different regimes. However this will no longer be the case going forward, as the IFR/IFD rules will impact all MiFID authorised firms, except those which are deemed to be "systemically large investment firms" (being extremely large firms typically with assets over €15 billion and which deal on their own account or carry on underwriting services). These extremely large firms will remain subject to the Capital Requirements Directive IV and Capital Requirements Regulation, rather than the IFR/IFD. EU investment managers which manage assets for their clients would not typically fall within the "systemically large investment firms" designation.

The exact impact of the IFR/IFD rules on MiFID-authorised firms will depend on the relevant firm's size and activities. Firms designated as "non-systemically important investment firms" will be subject to changes to capital and remuneration, governance and risk-management requirements as noted above. Smaller firms designated as "small and non-interconnected investment firms" will be subject to certain capital requirements but the remuneration, governance and risk management requirements will not apply.

The new regulatory capital requirements will require all firms subject to the IFR/IFD to hold an "initial capital" requirement as well as an additional capital amount by reference to their "annual fixed overheads". In particular, this is expected to impact certain adviser-arranger firms in the UK (known as "exempt CAD") firms who are currently required to hold an initial capital requirement of €50,000. This is expected to increase to €75,000 along with the requirement to hold additional capital by reference to fixed overheads. This could see a significant increase in the regulatory capital requirements that some EU firms will be subject to when the new IFR/IFD requirements come into force.

The remuneration requirements under the IFD framework will apply to individuals who are senior managers, risk-takers, and staff engaged in controlled functions and certain other highly paid functions within the relevant firm. Under the rules, there is no cap imposed on "variable remuneration", but certain restrictions may apply depending on factors such as the size and complexity of the relevant firm, and firms will be required to set "appropriate" fixed-to-variable remuneration ratios.

The UK FCA will implement its own prudential regime for investment firms ("UK IFPR"), based on achieving similar outcomes as IFR/IFD but tailored to apply to the UK financial services sector (particularly in light of Brexit). In December 2020, the UK FCA published a consultation paper on the IFPR proposals (CP20/24), containing some draft text for a new prudential sourcebook for investment firms in the UK. The FCA plans to publish two more consultation papers in due course to cover various aspects of the UK IFPR. It is currently working towards an implementation date of 1 January 2022 for the new rules. UK firms should continue to monitor further updates on the UK IFPR, to prepare for implementation.

New ESG Disclosure Requirements for Asset Managers in 2021

A new European regime on sustainability-related disclosures in the financial sector will come into force from March 2021.

The new rules have a wide scope and will impose environmental, social and corporate governance ("ESG") requirements for a wide range of "financial services participants", including investment firms and fund managers which will include non-EU fund managers such as US fund managers, which market funds in the European Economic Area ("EEA") under the NPPR.

The two key aspects are the EU Taxonomy Regulation (2018/0178 (COD)) and the Regulation on Disclosures (EU/2019/2088) – (referred to as the "Disclosure Regulation" or the "SFDR").

The Taxonomy Regulation aims to establish an EU-wide classification system (or taxonomy) intended to provide firms and investors with a framework to identify the degree at which their economic activities can be considered to be environmentally sustainable. It serves to establish a common language and a classification tool to help investors and companies make informed investment decisions as to what can be considered environmentally sustainable economic activities. The majority of the provisions of the Taxonomy Regulation will apply from 31 December 2021.

The SFDR introduces obligations on investors and asset managers to disclose how they integrate ESG factors into their risk processes.

Firms in scope will (to varying degrees) have to integrate ESG factors into their investment decision-making processes, fund documentation and website as part of their duties towards investors and beneficiaries. It is important to note that firms and advisers will be subject to additional disclosure obligations when the financial product promotes environmental and social characteristics, or has sustainable investment as part of its objective or has a reduction in carbon emissions as its objective. The majority of the SFDR provisions will apply from 10 March 2021.

Further information in relation to the above is expected to be published at the end of 2020, which make the timeline for implementation challenging for in-scope firms.

The UK proposes to implement its own measures that are broadly aligned with EU sustainability measures and has set out certain ESG guiding principles which will be at the core of its regime. Hence, firms in scope of the rules should monitor ongoing regulatory developments in the UK and plan accordingly.

UK Tax Update

DAC6

During the course of the last year there have been a number of important developments in relation to the sixth version of the European Union's Directive on Administrative Co-operation (DAC6), including the UK's ongoing implementation of DAC6, the impact of Brexit and delays to reporting due to the current COVID-19 pandemic.

As discussed in our 2019 Annual Review, DAC6 widens the scope of international tax reporting requirements in order to target and stop tax avoidance. The rules themselves, in fact, target a much wider range of transactions, some of which involve no tax avoidance at all. To fall within the scope of the rules, there needs to be a cross-border arrangement involving at least one EU Member State and which

contains at least one of the wide-ranging "hallmarks" prescribed in the directive. Disclosure of such reportable cross-border arrangements is required by "intermediaries" (a term widely defined in the directive), and the information disclosed will be collected by EU tax administrations and automatically shared between them.

UK DAC6 Implementation

As required under relevant EU law, and notwithstanding the UK's exit from the EU, the UK has taken steps to implement DAC6 with the publication of final UK regulations (the International Tax Enforcement (Disclosable Arrangements) Regulations 2020) in January 2020 and HM Revenue & Custom's (HMRC) corresponding guidance in July 2020.

The final UK regulations, which came into force on 1 July 2020, contain a number of important updates from the 2019 draft regulations, including:

- Penalties – the regulations have been amended to ensure the penalties are proportionate and flexible enough to ensure compliance, but will not unduly penalise genuine mistakes. In addition, where a person has reasonable procedures in place to secure compliance with the rules, this will be taken into account in determining whether they have a reasonable excuse for a failure.
- Taxes covered – the scope of "tax advantage" has been limited to include only taxes covered by DAC6.
- Reporting in multiple jurisdictions – the regulations have been amended to ensure that the same intermediary does not have an obligation to report in multiple jurisdictions for the same arrangement.
- UK intermediaries – the scope of the regulations has been limited to UK intermediaries only so they will not apply to intermediaries without a UK connection (as intended by DAC6).
- Legal professional privilege (LPP) – the regulations have been amended to ensure that they are compatible with LPP.

HMRC's DAC6 guidance, issued in July 2020, reflects the updates to the regulations themselves, and in particular includes a new section that discusses what might constitute "reasonable procedures" in the context of mitigation of penalties where reporting obligations are mistakenly not met. What reasonable procedures would be sufficient to prevent penalties arising is not certain, although HMRC do offer some examples in its guidance, such as staff training and governance procedures for determining what is reportable.

DAC6 and Covid-19

With the first reports under DAC6 due across the EU in August 2020, the continuing disruption of the COVID-19 pandemic has resulted in the EU allowing Member States an option to delay the reporting timeline by six months.

The UK has taken up the option to defer reporting under DAC6 by the full six months, along with a large number of other EU countries. However, a handful of countries, most notably Germany, Finland and Austria, have not taken up the option to defer and a number of other EU countries have gone for a shorter period.

