

CATHOLIC UNIVERSITY, COLUMBUS SCHOOL OF LAW – SECURITIES REGULATION

Developments in the Regulation of Financial Products

Hedge Funds and Private Equity Funds

October 4, 2024

These materials (1) do not constitute legal advice; (2) do not form the basis for the creation of the attorney/client relationship; and (3) should not be relied upon without seeking specific legal advice with respect to the particular facts and current state of the law applicable to any situation requiring legal advice. These materials may only be reproduced with the prior written consent of Kirkland & Ellis. These materials are provided with the understanding that the individual presenters and Kirkland & Ellis are not rendering legal, accounting, or other professional advice or opinions on specific facts or matters, and, accordingly, such entities assume no liability whatsoever in connection with their use. Pursuant to applicable rules of professional conduct, this material may constitute Attorney Advertising. Prior results do not guarantee a similar outcome.
© 2024 Kirkland & Ellis LLP. All rights reserved.

Legislative, Rulemaking and Other Regulatory Developments

Legislative, Rulemaking and Other Regulatory Developments

Private Fund Adviser Rules

▶ Private Fund Adviser Rules – Fifth Circuit Decision

- On June 5, 2024, the U.S. Court of Appeals for the Fifth Circuit struck down the private fund adviser rules adopted by the SEC (the “Rules”), voiding them in their entirety. The SEC did not appeal the Fifth Circuit ruling within applicable deadlines so the ruling stands and advisers do not need to comply with the Rules.
 - ▶ The Fifth Circuit found the SEC lacked statutory authority to adopt the Rules. The SEC had justified the rulemaking based on authority granted to it pursuant to Dodd-Frank Act-related and anti-fraud provisions in the Advisers Act, but the Fifth Circuit concluded the Dodd-Frank Act provisions were inapplicable because they applied to “retail customers” only and the SEC had failed to demonstrate a connection between the preventing fraud and the rulemaking.
 - ▶ The Rules were expected to have a broad impact on private fund adviser practices and increase regulatory burdens on advisers covered by the rules. In particular, the Rules were going to: (i) prohibit advisers from granting preferential treatment to certain investors absent disclosure; (ii) restrict advisers from taking certain actions, particularly with respect to fees and expenses, absent disclosure; (iii) require advisers to provide detailed quarterly disclosures to investors related to compensation, fees and expenses; (iv) require advisers to obtain annual audits of all of their private funds; (v) require advisers to obtain fairness opinions and make certain disclosures in connection with adviser-led secondary transactions; (vi) require advisers to document in writing annual compliance reviews (we continue to recommend as a best practice); and (vii) update books and records requirements.

Legislative, Rulemaking and Other Regulatory Developments

Private Fund Adviser Rules

► Potential Next Steps for the SEC with Respect to the Private Fund Adviser Rules

- *Examination / Enforcement.* Advisers should expect continued focus on areas that are the subject of the vacated Rules (e.g., based on SEC's view of an adviser's fiduciary duty) during examinations and should expect the SEC to look to bring enforcement cases that bolster the need for all or some of the rules on Advisers Act Section 206 (anti-fraud) grounds
- *Legislative Action / Rulemaking.* While the SEC could pursue legislative action or repropose some portion of the Rules, we view these as longer-term options for the SEC. In particular, given the impact political climate generally has on the likelihood of such initiatives being successful, we would expect, at a minimum, the SEC to await the outcome of the 2024 general election before taking formal action. Furthermore, given the Fifth Circuit's ruling, we expect the SEC may first focus on building a stronger evidentiary record to support its position that rulemaking on these issues is necessary

► Market Reaction

- We expect pro-LP industry trade groups and institutional LPs to continue pushing GPs to provide additional disclosures related to fees and expenses and conflicts and either to refrain from taking certain actions altogether to provide LPs/LPACs affirmative or negative approval rights on more issues

Legislative, Rulemaking and Other Regulatory Developments

Private Fund Adviser Rules

► Market Reaction (continued)

— Recent ILPA Initiatives

► Quarterly Reporting Standards Initiative (QRSI)

- Initiative updating reporting template and launching new performance template (drafts on ILPA's website); templates require much of the reporting that the now vacated Private Fund Adviser Rules were going to require
- Comment period (August 6 - October 11); Recommended implementation date not yet determined but likely to be Q4 2025 or Q1 2026; Implementation to be limited to certain vintage year funds and would be effected through side letters or voluntary sponsor compliance

