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Regulatory Developments and Annual Compliance Obligations Applicable to Private Fund Sponsors

By David Wohl

Over the course of the last year, there have been a number of regulatory developments affecting private funds and their investment advisers that private equity sponsors should be aware of. We would also like to remind our private equity clients of important upcoming regulatory filings and compliance obligations in 2021.[1]

REGULATORY DEVELOPMENTS

New Advisers Act Marketing Rule

In December 2020, the SEC substantially amended its rules under the Investment Advisers Act of 1940 (Advisers Act) governing advertisements by registered investment advisers and compensation paid to solicitors by such advisers.[2] The amendments create a single rule (the marketing rule) that replaces the current advertising and cash solicitation rules, Rule 206(4)-1 and Rule 206(4)-3, respectively. The SEC also made related revisions to Form ADV and Rule 204-2, the books and records rule.[3] The amendments will consolidate SEC staff positions from no-action letters and other guidance in a single rule and will replace the broadly drawn limitations in the current rules with more principle-based requirements.

New Marketing Rule - Amendments to Rule 206(4)-1

Definition of Advertisement. The amended definition of "advertisement" in the marketing rule contains two parts: one that covers communications currently covered by the advertising rule and another that governs solicitation activities previously covered by the cash solicitation rule.

1. The first part of the definition includes any direct or indirect communication an investment adviser makes that: (i) offers the 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. This part of the definition generally excludes one-on-one communications to private fund investors.[4]

2. The second part of the definition generally includes any endorsement[5] or testimonial[6] for which an adviser provides cash or non-cash compensation directly or indirectly. This part of the definition effectively governs activities covered by the current cash solicitation rule and applies to communications made by placement agents and other solicitors of private fund investors.

Note that an advertisement (including an endorsement or testimonial) can be written, digital or verbal.

General Prohibitions. The marketing rule prohibits certain practices and replaces elements of the current advertising rule, such as the prohibition on testimonials and profitable past recommendations. To establish a violation of the marketing rule, the SEC does not need to demonstrate that an investment adviser acted with scienter; negligence is sufficient. The new prohibited practices are:

- making an 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;[7]
- 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;
- 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 information that is otherwise materially misleading.

Testimonials and Endorsements. The current advertising rule prohibits the use of testimonials. The new marketing rule permits testimonials and endorsements in an advertisement, subject to the adviser satisfying certain disclosure, oversight and disqualification provisions:

- **Disclosure**. Advertisements must clearly and prominently disclose whether the person giving the testimonial or endorsement (the promoter) is a current client or investor and whether the promoter is compensated. Additional disclosures are required regarding compensation and conflicts of interest. There are exceptions from the disclosure requirements for SEC-registered broker-dealers under certain circumstances. The new rule eliminates the current rule's requirement that the adviser obtain from each investor acknowledgements of receipt of the disclosures.
- **Oversight and Written Agreement**. An adviser that uses testimonials or endorsements in an advertisement must have a reasonable basis for believing that the testimonial or endorsement complies with the marketing rule. An adviser also must enter into a written agreement with a promoter that describes the scope of its activities and the terms of any compensation, except where the promoter is an affiliate of the adviser or the promoter receives *de minimis* compensation (*i.e.*, $1,000 or less, or the equivalent value in non-cash compensation, during the preceding twelve months).
- **Disqualification**. The rule prohibits certain "bad actors" from acting as promoters.

These requirements will apply to private fund placement agent arrangements and will require advisers to police the conduct of placement agents to seek to ensure that solicitation activities comply with the marketing rule.

Third-Party Ratings. The new rule prohibits the use of third-party ratings in an advertisement, unless the adviser provides disclosures and satisfies certain criteria pertaining to the preparation of the rating.

