

2024

Investment Adviser Regulatory and Compliance Annual Letter



Introduction

29 January 2024

In 2024, investment advisers – those registered with the U.S. Securities and Exchange Commission (SEC) and those that file notices as exempt reporting advisers - will continue to feel the impact of the SEC's recent rule making frenzy. Among other things, this letter is intended to help address this new year's investment adviser and private fund regulatory reporting and compliance obligations. It also is intended to provide insight on regulatory initiatives that we expect to be just over the horizon.

We specialize in providing U.S. legal advice to investment advisers, especially those managing private funds. We represent investment advisers and their private funds, large and small, U.S. and foreign. Please let us know how we may help you.

Sullivan & Worcester, LLP

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2023 New Regulations

Among the new rules adopted in 2023 by the SEC and which apply to investment advisers were the following:

- **Short Position and Short Activity Reporting by Institutional Investment Managers** – Amendments to Reg SHO require institutional investment managers exercising discretionary authority with respect to gross short positions exceeding certain thresholds to file each month Form SHO in its new format. Effective Date: January 2, 2024. Compliance Dates: Mid 2025.

Take-Aways

- We recommend you consider, and update as necessary, filing calendars to accommodate new reporting requirements, and confirm that information is available for new reporting obligations on amended forms and schedules.
- For private fund advisers, we also suggest you review fund documentation, update as required, and prepare for the Private Funds Rules new reporting obligations.

- **Modernization of Beneficial Ownership Reporting** – Amendments to sections 13(d) and 13(g) of the Securities Exchange Act, which, among other things, shorten the deadlines for initial and amended filings on Schedules 13D and 13F, include new structured data requirements, and clarify the Schedule 13D disclosure requirements with respect to derivative securities. The adopting release also includes guidance on (a) the legal standards governing when two or more people are considered a group for determining whether the beneficial ownership threshold has been met, and (b) when a person's use of cash-settled derivative securities may result in the person being treated as the beneficial owner of the underlying securities. Effective Date: February 5, 2024. Compliance Dates: September 30, 2024 (Revised Schedule 13G filing deadlines); December 18, 2024 (Structured data requirements for Schedules 13D and 13G). [Amendments to Form 13F adopted in November 2022 will go into effect on July 1, 2024.](#)
- **Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews** – For registered private fund advisers, new rules include a new quarterly statement rule, a private fund audit rule, and an adviser-led secondaries rule as well as amendments to the books and records rule with corresponding changes. For all private fund advisers, new rules impose restrictions on an adviser's ability to charge its private funds certain fees and expenses, on adviser clawbacks, on portfolio investment fees and expenses allocated among a private fund and other clients, and on extensions of credit from the private fund without investor disclosure. For all private fund advisers, new rules also impose restrictions on specific types of preferential treatment to certain investors. For all registered investment advisers (private fund advisers and others), required annual CCO reviews must be in writing. Effective Date: November 13, 2023. Compliance Dates: Varies (either September 14, 2024 or March 14, 2025). [We discuss the implications to the Private Fund Adviser Rules to non-U.S. investment advisers here.](#)

2023 New Regulations (continued)

- **Conformed: Form PF; Event Reporting for Large Hedge Fund Advisers and Private Equity Fund Advisers; Requirements for Large Private Equity Fund Adviser Reporting** – Amendments to Form PF now require (a) large hedge fund managers to report certain events that may indicate certain stress at the fund, (b) large private equity fund advisers to report certain events that could raise investor protection issues, and (c) large private equity fund managers to provide enhanced reporting about the private equity funds they advise. Effective Date: December 11, 2023 (current and quarterly reporting events). Compliance Dates: June 11, 2024 (all other).
- **Shortening the Securities Settlement Cycle** - Amendments to broker-dealer rules generally shorten the settlement cycle for most securities to T+1. Registered investment advisers are required to make and maintain records, including by-minute time-and-date stamps, of each confirmation received in a transaction subject to Securities Exchange Act rule 15c6-2(a) (i.e., T+1 transactions), and of any allocation and each affirmation sent or received. Effective Date: May 5, 2023.