The changes to the timeline due to the deferral for reporting and exchange of information are as follows:

- The date for reporting cross-border arrangements where the first step in the implementation took place between 25 June 2018 and 30 June 2020 (i.e. the "look-back" period) is extended from 31 August 2020 to 28 February 2021.
- The start of the 30-day period for cross-border arrangements which become reportable after 30 June 2020 is changed from 1 July 2020 to 1 January 2021. This will apply to arrangements (i) which were made available for implementation, (ii) which were ready for implementation or (iii) where the first step in the implementation took place between 1 July 2020 and 31 December 2020 as well as arrangements where a UK intermediary provided aid, assistance or advice between 1 July 2020 and 31 December 2020.
- The date for the first mandatory exchange of information in relation to reportable cross-border arrangements between Member States is changed from 31 October 2020 to 30 April 2021.

The UK government will amend the UK DAC6 regulations to reflect this deferral and have indicated that no action will be taken for non-reporting in the period between 1 July 2020 (when the regulations came into force) and the date when the amended regulations come into force.

Given the continued uncertainty surrounding COVID-19, there is also an option to further extend the period of deferral by another three months.

DAC6 and Brexit

Following the end of the Brexit transition period, from 1 January 2021, the UK will no longer be under an obligation to comply with DAC6. It has, however, fully implemented the provisions of DAC6 into national legislation, as mentioned above.

In the response document to last year's DAC6 consultation, the UK government confirmed its commitment to tax transparency will not be weakened by leaving the EU and that the UK will continue to work with international partners to tackle offshore tax evasion and avoidance. However, the document also stated that changes may be required to the regulations in due course depending on the outcome of Brexit, and a possibility remains that the UK could look to amend, repeal or revoke the regulations.

As HMRC remains committed to tackling aggressive tax arrangements, and the international tax landscape continues to move against tax avoidance and evasion globally, it does not seem likely that the UK would repeal its implementation of DAC6 when the transition period comes to an end. Instead, it is pretty certain that the DAC6 rules will remain in force and unchanged initially, with future amendments possible as the UK's tax law and reporting regimes gradually become unaligned with those of the EU.

Despite the deferral of DAC6 reporting deadlines in the UK, managers of private funds should continue to implement internal procedures in order to prepare for the first reporting deadlines, given that the DAC6 rules are likely to impose compliance obligations on funds and intermediaries. In addition, managers should continue to work closely with intermediaries to ensure that the intermediaries have the correct mechanisms in place to notify managers of all relevant information in the event that a transaction in which a fund is involved becomes a DAC6 reportable transaction.

UK Corporate Tax Residence and COVID-19

A particular concern of managers of private investment funds whose structures include companies that are not incorporated in the UK (such as those registered in Luxembourg or the Channel Islands, for example) is to ensure that those companies are operated so as not to, inadvertently, become UK tax

resident. This would be relevant to a number of structures including where non-UK companies are used as hedge fund vehicles or act as managers of funds or as holding companies.

The restrictions on all but the most essential travel and the closure of international borders with a view to containing the coronavirus (COVID-19) pandemic have created unforeseen and unparalleled complexities in this regard. It was hoped that such restrictions would be short term and limited in nature, but – more than six months on – this seems increasingly unlikely.

UK Corporate Tax Residence – "Central Management and Control"

A non-UK incorporated company is UK tax resident under UK law if it is "centrally managed and controlled" in the UK. While the question of location of central management and control is a question of fact, to ensure that the foreign corporate residence of a non-UK company is respected by HM Revenue & Customs (HMRC), one would generally need to ensure that: (i) as many board meetings as possible of those companies are held outside the UK and are attended in person where possible; (ii) the board comprises at least a majority of locally-resident directors; (iii) board meetings are held outside the UK where the actual decision making takes place; and (iv) any UK-based directors join board meetings in person to the extent feasible at the location where those board meetings are held.

HMRC's guidance on COVID-19

The travel restrictions imposed in March as a response to COVID-19 made adhering to many elements of this typical approach to ensuring non-UK residence wholly or partly impractical. In response to this, in April, HMRC published guidance (HMRC Manuals at INTM120185) specifically addressing company residence issues arising from COVID-19. The guidance provided reassurance insofar as HMRC stated that it is "very sympathetic" to the difficulties brought about by COVID-19 movement restrictions. However, at the same time, HMRC stressed that it was not introducing any specific change of approach to corporate tax residence, stating instead that existing legislation provided sufficient flexibility for businesses to temporarily adjust their business activities in response to the pandemic.

In its guidance, HMRC has also stated that a non-UK resident company would not necessarily become resident in the UK because a few board meetings are held in the UK or because some decisions are taken in the UK over a short period of time. HMRC indicated that its approach to assessing the residence of a foreign company would involve taking a holistic view of the facts and circumstances in each case, and this reflected HMRC's longstanding approach to this question.

The Longer Term Outlook

In recent weeks, it has become increasingly apparent across Europe that COVID-19 is likely to have a long-term effect on international taxation. For many managers and advisers of private investment funds, the very concise nature of HMRC's guidance is unlikely to provide long-term certainty of tax treatment or to be a viable long-term option.

HMRC's guidance could be interpreted as indicating that HMRC would look at the historic pattern of location of board meetings of a non-UK resident company and UK participation in such meetings. This may be a working approach for those foreign companies that have been in existence for a sufficiently long period of time where it is possible to look back and determine a stable pattern of non-UK board meetings and non-UK participation at those meetings. However, for newly established non-UK fund managers, hedge funds and holding companies, this guidance is unlikely to be helpful.

In such new structures, in the absence of specific and clear guidance being introduced by HMRC to prevent foreign companies becoming unintentionally UK tax resident due to COVID-19-related travel restrictions, some private fund advisers may feel compelled to explore alternative structuring solutions.

One option may be to further enhance the level of the company's physical presence in non-UK jurisdictions, for example by the appointment of sufficiently experienced directors to the boards who would be resident either in the local foreign jurisdiction or in another non-UK jurisdiction so as to avoid or reduce the participation by UK resident individuals in board meetings. Provided it is commercially viable, this could provide a more prudent and sustainable approach.

In the case of investment funds' holding companies in particular, another potential approach may be to look closer to home and consider reengaging with the UK as a holding company jurisdiction. The approach of using UK incorporated companies that are undoubtedly UK resident should be less susceptible to being undermined by COVID-19-related or other travel restrictions and HMRC's scrutiny, which may make them more attractive in the future.

China Update

On December 28, 2019, the Standing Committee of the National People's Congress of China approved the amended Securities Law of the People's Republic of China (the New Securities Law), which took effect on March 1, 2020. As a basic law governing China's capital market, the Securities Law has undergone two sets of major changes since it was first passed in 1998. This is the second set of major changes to the Securities Law following the ones made in 2005. The New Securities Law is regarded as a milestone in China's capital market reform, and its implementation is expected to have a substantial impact on China's capital market and participants therein. Set out below are some of the highlights of the New Securities Law.