Performance Information. The new rule prohibits including in any advertisement:

- gross performance, unless the advertisement also presents net performance with equal prominence using the same time periods and calculation methodology;[8]
- any performance results for accounts other than private funds, unless they are provided for one-, five- and ten-year periods (if applicable);
- 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 as those being offered in the advertisement, unless the advertised performance results are not materially higher than if all related portfolios had been included;
- 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 (which includes target or projected returns), unless the adviser adopts and implements policies and procedures reasonably designed to ensure that the 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,[9] unless (i) the persons who were primarily responsible for achieving the prior performance results manage accounts at the advertising adviser, (ii) the accounts managed at the predecessor adviser are sufficiently similar to the accounts managed at the advertising adviser that the performance results would provide relevant information to clients and investors and (iii) all accounts that were managed in a substantially similar manner are advertised unless the exclusion of any such account would not result in materially higher performance. In addition, the advertising adviser must include all relevant disclosures clearly and prominently in the advertisement.

Amendments to Books and Records Rule and Form ADV

In connection with the marketing rule amendments and merger of the current advertising and cash solicitation rules, the SEC amended Rule 204-2 to conform recordkeeping requirements to the new provisions.

In addition, the SEC amended Item 5 of Part 1 of Form ADV to require advisers to provide additional information regarding their marketing practices to help facilitate the SEC's inspection and enforcement capabilities. An adviser will be required to state whether:

- any of its advertisements include performance results, a reference to specific investment advice, testimonials, endorsements or third-party ratings;
- it pays or otherwise provides cash or non-cash compensation, directly or indirectly, in connection with the use of testimonials, endorsements, or third-party ratings (this question will only require 'yes' or 'no' responses, and will not require additional information); and
- any of its advertisements include hypothetical performance and predecessor performance.

Effective and Compliance Dates

The new marketing rule, amended books and records rule and related Form ADV amendments will become effective 60 days after publication in the Federal Register. However, in order to give advisers time to prepare for the requirements imposed by the new rules, the compliance date will be **18 months following the effective date**. Any advertisements disseminated on or after the compliance date by advisers registered or required to be registered with the SEC would be subject to the new marketing rule. The compliance date for the amended recordkeeping rule will also provide an eighteen-month transition date from the effective date of the rule. Advisers filing Form ADV after a similar eighteen-month transition period from the effective date of the rule will be required to complete the amended form.

Amendment of "Accredited Investor" Definition

The SEC amended the definition of "accredited investor" in Regulation D under the Securities Act of 1933 (Regulation D) to add new categories of qualifying natural persons and entities and to make certain other modifications to the existing definition.[10] The amendments are intended to update and improve the definition in order to identify more effectively institutional and individual investors that have the knowledge and expertise to participate in private securities offerings. The amendments broaden the number of potential investors eligible to participate in a Regulation D offering by a private fund[11] or other issuer.

Knowledgeable Employees of Private Funds – "Knowledgeable employees" of a private fund now qualify as accredited investors for purposes of investing in that fund.[12] The SEC stated that such employees, through their knowledge of and active participation in the investment activities of the private fund, are likely to be financially sophisticated and capable of fending for themselves in evaluating investments in such private funds.

Professional Certifications and Designations and Other Credentials – The SEC added a new category for natural persons to qualify as accredited investors based on certain professional certifications and designations or other credentials that the SEC by order finds demonstrate an individual's background and understanding in the areas of securities and investing even if such persons do not meet the current financial thresholds in the accredited investor definition.[13] The SEC initially ordered that individuals holding the following certifications or designations are deemed accredited investors: (i) FINRA-licensed general securities representative (Series 7); (ii) FINRA-licensed investment adviser representative (Series 65); and (iii) FINRA-licensed private securities offerings representative (Series 82). The SEC will consider other categories of certifications or designations as eligible for accredited investor status based on public comment and market developments.

Adding Categories of Entities that Qualify as Accredited Investors - The former accredited investor definition included specific categories of entities, and any entity not covered by one of the enumerated categories was not an accredited investor under the rule. The SEC noted that this resulted in uncertainty for legal entities of a type similar, but not identical, to those listed entities. Therefore, the following categories of entities have been added to the definition: (i) registered investment advisers; (ii) limited liability companies with total assets in excess of $5 million that were not formed for the specific purpose of acquiring the securities being offered; (iii) any entity owning investments in excess of $5 million that is not formed for the specific purpose of acquiring the securities being offered; and (iv) "family offices" with at least $5 million in assets under management whose investments are directed by sophisticated individuals and "family clients" of such family offices, each as defined in Rule 202(a)(11)(G)-1 under the Advisers Act.