2023 Key Enforcement Actions and Litigation

In November 2023, the SEC published the results of its enforcement actions for the year as of that date. Among the key enforcement actions relating to investment advisers, in addition to the actions brought against FTX and Sam Bankman-Fried, were the following:

1. *Failure to Maintain and Preserve Electronic Communications*

Investment Advisers that failed to maintain copies of electronic communications, as required by Advisers Act rule 204-2(a)(7), as well as failure to supervise their employees in violation of Advisers Act section 203(e)(6).

2. *Investment Advisory Agreements*

An investment adviser that included in its investment advisory agreements a hedge clause that, when read in its entirety, could mislead retail clients into not exercising their legal rights. Under the SEC's 2019 interpretation on investment adviser's fiduciary duties, use of hedge clauses in retail client advisory agreements is inconsistent with the adviser's fiduciary duty to the client.

An investment adviser that signed contracts on behalf of clients with third parties without proper authorization.

3. *Advertising and Marketing*

Investment Advisers advertising hypothetical performance on their websites without the policies and procedures required pursuant to Advisers Act rule 206(4)-1, as well as, in certain cases, investment advisers not maintaining copies of advertisements.

An investment adviser that used misleading hypothetical performance metrics in advertisements (i.e., annualizing 3-week performance without disclosing the assumption that the 3-week performance would continue for an entire year).

An investment adviser that used misleading disclosure about the custody of crypto assets.

Take-Aways

- As part of the CCO annual review, we suggest a thorough review of the marketing process, especially the production and distribution of marketing materials, and when marketing ESG- and crypto-related investments.
- We also suggest a review of forms of client agreement, including whether the use of hedge clauses is permitted, and whether you have adequate client authority to effect client transactions.
- We also recommend that you review whether your conflicts of interest are fully disclosed, especially in your Form ADV, Part 2 and your private fund documentation.

2023 Key Enforcement Actions and Litigation (continued)

4. *Employee Trading*

An investment adviser's portfolio manager provided proprietary trading information to a friend, who traded ahead of the investment adviser's clients, i.e., front running.

5. *Environmental, Social, and Governance (ESG) - Related Cases*

Two investment advisers that made misleading statements about their controls concerning ESG products, including the failure to adopt policies and procedures reasonably designed to ensure that the statements about its ESG products were accurate.

6. *Failing to Disclose Conflicts of Interest*

Private equity firm that failed to adequately disclose real estate brokerage fees that were paid to an affiliated firm.

An investment adviser that failed to disclose to clients its conflict of interest in using its bank affiliate's cash sweep program, as well as its receipt of revenue sharing arrangements from third-party custodians.

7. *Other*

An investment manager used its employment and separation agreements as a means of impeding whistleblowers from raising issues detrimental to the manager, in violation of the whistleblower protections rules.



SEC 2024 Annual Examination Priorities

1. *Focus of Examinations of Registered Investment Advisers*

- *Fiduciary Duties*
 - Investment advice provided to clients with regard to products, investment strategies and account types, particularly complex products, high cost and illiquid products and unconventional strategies
 - Process for determining that investment advice is provided in the client's best interest, including initial and ongoing suitability determinations, seeking best execution, evaluations of costs and risks, and identifying and addressing conflicts of interests
 - Economic incentives that a registered investment adviser and its financial professional may have to recommend products, services and account types
 - Disclosure made to investors and whether they include all material facts relating to conflicts of interest
- *Compliance Programs*
 - Marketing practices, including compliance with rule 206(4)-1 (the Marketing Rule))
 - Compensation arrangement assessments
 - Valuation practices assessments, especially illiquid and difficult-to-value assets
 - Adviser controls on safeguarding client assets
 - Disclosure assessments of accuracy and completeness of regulatory filings

Take-Aways

- The SEC continues to focus on the products recommended, and services provided, by investment advisers to retail investors.
- The SEC also continues to focus on investment adviser compliance programs, generally, and marketing practices in particular.
- Although the SEC recently approved spot Bitcoin ETFs, the SEC Chair remains concerned with the efficacy of the crypto currency markets.