Transition from an Approval-Based Initial Public Offering (IPO) System to a Registration-Based One

The most significant change brought in by the New Securities Law is the adoption of a registration system for all IPOs, a system that had been previously tested on the new Science and Technology Innovation Board under the Shanghai Stock Exchange. Under the previous law, IPOs in China were subject to the regulatory approval of the China Securities Regulatory Commission (CSRC, the regulator of the securities industry in China). Under the New Securities Law, this IPO approval system will be abolished phase by phase and the newly adopted registration system will be implemented. Under the new registration system, stock exchanges will be responsible for reviewing whether issuers comply with the issuance conditions and information disclosure requirements, while the CSRC will instead be responsible for registration of stock listings. To ensure a smooth transition from the existing approval-based IPO system to the newly adopted registration-based one, the New Securities Law provides a phase-in implementation of the new registration system and authorizes the State Council (China's cabinet) to formulate detailed implementation rules.

Moreover, the New Securities Law also loosens the profit requirements for IPOs. Under the New Securities Law, a company seeking an IPO is no longer required to have the capacity for sustained profitability. Instead, it is required to have the capacity for sustainable operation.

Enhanced Information Disclosure and Investor Protection Provisions

The New Securities Law includes enhanced information disclosure and investor protection provisions. Among other changes, the New Securities Law (i) redefines the standards for information disclosure by adding requirements like "timely," "concise and clear," "easy to understand," etc. on the top of the "true," "accurate" and "complete" requirements provided in the previous law; (ii) fleshes out the list of disclosable "major events" that may affect stock trading prices; (iii) emphasizes the disclosure obligations of controlling shareholders, actual controllers, directors, supervisors and senior officers of the issuers; and (iv) imposes tougher punishments on violation of disclosure obligations. Moreover, for companies that are dual listed in China and other jurisdictions, the New Securities Law requires that any information they disclosed to offshore investors should be disclosed at the same time to PRC domestic investors.

The New Securities Law also brings in a securities representative litigation system, which enables investors to lodge, through certain investor protection institutions, civil claims against issuers and other responsible parties for false statements or other securities related violations. This system is very new and there are still many details that need to be supplemented before it could be implemented.

Tougher Punishments for Violations

The New Securities Law imposes substantially tougher punishments for violations. For example, the upper limit of fines against disclosure violations has increased from RMB600,000 to RMB10,000,000. The penalty for fraudulent listings under the New Securities Law is a fine of up to RMB20,000,000 or the entire proceeds from the IPO, while the penalty for similar violations under the previous law was a fine of up to RMB600,000 or 5% of the proceeds. For individuals engaging in serious breaches, under the New Securities Law CSRC could forbid securities trading by such individuals for a period and even for life, on top of the current ban on being hired as senior officials in listed companies and carrying out securities business.

Long-arm jurisdiction

The New Securities Law makes it possible for a company listed in a stock market outside of China that "distorts the order of the domestic markets and damages the legitimate rights and interests of domestic investors" to be punished according to the New Securities Law.

Limitation on non-Chinese securities regulators' ability to conduct investigations within China

Another notable change brought in by the New Securities Law is the addition of a new provision which prohibits non-Chinese securities regulators from conducting investigations within China and prevents Chinese entities and individuals from providing information to such regulators without first receiving approval from the CSRC and/or other relevant PRC governmental authorities. This "blocking" provision is regarded as one of the Chinese government's efforts in response to U.S. regulators' increasing scrutiny on Chinese companies listed in the United States.

China's New Foreign Investment Law

The Foreign Investment Law of the People's Republic of China (***FIL***), together with its Implementation Rules, took effect on January 1, 2020. The FIL reshapes China's foreign investment legal regime, as it has, as of its effective date, replaced the three existing PRC laws that have governed foreign investment in China for the last 40 years (namely the Law on Sino-Foreign Equity Joint Ventures, the Law on Sino-Foreign Cooperative Joint Ventures and the Law on Wholly Foreign Owned Enterprises). Set out below are some of the highlights of the FIL.

Giving national treatment to foreign investments not included in the "negative list"

The most significant change brought in by the FIL is the adoption of a new legal framework for management of foreign investments in China, under which foreign investments not included in the "negative list" published by the Chinese government from time to time will get national treatment. Under the FIL and its Implementation Rules, the Ministry of Commerce (together with its local counterparts, the "***MOFCOM***), the most important foreign investment regulator in China under the previous foreign investment legislation, will no longer have the power to pre-approve or accept record filing for the establishment and subsequent changes of foreign invested enterprises (***FIEs***," including wholly foreign owned enterprises and joint ventures) operating in industries not included in the "negative list." Instead, MOFCOM will only monitor foreign investments in such industries in China through an information reporting system.

Changes in corporate governance

The FIL requires all FIEs to follow the same corporate governance rules as those applicable to PRC domestic companies (that is, the corporate governance rules provided in the PRC Company Law, the PRC Partnership Law or other business organization laws, as applicable), and the corporate governance rules provided in the previous foreign investment legislation will cease to apply. For FIEs (in particular Sino-foreign joint ventures) which were formed prior to the adoption of the FIL and whose corporate governance is inconsistent with the requirements of the PRC Company Law, the PRC Partnership Law or other business organization laws (as applicable), the FIL provides a 5-year grace period to bring the corporate governance of such FIEs in line with the PRC Company Law, the PRC Partnership Law or other business organization laws (as applicable).

Strengthening protection of foreign investment

The FIL includes certain general provisions on strengthening protection of foreign investment. For example, the FIL includes certain provisions to address concerns among foreign investors about weak intellectual property (IP) protection in China, including a prohibition against "forced" transfer of technology or divulgence of trade secrets of FIEs, and enhanced remedies for IP infringement. However, the actual force and effect of such general provisions will still need to be tested in the real world in the coming years.

The provisions of the FIL are very general, and there are a lot of areas left by the legislators that will need to be clarified via implementing rules and policies. Also, there are still many existing specific regulations, rules and policies passed under the previous foreign investment legislation that remain to be reviewed and streamlined to make them consistent with the FIL.

Hong Kong Update

Introduction of Limited Partnership Funds Ordinance

The Limited Partnership Fund Ordinance (**LPFO**) came into effect on 31 August 2020, creating a brand new regime for the establishment of limited partnership fund vehicles (**LPF**) in Hong Kong. This follows the introduction of a regime in mid-2018 for the use of Hong Kong incorporated open-ended fund companies (OFCs) as local investment fund vehicles, as well as the creation of the Unified Funds Exemption Regime, which has the effect of granting a profits tax exemption at the fund level for all types of funds operating in Hong Kong, subject to the satisfaction of certain conditions. In addition, the Hong Kong government has published a consultation paper (see below), setting out its proposals for the

introduction of a tax concession on carried interest for private equity funds, which is intended to complement the Unified Funds Exemption Regime.

See this link for our client alert on this topic.