► NAV Loan Guidance (July 25, 2024) pushes for more transparency and increased role of LPs / LPAC in approving facilities

- Recommends GPs seek LPAC consent: prior to NAV loan implementation when LPA is silent; for use related to distributions; and to resolve conflicts related to such loans
- Recommends LPAs be updated to include provisions establishing clear expectations
- Encourages LPs to discuss NAV facility usage with GPs to understand whether older fund documents have been interpreted to exclude facilities at the SPV/master holding company from fund-level leverage provisions including borrowing limitations
- Recommends GPs provide standardized disclosure to all LPs

Legislative, Rulemaking and Other Regulatory Developments

Other Recent Litigation

► *Loper Bright Enterprises and Relentless v. Raimondo* (“*Loper Bright*”)

- In June 2024, the U.S. Supreme Court overruled its long-standing “Chevron Deference” doctrine, adopted in 1984 and requiring significant judicial deference to federal agency rulemaking. The Court’s decision built significantly on prior cases from the last decade aimed at curbing perceived Executive Branch overreach by administrative agencies

- Holding in *Loper Bright Enterprises and Relentless v. Raimondo*

“Chevron is overruled. Courts must exercise their independent judgment in deciding whether an agency has acted within its statutory authority, as the [Administrative Procedure Act] requires. Careful attention to the judgment of the Executive Branch may help inform that inquiry. And when a particular statute delegates authority to an agency consistent with constitutional limits, courts must respect the delegation, while ensuring the agency acts within it. But courts need not and under the APA may not defer to an agency interpretation of the law simply because a statute is ambiguous.”

- Recap of Prior Chevron Deference Doctrine

“When a court reviews an agency’s construction of the statute which it administers . . . [if] the court determines Congress has not directly addressed the precise question at issue, **the court does not simply impose its own construction on the statute**, as would be necessary in the absence of an administrative interpretation.”

“Rather, **if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency’s answer is based on a permissible construction of the statute.**” *Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 842–43 (1984)

Legislative, Rulemaking and Other Regulatory Developments

Other Recent Litigation

► ***Loper Bright* (continued)**

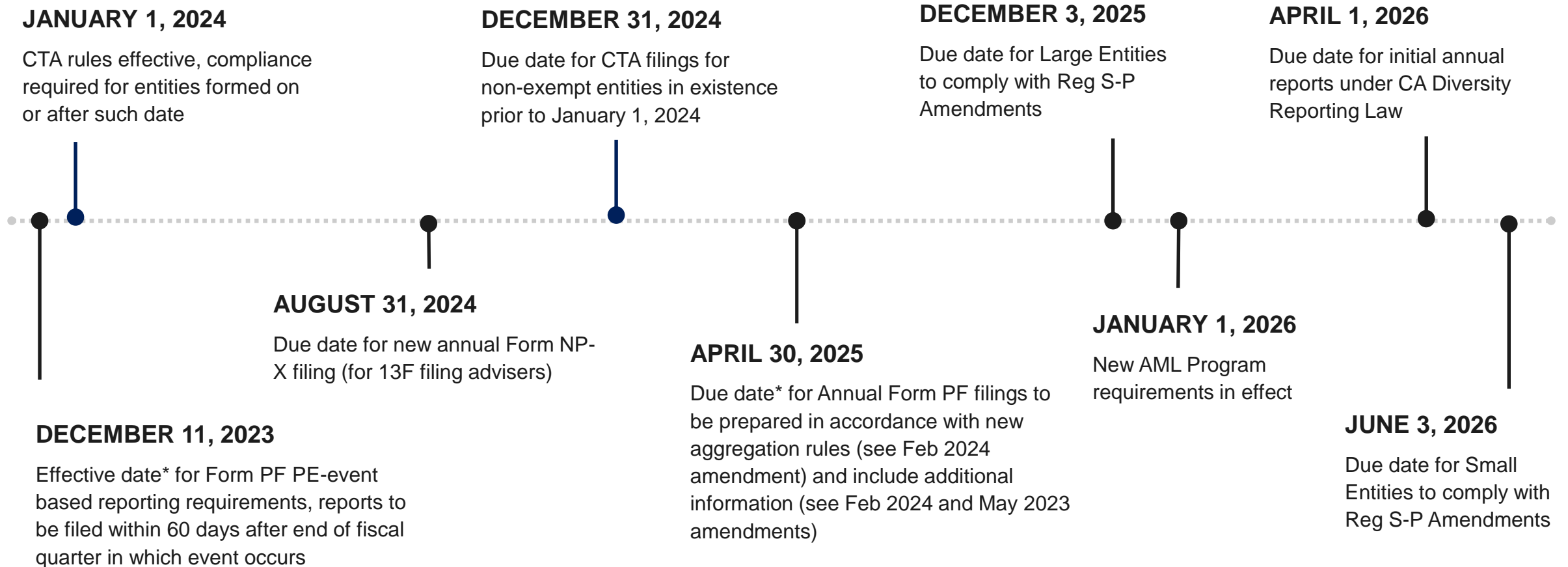
- The decision marks a significant shift in how federal courts generally approach challenges to agency rules that will affect a number of areas of law moving forward, absent a clear grant of authority by Congress to the agency
 - Prior cases that relied on *Chevron* remain good law
 - Existing rules remain in effect absent a court ruling or agency action, and many agency actions will not be impacted to the extent they turn on fact-finding within the scope of the agency's authority rather than questions of statutory interpretation
- While the decision might lead to further challenges to certain agency rules that have not been previously challenged, the decision attempts to limit opportunities for a second bite at the apple for rules that have already survived judicial review
- The decision may lead to more regulatory uncertainty given the potential for increased litigation and circuit splits