2. *Investment Advisers to Private Funds*

- Portfolio management risks, especially when there is significant exposure to market volatility and high interest rates
- Adherence to contractual requirements (e.g., fund partnership agreements, advisory committees)
- Accurate calculation and allocations of fund fees and expenses

SEC 2024 Annual Examination Priorities (continued)

- Due diligence practices
- Management and disclosure of conflicts in side-by-side management with registered funds and use of affiliated service providers
- Compliance with Advisers Act requirements regarding custody, Form ADV reporting, completion and distribution of private fund audits

3. *Other Focus Areas Affecting Investment Advisers*

- Information Security and Operational Resiliency
 - Review of Adviser practices to prevent interruptions to mission-critical services and to protect investor information, records and assets, especially when the registered investment adviser has multiple offices
 - Review of policies and procedures, internal controls, oversight of third-party vendors, governance practices and responses to cyber-related incidents, including how the registered investment adviser identifies and addresses risks to essential business operations
 - Review of preparations associated with the shortening of the settlement cycle
 - Review of practices to promote cyber resiliency
- Crypto Assets and Emerging Financial Technology
 - Review of use of using crypto assets and associated products and services
 - Automated investment advice
 - Registered investment advisers offering new products and services or employing new practices, particularly technological and online solutions that service online accounts aimed at meeting demands of compliance and marketing
 - Use of automated tools and Artificial Intelligence (AI), trading algorithms and platforms, and the risks associated with emerging technologies and alternative sources of data
- Anti-Money Laundering
 - Review whether registered investment advisers are monitoring Office of Foreign Assets Control (OFAC) sanctions and ensuring compliance with those sanctions

Expected SEC Rule Making in 2024

The SEC currently has an ambitious rule making agenda. With respect to investment advisers and private funds, the SEC is expected to consider the following rule amendments in 2024, either to adopt new rules or amendments to existing rules, or to propose new rules or amendments.

Take-Aways

- The proposed amendments to the SEC's custody rule (Advisers Act rule 206(4)-2) appear especially problematic for private equity real estate funds.

Rules that have been proposed by the SEC and awaiting final action

- **Safeguarding Advisory Client Assets** – Amendments to existing rules and new rules to improve and modernize the regulations around the custody of client funds and investments by investment advisers. Proposed March 9, 2023. Expected Final Action: April 2024.
- **Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices** – Amended rules that would require, among others, registered investment advisers and certain advisers exempt from registration to provide to investors additional information regarding their ESG investment practices. Proposed June 17, 2022. Expected Final Action: April 2024.
- **Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies** – New rules that would require, among others, registered investment advisers to adopt and implement written cybersecurity policies and procedures reasonably designed to address cybersecurity risks, as well as to report to the SEC significant cybersecurity incidents. Proposed March 9, 2022. Expected Final Action: April 2024.
- **Form PF; Reporting Requirements for All Filers and Large Hedge Fund Advisers** (Joint Rule with the CFTC) - Amendments to Form PF would require additional reporting by large SEC-registered investment advisers. Proposed September 1, 2022. Expected Final Action: April 2024.
- **Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers** – Proposed new rules that are intended to eliminate, or neutralize the effect of, certain conflicts of interest associated with broker-dealers' and investment advisers' interactions with investors through the firms' use of technologies that optimize, predict, guide, forecast or direct investment-related behaviors or outcomes. Proposed August 9, 2023. Expected Final Action: April 2024.
- **Outsourcing by Investment Advisers** – New rules would, among other things, prohibit a registered investment adviser from outsourcing certain services or functions without first meeting minimum requirements. Proposed November 16, 2022. Expected Final Action: April 2024.

Expected SEC Rule Making in 2024 (continued)

Rules that have been proposed by the SEC and awaiting final action (continued)

- **Regulation S-P: Privacy of Consumer Financial Information and Safeguarding Customer Information** – Amendments to Regulation S-P, which would require registered investment advisers, among others, to adopt written policies and procedures for incident response programs to address unauthorized access to or use of customer information, and to broaden the scope of information covered by the regulations. Proposed April 6, 2023. Expected Final Action: April 2024.
- **Exemption for Certain Investment Advisers Operating through the Internet** – Amendments to the current exemption from registration to modernize the rule to account for the evolution of technology. Proposed August 1, 2023. Expected Final Action: April 2024.

Rule under Consideration by the SEC which has not been proposed

- **Regulation D and Form D Improvements** – Proposed amendments to regulation D, including updates to the definition of an accredited investor.