Permitting Spousal Equivalents to Pool Finances for Purposes of Qualifying as Accredited Investors – To provide certainty, the amendments allow natural persons to include joint income and assets from spousal equivalents when calculating joint income and net worth under the Individual Financial Tests. The amendments define spousal equivalent as a cohabitant occupying a relationship generally equivalent to that of a spouse.

CFTC Adopts "Bad Actor" Disqualification for *De Minimis* Commodity Pool Operator Exemption

On June 4, 2020, the Commodity Futures Trading Commission (CFTC) amended CFTC Regulation 4.13 for exemption from commodity pool operator (CPO) registration to require a person claiming such exemption (including the so-called *de minimis* exemption under Regulation 4.13(a)(3)) to represent that neither it nor any of its "principals" are subject to any of the statutory disqualifications listed in Section 8a(2) of the Commodity Exchange Act (CEA).

The representation applies to the CPO and its principals. Under relevant CFTC regulations, a principal of a CPO is generally limited to those individuals and entities who have either management authority and responsibilities or significant power derived from stock ownership or capital contributions and generally includes managing members, company presidents, corporate executives, chief compliance officers, and any person who is a 10% or more shareholder of the CPO.

A person initially claiming a CPO exemption pursuant to CFTC Regulation 4.13 on or after September 8, 2020 must make the representation at the time of filing such claim. For a CPO currently relying on an exemption, the first representation must be made in its next annual reaffirmation notice for the exemption (*i.e.,* by March 1, 2021).

Section 8a(2) Disqualifications

1. A prior registration of such person in any capacity with the CFTC has been suspended (and the period of such suspension has not expired) or has been revoked.

2. Registration of such person in any capacity with the CFTC has been refused under the provisions of Section 8a(3) of the CEA within five years preceding the filing of the application for registration or at any time thereafter.

3. Such person is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction including an order entered pursuant to an agreement of settlement to which the CFTC or any Federal or State agency or other governmental body is a party, from (i) acting as a futures commission merchant, introducing broker, floor broker, floor trader, commodity trading advisor, commodity pool operator, associated person of any registrant with the CFTC, securities broker, securities dealer, municipal securities broker, municipal securities dealer, transfer agent, clearing agency, securities information processor, investment adviser, investment company, or affiliated person or employee of any of the foregoing or (ii) engaging in or continuing any activity where such activity involves embezzlement, theft, extortion, fraud, fraudulent conversion, misappropriation of funds, securities or property, forgery, counterfeiting, false pretenses, bribery, gambling, or any transaction in or advice concerning contracts of sale of a commodity for future delivery, concerning matters subject to CFTC regulation under Section 4c or 19 of the CEA, or concerning securities.

4. Such person has been convicted within ten years preceding the filing or at any time thereafter of any felony that (i) involves any transactions or advice concerning any contract of sale of a commodity for future delivery, or any activity subject to CFTC regulation under Section 4c or 19 of the CEA, or concerning a security, (ii) arises out of the conduct of the business of a futures commission merchant, introducing broker, floor broker, floor trader, commodity trading advisor, commodity pool operator, associated person of any registrant under the CEA, securities broker, securities dealer, municipal securities broker, municipal securities dealer, transfer agent, clearing agency, securities information processor, investment adviser, investment company, or an affiliated person or employee of any of the foregoing, (iii) involves embezzlement, theft, extortion, fraud, fraudulent conversion, misappropriation of funds, securities or property, forgery, counterfeiting, false pretenses, bribery, or gambling, or (iv) involves the violation of Section 152, 1001, 1341, 1342, 1343, 1503, 1623, 1961, 1962, 1963, or 2314, or chapter 25, 47, 95, or 96 of Title 18 of the U.S. Code, or Section 7201 or 7206 of the Internal Revenue Code of 1986.