Particular features of the new LPF regime are as follows:

- The process for setting up an LPF is very similar to that for a Cayman GP/LP structure, and the General Partner (GP) and limited partners (LPs) are given very broad contractual freedom to negotiate and agree the fund terms, so that the terms of the limited partnership agreement can be very similar to those of a Cayman partnership.
- The GP must appoint an investment manager (IM). This can be the GP itself, but must otherwise be either a Hong Kong company or a registered non-Hong Kong company. As the GP and the IM (if different) are required to be Hong Kong based and will be managing the fund in Hong Kong, it is highly likely that its activities will amount to carrying out a "regulated activity" in Hong Kong, so that it will need to be appropriately licensed by the Hong Kong Securities and Futures Commission (SFC) (typically for Type 9) before it can lawfully carry out that activity in Hong Kong.
- If the GP is another LPF or a non-Hong Kong limited partnership without legal personality, the GP must appoint a person as the authorised representative of the fund to be responsible for the management and control of the fund. That person must be an individual, a Hong Kong company or a registered non-Hong Kong company. No such requirement applies to a Cayman Islands private fund.
- The LPFO contains a very widely drawn list of safe harbour activities for an LP which will not cause it to be regarded as taking part in the management of the LPF, thus preserving its limited liability status. This includes appointing a member to the LPF's LP advisory committee or a director to the board of a portfolio company of the LPF. Otherwise, it would potentially incur joint and several liability with the GP for all the debts and obligations of the fund incurred whilst the LP took part in the management of the LPF;
- The LPF is required to have an office in Hong Kong to which communications and notices may be sent.
- Whilst the LPF will have a duty to keep records including a register of LPs, the need for confidentiality of the identity of the LPs is recognised. These records are not available for public inspection. Additionally, details of LPs would not be included in the application to the HKCR for registration nor would they be disclosed to the Inland Revenue Department.
- The GP must appoint a responsible person in Hong Kong (who may be the GP) to carry out measures required by the Anti-Money Laundering and Counter-Financing of Terrorist Ordinance (**AMLO**). The responsible person must be an authorised institution (under the Banking Ordinance), a licensed corporation (under the Securities and Futures Ordinance), or a qualified accounting professional or legal professional (as defined in the AMLO).

The GP must ensure that there are proper custody arrangements for the assets of the LPF. Such arrangements are not prescribed in the LPFO, but if the manager is licensed by the SFC, it may well also be subject to the custody requirements set out in the SFC's Fund Manager Code of Conduct.

Proposed Tax Concession on Carried Interest for Private Equity Funds

As mentioned above, in August, 2020, the Hong Kong government issued a consultation paper containing a proposal to provide a tax concession for carried interest for private equity funds. The fund management industry in Hong Kong made considerable efforts lobbying the government for a relaxation of tax treatment of carried interest and the paper recognises the need for this step to attract more private equity firms to Hong Kong as a centre for asset managers.

Some of the key features of the proposal are as follows:

- The carried interest must be derived from the provision of investment management services in Hong Kong by an eligible carried interest recipient to a fund validated by Hong Kong Monetary Authority (HKMA) (see below).
- The tax concession would only be available in relation to an eligible "fund" to which the investment management services are provided which must be validated (i.e. verified by due diligence) by the HKMA. The fund would need to demonstrate to the HKMA that it satisfies the eligibility criteria conditions for the tax exemption such as, that it is focused on private equity investment strategies; as well as satisfying the substantial activities test below.
- Once a fund has been "validated", for the purpose of ongoing monitoring,
- The fund would need to engage an external auditor for any year in which carried interest was paid, to certify that certain conditions required for the tax exemption to apply have been met. This certificate would be available for inspection by the HKMA and the Inland Revenue Department.
- The fund manager must satisfy a substantial activities test to ensure that the beneficiaries of the preferential tax regime will undertake core income generating activities in Hong Kong. This will require the fund manager to have (i) an adequate number of qualified full-time employees, being not less than two investment professionals (or one investment professional and one related professional in legal, compliance or finance); and (ii) operating expenditure incurred in Hong Kong for the year of assessment in which the exemption is claimed, of not less than HK$3 million.
- A condition for a fund's profits to qualify for tax exemption under the Unified Funds Exemption Regime is that they must have arisen from "qualifying transactions"[7]. For carried interest to qualify for the tax exemption, it must have arisen from a subset of these qualifying transactions made in private companies, thus limiting the scope of the proposed exemption to private equity funds.
- The carried interest must arise after all, or substantially all, of the fund's investments have been repaid to external investors (i.e. its LPs).
- Each external investor must receive a minimum return equal to an IRR of 6%.
- The rate of tax applicable (which has not yet been provided) to eligible carried interest would, according to the consultation paper, be highly competitive, taking into account the latest developments in international tax standards.
- When introduced, the tax concession would have retrospective effect as from 1 April, 2020.

[7] Defined in the Hong Kong Inland Revenue Ordinance.

Further Consultation on Proposed Amendments to SFC Guideline on Anti-Money Laundering and Counter-Financing of Terrorism

We reported in 2019 that substantial amendments had been made to the SFC's Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Licensed Corporations), as of October 2018 (Guideline), to keep it in line with the latest Financial Action Task Force (FATF) standards. Following the publication by the FATF also in October 2018, of its Guidance for a Risk-based Approach for the Securities Sector (RBA Guidance), the SFC published a new Consultation Paper in September, 2020 proposing amendments to the Guideline to keep in line with the FATF's standards.

This latest Consultation Paper proposes some key changes to the Guideline to address the following aspects of the RBA Guidance:

- the process and methodology of money laundering and terrorist financing (ML/TF) risk assessment as well as indicators of a higher or lower risk level associated with specific risk factors which should be considered in the assessment;
- the risk mitigating policies, procedures and controls for client due diligence and ongoing monitoring in various risk situations including:
  - additional measures to mitigate the risks associated with business relationships in the securities sector similar to cross-border correspondent banking relationships;
  - possible simplified and enhanced measures for customers assessed to be either of lower or higher ML/TF risk; and
  - red-flag indicators of suspicious transactions and activities.

Other aspects of the RBA Guidance such as third-party reliance, electronic wire transfers, internal controls, compliance and targeted financial sanctions are already adequately addressed in the current Guideline.

The proposed amendments also seek to address some areas where LCs could improve as identified in the latest FATF Mutual Evaluation Report of Hong Kong published in September 2019.

The SFC also proposes to incorporate into the Guideline the SFC's own guidance which is now set out in its circulars to licensed corporations (LCs) in several areas such as institutional risk assessments and third-party deposits and payments.