► ***Corner Post v. Board of Governors of the Federal Reserve System***

- The Court held that the Administrative Procedure Act's 6-year statute of limitations begins to run when the plaintiff is injured by a final agency action, which potentially opens the gates for challenges to old regulations (e.g., entity formed in the last six years may be able to challenge an older rule). Any such challenges would be subject to the *Loper Bright* review standard

Legislative, Rulemaking and Other Regulatory Developments

Other Regulatory Updates – Key Compliance Dates for Private Fund Sponsors for Newly Adopted Rules



* The Form PF compliance dates referenced above are for PE annual filers. Quarterly filers (e.g., large hedge fund filers) are required to comply with aspects of these rules on earlier timeframes

Legislative, Rulemaking and Other Regulatory Developments

Other Regulatory Updates – Form PF Amendments

Form PF Amendments – 2023 and 2024 Overview

Overview of May 2023 Amendments	These amendments added certain event-based reporting requirements, as well as broadened information that must be reported in connection with routine filings
Overview of February 2024 Amendments*	These amendments are in addition to the amendments adopted in May 2023 (see below) and change private fund aggregation rules and requirements regarding information to be reported in certain categories of Form PF
Effective / Compliance Dates for PE Fund Advisers**	<p><u>PE Event-Based Reporting.</u> Reporting due within 60 days after the end of the adviser's fiscal quarter in which the event occurred (Rule became effective December 11, 2023)</p> <p><u>New Aggregation Rules.</u> For annual filers with a December fiscal year end, the annual filing due to be filed in April 2025 (Rule becomes effective March 12, 2025)</p> <p><u>Updated Information Requirements.</u> For annual filers with a December fiscal year end, the annual filing due to be filed in April 2025 (May 2023 Amendments effective June 11, 2024; Feb. 2024 Amendments effective March 12, 2025)</p>
Action Required	Sponsors should begin preparing for these changes, including determining whether they need to amend Form ADV to add entities in order to be able to complete Form PF in accordance with these new aggregation rules

*Amendments jointly adopted by CFTC and apply to CFTC-registered commodity pool operators and commodity trading advisers.