5. Such person, within ten years preceding the filing or at any time thereafter, has been found in a proceeding brought by the CFTC or any Federal or State agency or other governmental body, or by agreement of settlement to which the CFTC or any Federal or State agency or other governmental body is a party, (i) to have violated any provision of the CEA, the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, the Investment Advisers Act of 1940, the Investment Company Act of 1940, the Securities Investors Protection Act of 1970, the Foreign Corrupt Practices Act of 1977, chapter 96 of Title 18 of the U.S. Code, or any similar statute of a State or foreign jurisdiction, or any rule, regulation, or order under any such statutes, or the rules of the Municipal Securities Rulemaking Board where such violation involves embezzlement, theft, extortion, fraud, fraudulent conversion, misappropriation of funds, securities or property, forgery, counterfeiting, false pretenses, bribery, or gambling, or (ii) to have willfully aided, abetted, counseled, commanded, induced, or procured such violation by any other person.

6. Such person is subject to an outstanding order of the CFTC denying privileges on any registered entity to such person, denying, suspending, or revoking such person’s membership in any registered entity or registered futures association, or barring or suspending such person from being associated with a registrant under the CEA or with a member of a registered entity or with a member of a registered futures association.

7. As to any of the matters set forth in Section 8a(2) and Section 8a(3) of the CEA, such person willfully made any materially false or misleading statement or omitted to state any material fact in such person’s application for registration with the CFTC or any update thereto.

COMPLIANCE OBLIGATIONS FOR PRIVATE EQUITY FUND ADVISERS[14]

Form ADV
(Annual Amendment due by March 31, 2021)

Investment advisers that are registered with the SEC under the Advisers Act, and advisers filing as exempt reporting advisers with the SEC, must file an annual amendment to Form ADV within 90 days of the end of their fiscal year (*i.e.*, by March 31, 2021 for advisers with a fiscal year-end of December 31).[15]

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

Form PF
(Annual Filing due by April 30, 2021)

Registered investment advisers to private equity funds with more than $150 million of assets under management attributable to those funds (as of the last day of their most recent fiscal year) are required to file Form PF with the SEC within 120 days after such adviser's fiscal year-end (*i.e.*, by April 30, 2021 for advisers with a fiscal year-end of December 31).[16] Form PF requires disclosure of the adviser's assets under management and information on each private fund it advises.

CFTC Filings
(Annual Affirmation of De Minimis and Commodity Trading Advisor Exemptions due by March 1, 2021)

Many private equity fund sponsors are able to rely on the exemption from registration with the National Futures Association (NFA) that is available under Commodity Futures Trading Commission (CFTC) Rule 4.13(a)(3) (the *de minimis* exemption) and have claimed such exemption.[17] The *de minimis* exemption is subject to an annual affirmation which must be completed within 60 days after the end of each calendar year. Failure to affirm the exemption is deemed a withdrawal of the exemption once the 60 day period has elapsed. As noted above, starting this year the annual affirmation must include a representation that neither the sponsor nor any of its "principals" are subject to certain statutory disqualifications. Private fund sponsors that do not qualify for the *de minimis* exemption may be subject to registration with the NFA as commodity pool operators and commodity trading advisors.

In addition, many fund managers rely on the "solely incidental" exemption from registering as a commodity trading advisor pursuant to CFTC Rule 4.14(a)(8). An annual affirmation of this exemption is also required to be filed within 60 days after the end of each calendar year.

Cayman Islands Private Funds Act

All private funds registered under the Cayman Islands Private Funds Act must (i) pay an annual registration fee of CI$3,500 (US$4,268) by January 15 of each year and (ii)(A) have their accounts audited annually by a Cayman Islands-based auditor approved by the Cayman Islands Monetary Authority (the Authority) and (B) submit its audited accounts, along with the Fund Annual Return, to the Authority within six months of the end of each fiscal year.