SFC Issues Guidance for LCs on External Electronic Data Storage

The SFC issued a circular to LCs on 31 October 2019 on the "Use of External Electronic Data Storage" which (a) sets out the requirements applicable to an LC where any records and documents required to be kept by it under the the Securities and Futures or the AMLO (Regulatory Records)[8], are kept exclusively with an External Electronic Data Storage Provider (EDSP), and the approval requirements for such record keeping[9], and (b) explains the regulatory standards to be observed by an LC when information is kept or processed electronically using an EDSP. One of the requirements contained in the circular is to ensure that the LC and the SFC can secure access to all the LC's Regulatory Records within the territory whenever required. The Circular does not apply to the storage of physical Regulatory Records, or

[8] The phrase "Regulatory Records" is not defined in the legislation.

[9] SFC approval is required for any premises where the LC is to keep any of its Regulatory Records.

electronic copies of physical Regulatory Records when the physical Regulatory Records are already kept at premises in Hong Kong that have been approved by the SFC.

The circular requires that an LC conduct proper initial due diligence on the EDSP and its controls relating to its infrastructure, personnel and processes for delivering its data storage services, as well as regular monitoring of the EDSP's service delivery, in each case commensurate with the criticality, materiality, scale and scope of the EDSP's service. When applying to the SFC for approval of its premises for record keeping purposes, the LC will be required to provide the SFC with a notice from it to the EDSP authorising and requesting it to provide the LC's records to the SFC, and counter-signed by the EDSP as evidence of its recognition of such authorisation and request. If the EDSP is not Hong Kong based, the LC will also be required to have the EDSP sign an undertaking to the SFC which will include an obligation to disclose and transfer to the SFC both the LC's data and the EDSP's audit trail of access for that data (e.g. audit logs showing access to the data, including generation and modification of the data), and to provide all necessary assistance to the SFC in the performance of its functions and powers.

Notably, certain requirements of the Circular do not apply as follows: (a) where the LC keeps Regulatory Records with an EDSP, and at the same time keeps a full set of identical Regulatory Records at premises used by it in Hong Kong approved by the SFC, such as when cloud storage is only used for the purposes of data backup or ensuring data availability; or (b) where the LC uses computing services without keeping any Regulatory Records with an EDSP, for example where cloud computing services are only used for computations and analytics, while Regulatory Records are kept at the LC's premises.

Amendments to the Open-Ended Fund Companies Regime

Amendments have been made to the Code on Open-ended Fund Companies (OFC Code) effective 11 September, 2020 to enhance to the Open-ended fund companies regime. The regime for the use of Hong Kong incorporated open-ended fund companies (OFCs) as local investment fund vehicles was introduced in mid-2018, and whilst it was expected to be used mostly by retail funds, it was also designed for use by private funds, in particular hedge funds, given the requirement for the fund be open-ended. The amendments include the following:

- For private OFCs, the removal from the OFC Code of all investment restrictions, so that a private OFC can now invest in all asset classes without limit. The intention behind this amendment was to create a level playing field with other overseas corporate fund structures as well as other private fund structures in Hong Kong, including the recently enacted LPFO.
- Permitting an LC or a registered institution, licensed or registered for Type 1 regulated activity (dealing in securities), to act as a custodian for a private OFC, subject to its satisfying certain conditions including the following: (i) its licence must not be subject to the condition that it shall not hold client assets; (ii) minimum regulatory capital requirements; (iii) private OFC is, and remains at all times, a client of the custodian in respect of its business in Type 1 regulated activity; (iv) the custodian must have at least one responsible officer or executive officer responsible for the overall management and supervision of its custodial function; and (v) be independent of the investment manager.

It is also intended that a statutory mechanism be introduced for the re-domiciliation of overseas corporate funds to Hong Kong. As this will require a change to the primary legislation, a longer timeframe will be necessary before this change is made.

In addition, the SFC is carrying a further market consultation on the customer due diligence requirements for OFCs to better align them with the practices applicable to LPFs.

SFC Issues Guidance on Licensing Obligations of Private Equity Firms Which Conduct Business in Hong Kong

In response to enquiries from industry participants and their professional advisers, the SFC issued a circular on 7 January, 2020[10], providing more information about the licensing requirements for private equity firms' general partners, investment committee members and fund marketing activities. The guidance is high level and to a large extent confirms existing practice.

LP and GP Licensing Obligations: Where the private equity fund is formed as a limited partnership, and the GP has assumed ultimate responsibility for the management and control of the fund in return for fees, the GP would generally be required to be licensed for Type 9 regulated activity (RA9) if it conducts fund management business in Hong Kong, subject to its fund management activities constituting "asset management" activities. Likewise, individuals who perform asset management activities for the GP in Hong Kong are also required to be licensed as representatives and, where appropriate, be approved as ROs accredited to the GP.

A GP would not, however, need to be licensed for RA9 if it has delegated all of the asset management functions to another entity which is itself licensed or registered to carry on that regulated activity.

Requirement for discretionary investment authority: To differentiate RA9 from the regulated activities of advising on securities (and dealing in securities), the SFC takes the view that licensed asset managers must be granted full discretionary investment authority over the funds they manage. As an example, the SFC may regard a private equity firm as having discretionary investment authority if it proposes to have an RO (i.e. in Hong Kong) with sufficient authority and seniority to make investment decisions throughout the life cycle of each fund under its management. If, however, approval for investment decisions is subject to investment committee approval, and the majority of the committee is located outside of Hong Kong, the SFC is unlikely to regard the proposed ROs in Hong Kong as having discretionary investment authority, so that that an application for a licence for RA9 would be more likely to be rejected.

Investment committee members': Generally speaking, investment committee members located in Hong Kong who play a dominant role in making investment decisions for the funds are required to be licensed as representatives and, where appropriate, be approved as ROs.

SFC Issues Policy Statement on Hong Kong's National Security Law

On 19 July, 2020, in response to communications between the SFC and globally active financial institutions operating in the Hong Kong markets, that centered on concerns about the potential ambit and effect of the new National Security Law (NSL), which took effect on 1 July, 2020, on the way they currently do business in Hong Kong, the SFC, as the statutory regulator of Hong Kong's capital markets, issued a statement that included the following:

"The SFC would like to clarify that it is not aware of any aspect of the NSL which would affect or alter the existing ways in which firms and listed companies originate, access, disseminate and transmit financial market and related business information under the regulatory regime it administers. For example, the principles applicable to, and methodologies used by, analysts in terms of the sources of information and data they use and the manner in which their views and opinions are expressed in their reports should remain unaltered.

[10] The SFC simultaneously issued a separate circular discussing how the SFC's licensing regime applies to family offices intending to carry out asset management or other services in Hong Kong and explaining the potential implications for both single and multi-family offices.

"Equally, the rules and accepted practices governing market trading activities, including in exchange traded and over-the-counter derivative markets, the use of hedging strategies and activities under Hong Kong's short selling regime, also remain unaltered; all related regulations will be administered by the SFC in the same manner as before the advent of the NSL.

"Since the enactment of the NSL, the stock and derivatives markets in Hong Kong have operated in an orderly manner, and trading in the Hong Kong stock market has been very active. In the first half of July average daily trading increased substantially, with the participation of a range of local and international investors, as well as Mainland investors through Stock Connect. Northbound trading through Stock Connect by international investors doubled, confirming Hong Kong's role as the principal conduit for global savings to access Mainland China's capital markets.