**The effective / compliance dates listed are for PE Fund Adviser annual filers. Please note the effective / compliance dates for certain aspects of the February 2024 and March 2023 amendments differ, including based on filer type. Due to the differing compliance dates, quarterly filers will need to address form changes across multiple reporting cycles. In addition, large hedge fund advisers and large liquidity fund advisers are now required to update Form PF within 60 days after the end of each calendar quarter, rather than after each fiscal quarter. However, they are not required to transition to this new timing requirement until the first calendar quarter-end filing for the first full quarterly reporting period after the compliance date so the transition will not require a filer to file its quarterly report more than once in a single calendar quarter

Legislative, Rulemaking and Other Regulatory Developments

Other Regulatory Updates – Form PF Amendments

Form PF New Aggregation Instructions (Compliance Date: Filing due April 2025 for PE Fund Adviser with December fiscal year end filing annually; Rule Reference: Feb. 2024 Amendment)			
Form Responses	Master-Feeder Fund Structures	Parallel Fund Structures	Parallel Managed Accounts
Calculating Reporting Threshold	Aggregation required	Aggregation required	Aggregation required for dependent parallel managed accounts (aggregates to largest private fund to which it relates)
Responding to Form PF Questions for Individual Funds	<p>Separately report for each private fund in “master-feeder arrangements” except a “disregarded feeder fund,” which is a feeder fund that invests all of its assets in: (1) a single master fund; (2) U.S. Treasury bills; and/or (3) cash and cash equivalents</p> <p>Master fund separately identifies whether each of its feeders is disregarded and includes information about a disregarded feeder fund’s investors in certain answers</p> <p>Feeder fund reporting separately disregards its holdings in master fund’s equity for purposes of determining its reporting category to avoid double-counting assets</p>	Separately report for each private fund in a “parallel fund structure”	Do not report information for “parallel managed accounts” except in Question 16

Legislative, Rulemaking and Other Regulatory Developments

Other Regulatory Updates – Form PF Amendments

Form PF New PE Event-Based Reporting Requirements

(Compliance Date: Within 60 days after end of fiscal quarter in which event occurs; Rule Reference: May 2023 Amendment)

Trigger*	Reporting Details
Adviser-Led Secondary Transactions	<p>Reporting required upon the closing of any transaction initiated by the adviser or its related persons that offers investors a choice to either: (i) sell interests in the private fund or (ii) convert or exchange interests in the fund for interests in another vehicle advised by the adviser or its related persons</p> <ul style="list-style-type: none">• Excludes transactions where adviser or its related persons, at the unsolicited request of an investor, participate in the secondary sale of an investor's fund interest• Excludes transactions where investors do not receive an option to sell their interests (e.g., pure cross-fund transactions)• Reporting must include the adviser-led secondary transaction closing date and a brief description of the transaction
GP Removal, Elective Termination of Investment Period or Elective Termination of a Private Fund	<p>Reporting required if investors take formal action to remove the adviser as GP, elect to terminate the private fund's investment period or elect to terminate the private fund</p> <ul style="list-style-type: none">• Reporting must include the effective date and description of the removal or termination event

*GP and LP clawback obligations also trigger reporting on Form PF, but information about any such obligations would be included in a PE advisor's annual filing (i.e., does not trigger an other-than-annual filing) so information GP and LP clawback obligation reporting is covered in a later slide

Legislative, Rulemaking and Other Regulatory Developments

Other Regulatory Updates – Form PF Amendments

2023 and 2024 Form PF Amendments New, Expanded and / or Modified Information Requirements		Compliance Dates / Rule References
Fund Profile	Identify the fund type/strategy (e.g., PE fund), and indicate whether it is an “open-end private fund” or “closed-end private fund”	April 2025 Annual Filing Feb. 2024 Amendment
Fund Profile (New)	Each private fund’s investment strategy by percentage of deployed capital	April 2025 Annual Filing May 2023 Amendment
AUM	For purposes of reporting AUM attributable to certain private funds, exclude the value of private funds’ investments in other internal private funds to avoid double counting of assets	April 2025 Annual Filing Feb. 2024 Amendment
Unfunded Commitments	Report separately the unfunded commitment values currently included in a fund’s net and gross asset values	April 2025 Annual Filing Feb. 2024 Amendment
Inflows and Outflows	<p>Report all new capital contributions (since the prior report) from investors and exclude contributions of committed capital that were already included in the reporting fund’s gross asset value, and report investor withdrawals, redemptions or other distributions</p> <ul style="list-style-type: none">• Therefore, to the extent an adviser has already reported an investor’s capital commitment to a fund in the fund’s gross asset value, the adviser would not have to report any additional information when the investor contributes capital pursuant to that commitment	April 2025 Annual Filing Feb. 2024 Amendment
Base Currency	Identify the base currency of all reporting funds	April 2025 Annual Filing Feb. 2024 Amendment