Annual and Periodic SEC Reporting Requirements

For SEC-Registered Investment Advisers

- **Annual Updating Amendment to Form ADV (all parts)** – Deadline (for advisers with a fiscal year end of December 31, 2023) March 30, 2024.
- **Deliver to clients Form ADV, Parts 2A and 2B** – Deadline (for advisers with a fiscal year end of December 31, 2023) April 29, 2024.

Take-Aways

- You should consider whether changes in your assets under management or in your business generally require you to change your status and register with the SEC, de-register with the SEC, and/or register with a state securities regulator.
- The CCO's annual evaluation of your firm's compliance policies and procedures is now required to be in writing.

- **Update and Deliver (if necessary) Part 3 (Form CRS)** - must be amended within 30 days of any material change, and it must be sent to retail clients within 60 days. *We recommend reviewing and updating as necessary in conjunction with the update of Form ADV.*
- **State Notice Filings** – State notice filings typically require payment of a notice fee concurrently with the notice filing. If you previously filed in a state, that state likely will notify you of the required renewal fees. Fees are paid through the IARD. *Massachusetts required notice filing renewals to be paid by December 11, 2023.*
- **State Registration of Investment Adviser Representatives** – You may be required to register one or more of your employees with a state securities regulator. The requirement to register an individual may vary from year to year. *You are encouraged to review individual activity each year in each state to determine whether to register such person for that year. Massachusetts required investment adviser representative registration renewals to be paid by December 11, 2023.*
- **Code of Ethics** – “Access persons” are required to submit annual holdings reports annually. *“Access persons” also have quarterly reporting obligations.*
- **Annual Review of Compliance Policies and Procedures** – Effective November 13, 2023, a CCO must at least annually review the adviser’s compliance policies and procedures, document the review in writing, and require employees to certify quarterly or annually that they have complied with the policies and procedures.
- **Custody of Client Assets** – Where an investment adviser has custody of client assets, it generally must have engaged an independent public accountant to conduct a surprise examination of the assets. Alternatively, if the client is a private fund, the investment adviser is not required to have surprise examinations if it provides investments with audited financial statements of the fund within 120 days of the fund’s fiscal year end (or 180 days in the case of a fund of funds) that meet certain standards. Compliance with these requirements must be reflected in the investment advisers Form ADV.

Annual and Periodic SEC Reporting Requirements (continued)

For Exempt Reporting Advisers

- **Annual Updating Amendment to Form ADV, Part 1** – Deadline (for advisers with a fiscal year end of December 31, 2023) March 30, 2024. *Exempt reporting advisers are not required to complete each item of Form ADV, Part 1. Investment advisers filing notices with the SEC also may have a requirement to register with one or more states as an investment adviser or as a state-exempt reporting adviser. Finally, Massachusetts required ERA filing renewals to be paid by December 11, 2023.*

For Massachusetts Registered Investment Advisers and Investment Adviser Representatives

- **Annual Updating Registration of Investment Adviser** – The Massachusetts Securities Division sent notice in mid-November 2023 of your obligation to renew your registration by December 11, 2023. Filing fees are paid through the IARD. *An investment adviser ceasing operations before January 1, 2024 was required to file Form ADV-W no later than December 26, 2023.*
- **State Registration of Investment Adviser Representatives** – The Massachusetts Securities Division sent notice in mid-November 2023 of your obligation to renew your investment adviser representatives' registration by December 11, 2023. Filing fees are paid through the IARD.

Other Common Reporting Requirements

Other U.S. laws and regulations require annual government reporting or certifications to counterparties to permit the counterparties to comply with applicable law. Some of the most common with respect to investment advisers and private funds are the following:

- **Form D** – A private fund that has filed a Form D relating to an initial offer and sale of fund interests in reliance on rule 506 must file an amendment annually if the offer is continuing.
- **Rule 506(d) “Bad Actor” certifications** – A private fund relying on rule 506 must determine whether “Bad Actor” disqualification applies. If the offering is “continuous or long-lived” (which would include most hedge funds and continuously offered private equity funds), the fund must update its factual findings. *Rule 506 does not state how frequently an issuer, such as a fund, would have to update its factual findings. In our experience, many hedge funds update them annually.*
- **New Issue Certifications** – FINRA rule 5130 and 5131 require members to obtain from private funds representations that they are eligible to participate in new issues. To make that representation, a private fund must receive from each investor a certification that the investor is an exempted person, a restricted person or a covered person.
- **CFTC Annual Affirmations** – CFTC rules require any person claiming an exemption from the requirement to register as a commodity pool operator (CPO) under CFTC rule 4.13(a)(1), (2), (3) or (5), or an exclusion from CPO registration under CFTC rule 4.5, or an exemption from commodity trading advisor (CPO) registration obligation under 4.14(a)(8) must annually affirm the applicable notice within 60 days from the end of the prior calendar year (i.e., February 29, 2024). *No annual affirmation with respect to a pool is required of a registered CPO that has filed a 4.7 exemption for that pool.*
- **Form PF** – Private fund reporting by registered investment advisers and registered commodity pool operators, annually within 120 calendar days after the end of the fourth quarter (i.e., for calendar year 2023, April 29, 2024). *Large hedge fund advisers and large liquidity fund advisers file quarterly (i.e., for quarter ended December 31, 2023, and the first three calendars of 2024, February 29, 2024, April 29, 2024, August 29, 2024, and November 29, 2024, respectively).*
- **Form 13F** – Institutional investment adviser reporting when the adviser exercises investment discretion over accounts holding Securities Exchange Act section 13(f) securities with an aggregate market value of at least \$100 million on the last trading day of any month of any year, and then 45 calendar days after the end of a calendar quarter (i.e., for calendar year ended December 31, 2023, February 14, 2024, May 15, 2024, August 14, 2024, and November 14, 2024).

Other Common Reporting Requirements (continued)

- **Form 13H** – Large trader report (for calendar year 2023, February 14, 2024).
- **Form N-PX** - Institutional investment adviser reporting when the adviser votes “say-on-pay” proxies (for the period July 1, 2023 through June 30, 2024, August 31, 2024).
- **Privacy Policy Notices** – Regulation S-P requires investment advisers to provide annually to customers (e.g., private fund investors who are natural persons) notice of the adviser’s privacy policies and procedures. *No annual privacy notice is required if (a) the adviser only shares nonpublic personal information with third parties in a manner that does not trigger an opt-out right and (b) the adviser has not changed its privacy policies from those previously disclosed to the customer.*



Other Considerations

1. **Corporate Transparency Act (CTA)** – requires many types of business entities to disclose their beneficial owners to FinCEN. SEC-registered investment advisers and venture capital advisers are exempt from this disclosure, as are private funds relying on section 3(c)(1) or section 3(c)(7) that are included in their adviser’s Form ADV, Part 1, Item 7. However, private fund advisers, state registered advisers and non-registered commodity pools are among those not exempt. Effective January 1, 2024. Compliance date December 31, 2024.

Take-Aways

- The CTA is in effect for entities created on or after January 1, 2024, and reporting is generally required within 90 days.
- The FTC’s safeguard rule amendments are comparable to proposed SEC rule amendments to Regulation S-P, which is applicable to SEC-registered investment advisers and discussed above.

2. **Amendment of the Federal Trade Commission’s Safeguard Rule** – which amends the FTC rules for safeguarding consumer financial information, requires notification to the FTC of certain security breaches. Effective June 9, 2023. Compliance date May 13, 2024. *This rule applies to exempt reporting advisers and state registered advisers. It does not apply to SEC-registered investment advisers, which are covered by SEC Regulation S-P.*
3. **European Long-Term Investment Fund (ELTIF) 2.0** – recent amendments to this form fund, which now permits investment managers to offer certain hedge fund and private equity funds strategies in an investment fund offered with an EEA passport to retail investors. Effective date January 10, 2024. *We discuss in a magazine article the ELTIF 2.0 in the context of U.S. liquid alternative funds – the interval fund and the tender-offer fund. [A link to that article is available here.](#)*
4. **CFTC Proposed Guidance on Voluntary Carbon Credit Derivatives** – In December 2023, the CFTC published guidance outlining how designated contract markets (i.e., derivative exchanges) may list voluntary carbon credit derivative contracts.
5. **U.S. Department of Labor proposed amendments to the Prohibited Transaction exemption (PTE 2020-02) as well as new regulations on “investment advice” provided in connection with IRA rollovers** – each proposal would if enacted impose additional documentation and recordkeeping.

For Additional Information

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