The SFC will continue to regulate Hong Kong's markets as it has done so before the NSL was enacted and in line with this Statement."

Annual and Other Periodic Filing Requirements

Below is a summary of certain key filing requirements applicable to 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, advisers should examine the nature of their business and operations and determine whether any other filings or actions will be required pursuant to applicable federal, state and non U.S. laws and regulations.

Form ADV

Registered investment advisers must file an updated Form ADV Part 1 and Part 2A with the SEC within 90 days after the investment adviser's fiscal year-end (by March 31, 2021 for advisers with a December 31 fiscal year-end). Registered advisers must deliver the updated Form ADV Part 2A, or a summary of the changes made, to clients within 120 days following the adviser's fiscal year-end (by April 30, 2021 for advisers with a December 31 fiscal year-end). Although underlying investors of private funds managed by the advisers are not "clients" of the 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, 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 advisers to file their Form ADV with the relevant state securities authorities. Advisers may also be subject to additional state requirements where, for example, the adviser has a place of business in the state and/or has over five non-exempt clients in that state. Advisers may also be subject to certain blue sky requirements, as discussed below. An adviser should review its business on a periodic basis to determine whether any additional state requirements have been triggered.

Form PF

A registered 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 adviser and the type of private funds managed by it.

In general, a registered 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 adviser's fiscal year (by April 30, 2021 for advisers with a December 31 fiscal year-end). However, the reporting requirements for advisers with larger RAUMs will be more frequent and/or more extensive. In particular:

- *Large Hedge Fund Advisers*. An adviser with at least $1.5 billion in RAUM attributable to hedge funds as of any month-end during the preceding fiscal quarter is subject to more comprehensive quarterly reporting requirements with respect to hedge funds under its management. In addition, the Large Hedge Fund Adviser is required to provide fund-specific information with respect to any "qualifying hedge funds" (*i.e.*, hedge funds with more than $500 million in net asset value). A Large Hedge Fund Adviser must file Form PF within 60 days of each quarter-end (by February 28, 2021 for the quarter ending December 31, 2020).
- *Large Private Equity Fund Advisers*. An 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, 2021 for investment advisers with a December 31 fiscal year-end).
- *Large Liquidity Fund Advisers*. An adviser with at least $1.0 billion in RAUM attributable to private liquidity funds and registered money market funds as of any month-end during the preceding fiscal quarter will be subject to more comprehensive quarterly reporting requirements with respect to private liquidity funds under its management. Large Liquidity Fund Advisers must file Form PF within 15 days of each quarter-end (by January 15, 2021 for the quarter ending December 31, 2020).

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

Advisers 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 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 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 advisers that exceeded the reporting threshold for the first time in 2020, the first Form 13F filing deadline in 2021 will be February 14, 2021 (for the quarter ending December 31, 2020).

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 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, 2021 for 2020). 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, 2021 for 2020).

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 2020 amendments will be February 14, 2021.

Forms 3, 4 and 5

Form 3. A person, including an 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, 2021 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, 2021 for 2020). 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, 2021 for 2021).

Annual Reports and Account Statement Requirements. Each registered CPO, including a CPO relying on CFTC Rule 4.7, must file financial statements of each commodity pool it operates with the NFA within 90 days after each such commodity pool's fiscal year-end (by March 31, 2021, if the fiscal year ends on December 31).

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

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

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

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 (CPO with AUM of at least $1.5 billion)	CFTC Form CPO-PQR Schedules A, B and C (within 60 days of quarter-end)	CFTC Form CPO-PQR Schedules A, B and C (within 60 days of quarter-end)	CFTC Form CPO-PQR Schedules A, B and C (within 60 days of quarter-end)	CFTC Form CPO-PQR Schedules A, B and C (within 60 days of quarter-end)
Mid-Sized CPO (CPO with AUM of at least $150 million but less than $1.5 billion)	NFA Form PQR (within 60 days of quarter-end)	NFA Form PQR (within 60 days of quarter-end)	NFA Form PQR (within 60 days of quarter-end)	CFTC Form CPO-PQR Schedules A and B (within 90 days of year-end)
Small CPO (CPO with AUM of less than $150 million)	NFA Form PQR (within 60 days of quarter-end)	NFA Form PQR (within 60 days of quarter-end)	NFA Form PQR (within 60 days of quarter-end)	CFTC Form CPO-PQR Schedule A and NFA Form PQR (within 90 days of year-end)
Dual-Registered CPO (CPO that is an SEC-registered investment adviser and files	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,

Form PF with the SEC)				depending on AUM)

The upcoming filing deadlines for the period ending on December 31, 2020 will be March 1, 2021 for Large CPOs and March 31, 2021 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, 2020 will be February 14, 2021. 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. adviser (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 adviser 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. If the due date of a report falls on a weekend or holiday, the due date is the following business day. 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 advisers or funds, or be used to calculate whether the threshold limits have been exceeded.

A U.S. resident investment adviser 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 adviser 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 advisers 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. If the due date of the report falls on a weekend or holiday, TIC Form S is due the following business day. U.S. investment advisers 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. advisers with aggregate holdings of reportable long-term securities with a fair market value of at least $1 billion by the adviser and its clients are likely to be subject to Form SLT reporting. An 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 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 J**anuary 23, 2021** for December 2020). If the due date of the report falls on a weekend or holiday, the TIC Form SLT report should be submitted the following business day. 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.

The discussion above focuses on the regulatory obligations applicable to investment advisers to private funds and the filing obligations applicable to other types of investment advisers (particularly investment advisers to separately management accounts or retail investors, banks, bank holding companies and non-financial entities) may be different.

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.

Form 8832 Filings. If an entity filed an IRS Form 8832 (an entity classification election) with respect to 2020, 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 2020 U.S. federal income tax return.

"Qualified Electing Fund" (QEF) Election. If a private fund has invested in a non-U.S. portfolio company that is (or may be) a "passive foreign investment company" (PFIC), the first U.S. person in the PFIC's ownership chain (*e.g.*, the fund itself, if a U.S. fund, or each U.S. investor, if a non-U.S. fund) may wish to file a QEF election with respect to that PFIC. The QEF election must be filed with that U.S. person's U.S. federal income tax return for the first year in which the fund invested in the PFIC. The deadline for PFICs acquired in 2020 will be the due date (including any applicable extensions) of that U.S. person's 2020 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 2020 (and subsequent years), the deadline will be the due date (including any applicable extensions) of the private fund's 2020 U.S. federal income tax return.

CbCR Reporting. A U.S. tax resident parent entity of a multinational enterprise (MNE) group 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 2020 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 generally is 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);
- IRS Form 8938 (with respect to certain non-U.S. financial assets); and
- IRS Form 8992 (with respect to certain U.S. shareholders of controlled foreign corporations to calculate their share of "global intangible low-taxed income" (GILTI)).

Generally, the deadline will be the due date (including any applicable extensions) of the U.S. person's 2020 U.S. federal income tax return.