Custody Rule

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

Annual Review of Compliance Policies and Procedures

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

Review of Offering Materials

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

Accordingly, it may be an appropriate time for an investment adviser to review its offering materials (including investor newsletters and pitch books) and confirm whether any updates or amendments are necessary. In particular, an investment adviser should take into account the impact of recent market conditions on its funds and review its current disclosure regarding: investment objectives and strategies; valuation practices; performance and related disclaimers; any mention of specific investments to confirm that there are no "cherry picking" issues; conflicts of interests; risk factors; personnel; service providers; "bad actor" disclosures; and any relevant legal or regulatory developments. In light of the SEC's continuing focus on the allocation of private fund fees and expenses and conflicts of interest, advisers must take special care in reviewing their practices and disclosure in these areas.

Certain Filings Required Under the Securities Exchange Act of 1934

Form 13F

The Securities Exchange Act of 1934 requires investment advisers (whether or not registered) to submit a report on Schedule 13F to the SEC, within 45 days after the last day of any calendar year and within 45 days after the last day of each of the next three calendar quarters following such calendar year, if on the last day of any month of such calendar year the investment adviser exercised discretion with respect to accounts holding Section 13(f) securities (generally, publicly traded securities) having an aggregate fair market value of at least $100 million. Note that the SEC has proposed, but not yet adopted, an amendment increasing this threshold to $3.5 billion.

Form 13H

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

Privacy Policy Notice

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

Form D and Blue Sky Filings

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

Bad Actor Rules

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

State Lobbyist Registrations

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

Annual VCOC/Plan Assets Certifications

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

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

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

TIC Reporting

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

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

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

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

Form BE-13

The BEA requires a U.S. entity, including a private fund domiciled in the U.S., to make a filing on Form BE-13 if a non-U.S. person acquires ownership of 10% or more of its voting securities and the cost of acquiring such securities is more than $3 million.[18] The BEA generally does not consider limited partner interests or non-managing member limited liability company interests to be voting securities, so most U.S. funds with foreign investors would not have to file. However, general partner/managing member interests generally are considered voting securities for purposes of Form BE-13. Therefore, a fund domiciled in the U.S. that has a general partner domiciled outside the U.S. generally would be required to file. In addition, if a non-U.S. fund owns 10% or more of the voting securities of a U.S.-domiciled portfolio company, the portfolio company generally would have to file. Reports are required to be filed within 45 days of a reportable transaction. After an initial BE-13 filing is made, the BEA requires quarterly, annual, and five-year benchmark filings. A U.S. person must file a Form BE-13 for a reportable transaction even if not directly requested to do so by the BEA.

European Union Regulation of the Private Equity Industry

The Directive on Alternative Investment Fund Managers (AIFM Directive) has now been implemented into the national laws of all key European Economic Area (EEA) member states and the United Kingdom (UK). Managers bringing funds to the market in the EEA and/or the UK have to comply with the AIFM Directive and its varied implementation across the EEA and the UK. The AIFM Directive subjects EEA and UK private fund sponsors and private fund sponsors using EEA and UK fund vehicles to certain operational and organizational requirements.

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

others the process can be completed in a matter of days or weeks. In addition, fund managers will be required to carry out a short form compliance process to ensure they are ready to meet the European reporting requirements. We are currently assisting a significant number of U.S.-based and global private fund managers in making applications to EEA/UK regulators for approval under the AIFM Directive's private placement regimes in a variety of EEA jurisdictions and the UK.

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

The UK left the European Union (EU) and the EEA on January 31, 2020 under the terms of a withdrawal agreement (which established an implementation period within which aspects of EU law would continue to apply in the UK until December 31, 2020). While the terms of the withdrawal agreement did not include a deal regarding the trade of goods and services between the UK and the EU, the UK reached a separate agreement with the EU regarding such matters on December 24, 2020. Nonetheless, the Brexit deal is limited for financial services and therefore the future application of EU-based legislation to the private fund industry in the UK and the EU will ultimately depend on how the UK renegotiates its financial services relationship with the EU.

ENDNOTES

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

[2] Exempt reporting advisers are not subject to the new rules.

[3] The adopting release can be found here.