Other Annual Requirements and Considerations

Audited Financial Statements Delivery

Rule 206(4)-2 of the Advisers Act (the Custody Rule) requires registered 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 adviser's clients to be held by a qualified custodian and to be subject to surprise annual examinations by an independent public accountant that is registered with and subject to inspection by the Public Company Accounting Oversight Board (PCAOB). With respect to private fund clients, however, an 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 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, 2021, 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 July 1, 2021, 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 December 11, 2019, 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 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 permitted by the SEC through the date the SEC would approve a PCAOB-adopted permanent program for the inspection of broker and dealer auditors.

Privacy Policy Delivery

Following changes to the Gramm-Leach-Bliley Act contained in Section 75001 of the Fixing America's Surface Transportation Act of 2015 (the FAST Act), and subsequent 2019 conforming rulemaking from the CFTC, 2018 rule amendments from the U.S. Bureau of Consumer Financial Protection and 2019 staff guidance from DoE, delivery of annual privacy notices is now required only if a financial institution's privacy policies and practices have changed since the last distribution of a privacy notice. Specifically, if there has been any change to the privacy policy that would permit non-public 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.

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 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 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 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 actually are 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, also known as a 408(b)(2) notice, by reference to the relevant section of ERISA.

California Financing Law Requirements

The California Financing Law 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 Proskauer 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 advisers 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 been previously 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.

2021 Federal Filings and Other Document Delivery Calendar

Filing / Delivery	Who must file	Deadline
January 2021		
Form PF	Large Liquidity Fund Advisers	January 15 (for the quarter ending December 31, 2020)
TIC Form BC, BL-1 and BL-2	U.S. residents with reportable cross-border claims or liabilities in excess of $50 million (or $25 million with respect to an individual country)	January 15 (for December 2020)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding $350 million as of any month	January 15 (for December 2020)
TIC Form BQ-1, BQ-2 and BQ-3	U.S. residents with reportable cross-border claims or liabilities in excess of $50 million (or $25 million with respect to an individual country) (Form BQ-1 and BQ-2 Part 1), in excess of $50 million (no country limit) (Form BQ-2 Part 2) or in excess of $4 billion (no country limit) (Form BQ-3)	January 20 (for the quarter ending December 31, 2020)
TIC Form SLT	U.S. resident custodian, issuer or end-investor having cross-border ownership of reportable long-term securities exceeding $1 billion as of the last day of any calendar month	January 25 (for December 2020) Note: Usually filed on the 23rd calendar day of the following month, but if the 23rd day is a holiday, Saturday or Sunday, the filing deadline is extended until the next business day.
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, 2020)

Filing / Delivery	Who must file	Deadline
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)	January 30 (for December 2020)
February 2021		
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 (*e.g.*, Qualified Institutional Investors and/or passive investors)	February 16 (for 2020)
Form 13H Annual Update	Large traders of Regulation NMS securities	February 16 (for 2020)
Form 5	Insiders required to report any exempt or other insider transactions not previously reported on Form 4	February 16 (if the issuer has a December 31 fiscal year-end)
CFTC Form CTA-PR	Registered CTAs	February 16 (for the quarter ending December 31, 2020)
Form 13F	Investment managers that exercise investment discretion over $100 million or more in Section 13(f) securities	February 16 (for the quarter ending December 31, 2020)
TIC Form BC, BL-1 and BL-2	U.S. residents with reportable cross-border claims or liabilities in excess of $50 million (or $25 million with respect to an individual country)	February 16 (for January 2021). Note: Usually filed on the 15th calendar day of the following month, but if the 15th day is a holiday, Saturday or Sunday, the filing deadline is extended until the next business day. (Presidents' Day is on February 15th, 2020)

Filing / Delivery	Who must file	Deadline
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding $350 million as of any month	February 16 (for January 2021). Note: Usually filed on the 15th calendar day of the following month, but if the 15th day is a holiday, Saturday or Sunday, the filing deadline is extended until the next business day. (Presidents' Day is on February 15th, 2020)
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 2021)
March 2021		
Form PF	Large Hedge Fund Advisers	March 1 (for the quarter ending December 31, 2020)
CFTC Form CPO-PQR	Large CPOs	March 1 (for the quarter ending December 31, 2020)
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 2020)
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 2021)
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 2021)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding $350 million as of any month	March 15 (for February 2021)

Filing / Delivery	Who must file	Deadline
TIC Form SLT	U.S. resident custodian, issuer or end-investor having cross-border ownership of reportable long-term securities exceeding $1 billion as of the last day of any calendar month	March 23 (for February 2021)
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 2021)
CRS Information Reports	Financial institutions in "Participating Jurisdictions" (which currently do not include the US)	Consult local advisers
Form ADV Annual Update	Registered investment advisers and exempt reporting advisers	March 31 (for an investment adviser with a December 31 fiscal year-end)
NFA Commodity Pool Annual Financial Statements Filing	Registered CPOs	March 31 (for a pool with a December 31 fiscal year-end)
FATCA Information Report	Participating FFIs (except for FFIs in Model 1 IGA jurisdictions) FFIs in Model 1 IGA jurisdictions	Consult local advisers
April 2021		
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 15 (for the quarter ending March 31, 2021)
TIC Form BC, BL-1 and BL-2	U.S. residents with reportable cross-border claims or liabilities in excess of $50 million (or $25 million with respect to an individual country)	April 15 (for March 2021)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding $350 million as of any month	April 15 (for March 2021)

Filing / Delivery	Who must file	Deadline
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, 2021)
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 2021)
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 Private Fund Investors	Registered investment advisers (except with respect to fund-of-funds)	April 30 (for private fund with a December 31 fiscal year-end)
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)
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, 2021)
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 2021)
May 2021		
NFA Form PR	All registered CTAs	May 15 (for the quarter ending March 31, 2021)
Form 13F	Investment managers that exercise investment discretion over $100 million or more in Section 13(f) securities	May 17 (for the quarter ending March 31, 2021)

Filing / Delivery	Who must file	Deadline
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 17 (for April 2021) Note: Usually filed on the 15th calendar day of the following month, but if the 15th day is a holiday, Saturday or Sunday, the filing deadline is extended until the next business day.
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding $350 million as of any month	May 17 (for April 2021) Note: Usually filed on the 15th calendar day of the following month, but if the 15th day is a holiday, Saturday or Sunday, the filing deadline is extended until the next business day.
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 24 (for April 2021) Note: Usually filed on the 23rd calendar day of the following month, but if the 23rd day is a holiday, Saturday or Sunday, the filing deadline is extended until the next business day.
Form PF	Large Hedge Fund Advisers	May 30 (for the quarter ending March 31, 2021)
CFTC Form CPO-PQR	Large CPOs	May 30 (for the quarter ending March 31, 2021)
NFA Form CPO-PQR	All registered CPOs, except Large CPOs	May 30 (for the quarter ending March 31, 2021)
Delivery of Monthly Account Statements to Pool Participants	Registered CPOs (except for CPOs exempt under CFTC Reg. 4.7 or with respect to commodity pools with NAV below $500,000)	May 30 (for April 2021)
June 2021		
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 2021)

Filing / Delivery	Who must file	Deadline
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding $350 million as of any month	June 15 (for May 2021)
TIC Form SLT	U.S. resident custodian, issuer or end-investor having cross-border ownership of reportable long-term securities exceeding $1 billion as of the last day of any calendar month	June 23 (for May 2021)
Delivery of Annual Audited Financial Statements to Private Fund Investors	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 2021)
July 2021		
Form PF	Large Liquidity Fund Advisers	July 15 (for the quarter ending June 30, 2021)
TIC Form BC, BL-1 and BL-2	U.S. residents with reportable cross-border claims or liabilities in excess of $50 million (or $25 million with respect to an individual country)	July 15 (for June 2021)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding $350 million as of any month	July 15 (for June 2021)
TIC Form BQ-1, BQ-2 and BQ-3	U.S. residents with reportable cross-border claims or liabilities in excess of $50 million (or $25 million with respect to an individual country) (Form BQ-1 and BQ-2 Part 1), in excess of $50 million (no country limit) (Form BQ-2 Part 2), or in excess of $4 billion (no country limit) (Form BQ-3)	July 20 (for the quarter ending June 30, 2021)
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 2021)

Filing / Delivery	Who must file	Deadline
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, 2021)
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 2021)
August 2021		
NFA Form PR	All registered CTAs	August 14 (for the quarter ending June 30, 2021)
Form 13F	Investment managers that exercise investment discretion over $100 million or more in Section 13(f) securities	August 16 (for the quarter ending June 30, 2021)
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 16 (for July 2021) Note: Usually filed on the 15th calendar day of the following month, but if the 15th day is a holiday, Saturday or Sunday, the filing deadline is extended until the next business day.
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding $350 million as of any month	August 16 (for July 2021) Note: Usually filed on the 15th calendar day of the following month, but if the 15th day is a holiday, Saturday or Sunday, the filing deadline is extended until the next business day.
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 2021)
Form PF	Large Hedge Fund Advisers	August 29 (for the quarter ending June 30, 2021)
CFTC Form CPO-PQR	Large CPOs	August 29 (for the quarter ending June 30, 2021)

Filing / Delivery	Who must file	Deadline
NFA Form CPO-PQR	All registered CPOs, except Large CPOs	August 29 (for the quarter ending June 30, 2021)
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 2021)
September 2021		
TIC Form BC, BL-1 and BL-2	U.S. residents with reportable cross-border claims or liabilities in excess of $50 million (or $25 million with respect to an individual country)	September 15 (for August 2021).
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding May $350 million as of any month	September 15 (for August 2021)
TIC Form SLT	U.S. resident custodian, issuer or end-investor having cross-border ownership of reportable long-term securities exceeding $1 billion as of the last day of any calendar month	September 23 (for August 2021)
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 2021)
October 2021		
Form PF	Large Liquidity Fund Advisers	October 15 (for the quarter ending September 30, 2021)
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 2021)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding $350 million as of any month	October 15 (for September 2021)

Filing / Delivery	Who must file	Deadline
TIC Form BQ-1, BQ-2 and BQ-3	U.S. residents with reportable cross-border claims or liabilities in excess of $50 million (or $25 million with respect to an individual country) (Form BQ-1 and BQ-2 Part 1), in excess of $50 million (no country limit) (Form BQ-2 Part 2), or in excess of $4 billion (no country limit) (Form BQ-3)	October 20 (for the quarter ending September 30, 2021)
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 25 (for September 2021) Note: Usually filed on the 23rd calendar day of the following month, but if the 23rd day is a holiday, Saturday or Sunday, the filing deadline is extended until the next business day.
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, 2021)
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 2021)

Filing / Delivery	Who must file	Deadline
November 2021		
NFA Form PR	All registered CTAs	November 14 (for the quarter ending September 30, 2021)
Form 13F	Investment managers that exercise investment discretion over $100 million or more in Section 13(f) securities	November 15 (for the quarter ending September 30, 2021)
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 2021)
TIC Form S	U.S. resident entities conducting cross-border reportable transactions exceeding $350 million as of any month	November 15 (for October 2021)
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 2021)
Form PF	Large Hedge Fund Advisers	November 29 (for the quarter ending September 30, 2021)
CFTC Form CPO-PQR	Large CPOs	November 29 (for the quarter ending September 30, 2021)
NFA Form CPO-PQR	All registered CPOs, except Large CPOs	November 29 (for the quarter ending September 30, 2021)
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 2021)

Filing / Delivery	Who must file	Deadline
Other Floating Deadlines		
Form D	Private funds conducting an offering under Regulation D	Initial Filing: Within 15 days of the initial sale of securities Annual Amendment: Anniversary date of the previous Form D filing Interim Amendment: As soon as practicable after certain changes in information Note: Additional state blue sky filing requirements may apply
Schedule 13D	Beneficial owners of at least 5% of a class of outstanding equity securities of a U.S. public company	Initial Filing: Within 10 days of crossing the 5% threshold Amendment: Promptly after any material change in beneficial ownership percentage
Schedule 13G	Beneficial owners of at least 5% of a class of outstanding equity securities of a U.S. public company eligible to file Schedule 13G (*i.e.*, Qualified Institutional Investors and/or passive investors)	Initial Filing: Generally, within 45 days of year-end (if a QII or passive 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 increases or decreases by over 5%

Filing / Delivery	Who must file	Deadline
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 $84.4 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

Filing / Delivery	Who must file	Deadline
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 $3 million, then the U.S. entity should file Form BE-13A If the cost of the transaction does not exceed $3 million, then the U.S. entity should file a BE-13 Claim for Exemption	Within 45 days after a reportable transaction
New Issues Affirmations	Private funds that invest in new issues	Annually
Delivery of Privacy Policy Notice to Clients	Financial institutions who have changed their privacy policies and practices since the last distribution of a privacy notice (see above)	Annually
Delivery of ERISA/VCOC Annual Certification to ERISA Investors	Private funds operating as a VCOC or pursuant to the 25% cap	As per fund documents and/or other contractual agreements with ERISA investors (typically no more frequently than annually)
Delivery of Schedule K-1	Private funds that are partnerships for tax purposes	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 2020	Due date (including any applicable extension) of that entity's 2020 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 2020 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 2020 U.S. federal income tax return

Filing / Delivery	Who must file	Deadline
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 2020 U.S. federal income tax return
Certain U.S. Tax Filings with respect to Non-U.S. Entities	Private funds and their U.S. investors may be required to make certain filings with respect to non-U.S. entities owned by the private fund, including, without limitation: IRS Form 5471 IRS Form 926 IRS Form 8621 IRS Form 8865 IRS Form 8858 IRS Form 8938	Generally, due date (including any applicable extensions) of the U.S. person's 2020 U.S. federal income tax return

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