[4] Importantly, the first prong of the definition does not include: (i) extemporaneous, live, oral communications; (ii) any information contained in a statutory or regulatory notice, filing, or other required communication, provided that such information is reasonably designed to satisfy the requirements of such notice, filing, or other required communication; or (iii) a communication that includes hypothetical performance that is provided: (A) in response to an unsolicited request for such information from a prospective or current client or investor in a private fund advised by the investment adviser; or (B) to a prospective or current investor in a private fund advised by the investment adviser in a one-on-one communication. Note that unsolicited hypothetical performance given in a one-on-one presentation to a current or prospective client other than a fund investor would be considered an advertisement. "Hypothetical performance" is generally defined as performance results that were not actually achieved by any portfolio of the investment adviser and includes, but is not limited to: (i) performance derived from model portfolios; (ii) performance that is backtested by the application of a strategy to data from prior time periods when the strategy was not actually used during those time periods; and (iii) targeted or projected performance returns with respect to any portfolio or to the investment advisory services with regard to securities offered in the advertisement.

[5] The marketing rule defines "endorsement" as any statement by a person other than a current client or investor in a private fund advised by the investment adviser that: (i) indicates approval, support, or recommendation of the investment adviser or its supervised persons or describes that person's experience with the investment adviser or its supervised persons; (ii) directly or indirectly solicits any current or prospective client or investor to be a client of, or an investor in a private fund advised by, the investment adviser; or (iii) refers any current or prospective client or investor to be a client of, or an investor in a private fund advised by, the investment adviser.

[6] The marketing rule defines "testimonial" as any statement by a current client or investor in a private fund advised by the investment adviser: (i) about the client or investor's experience with the investment adviser or its supervised persons; (ii) that directly or indirectly solicits any current or prospective client or investor to be a client of, or an investor in a private fund advised by, the investment adviser; or (iii) that refers any current or prospective client or investor to be a client of, or an investor in a private fund advised by, the investment adviser.

[7] This requirement in particular will likely lead to an increased recordkeeping burden since it will require advisers to maintain documentary proof for each material factual assertion made in an advertisement.

[8] The SEC's proposed marketing rule would have allowed advisers to omit net performance if the advertisement was given only to non-retail investors. However, this distinction between retail and non-retail investors was not included in the final rule, and therefore net performance generally must be included in all advertisements (but note that one-on-one communications to private fund investors are not considered advertisements under the rule).

[9] The marketing rule defines "predecessor performance" as investment performance achieved by a group of investments consisting of an account or a private fund that was not advised at all times during the period shown by the investment adviser advertising the performance.

[10] The release adopting the amendments can be found here.

[11] Note, however, that a private fund offering generally would still have to comply with the investor eligibility requirements of Section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940 (Investment Company Act).

[12] Rule 3c-5 under the Investment Company Act generally defines a "knowledgeable employee" with respect to a private fund as: (i) an executive officer, director, trustee, general partner, advisory board member, or person serving in a similar capacity, of the private fund or an affiliated management person (as defined in Rule 3c-5(a)(1)) of the private fund; and (ii) an employee of the private fund or an affiliated management person of the private fund (other than an employee performing solely clerical, secretarial or administrative functions with regard to such company or its investments) who, in connection with his or her regular functions or duties, participates in the investment activities of such private fund, other private funds, or investment companies the investment activities of which are managed by such affiliated management person of the private fund, provided that such employee has been performing such functions and duties for or on behalf of the private fund or the affiliated management person of the private fund, or substantially similar functions or duties for or on behalf of another company for at least 12 months.

[13] The current thresholds are (i) individuals who have a net worth exceeding $1 million (excluding the value of the individual's primary residence), either alone or with their spouses and (ii) individuals who had an income in excess of $200,000 in each of the two most recent years, or joint income with the individual's spouse in excess of $300,000 in each of those years, and have a reasonable expectation of reaching the same income level in the current year (the Individual Financial Tests).

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

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

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

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

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

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Authors

David Wohl (NY) View Bio david.wohl@weil.com +1 212 310 8933

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