Legislative, Rulemaking and Other Regulatory Developments

Other Regulatory Updates – Form PF Amendments

2023 and 2024 Form PF Amendments New, Expanded and / or Modified Information Requirements		Compliance Dates / Rule References
Fund-Level Borrowings (New)	Fund-level borrowings, including: (i) the value of the private fund's borrowings and types of creditors (e.g., U.S. financial institutions, non-U.S. financial institutions, U.S. non-financial institutions and non-U.S. non-financial institutions); and (ii) borrowings made by the private fund as an alternative or complement to financing of portfolio companies, and the dollar values of the types of such borrowings (e.g., based on the type of collateral)	April 2025 Annual Filing May 2023 Amendment
Fund Creditors	In addition to the value of the reporting fund's borrowings and types of creditors, indicate whether a creditor is based in the U.S. and whether it is a U.S. depository institution (rather than a U.S. financial institution as currently required)	April 2025 Annual Filing Feb. 2024 Amendment
PortCo Creditors	Provide additional counterparty identifying information for institutions providing bridge financing to controlled portfolio companies (e.g., LEI (if any) and if the counterparty is affiliated with a major financial institution, the name of the financial institution) Identify	April 2025 Annual Filing May 2023 Amendment
Events of Default	Expand detail required to be reported regarding events of default, including the type of default (e.g., payment default by a private fund or its controlled portfolio company, or failure to uphold terms of a borrowing agreement unrelated to non-payment)	April 2025 Annual Filing May 2023 Amendment
Geographical Exposure	Identify each private fund's greatest country exposures based on a percentage of net asset value (reflects a change from current reporting based on a static group of regions and countries)	April 2025 Annual Filing May 2023 Amendment

Legislative, Rulemaking and Other Regulatory Developments

Other Regulatory Updates – Form PF Amendments

2023 and 2024 Form PF Amendments New, Expanded and / or Modified Information Requirements		Compliance Dates / Rule References
Fair Values	Indicate the date on which assets were categorized by fair value (e.g., prior year or current as of the date of report), and separately report cash and cash equivalents (which excludes digital assets)	April 2025 Annual Filing Feb. 2024 Amendment
Fund Investor Information	Report more granular information about beneficial ownership, including: (1) whether beneficial owners that are broker-dealers, insurance companies, nonprofit organizations, pension plans, banking or thrift institutions are U.S. persons or non-U.S. persons, (2) whether beneficial owners that are private funds are either internal private funds or external private funds; (3) a description of any investors included in the “other” category and why such investors would not qualify for any of the other categories	April 2025 Annual Filing Feb. 2024 Amendment
Fund Performance	Report fund performance: <ul style="list-style-type: none">• As a money-weighted IRR if the fund performance is reported as an IRR since inception (this is consistent with most RIAs’ IRR reporting for private illiquid funds)• Using the reporting fund’s base currency• Consistent with performance provided to investors, counterparties or otherwise (or the most representative set of performance if the adviser reports different fund performance results to different groups, with an explanation of its selection)• With an indication of whether the reported IRR includes or does not include the impact of subscription facilities (does not prescribe an approach)	April 2025 Annual Filing Feb. 2024 Amendment

Legislative, Rulemaking and Other Regulatory Developments

Other Regulatory Updates – Form PF Amendments

2023 and 2024 Form PF Amendments New, Expanded and / or Modified Information Requirements		Compliance Dates / Rule References
GP or LP Clawbacks (New)	<p>Annual reporting required for any GP or LP clawback, including the effective date of, and a brief description of the reason for, the clawback</p> <ul style="list-style-type: none">• “GP clawback” means an obligation of the GP or its related persons to return performance-based compensation to a private fund, as required by the private fund’s governing documents<ul style="list-style-type: none">— Triggered at the time the GP becomes obligated to return the excess of the amount it was ultimately entitled to receive under the private fund’s governing documents, regardless of when such compensation is actually returned, which typically is upon the final liquidation of the private fund, but, depending on the governing documents, may be required on an interim basis• “LP clawback” means an obligation of a private fund’s investors to return a distribution made by the private fund to satisfy a liability, obligation or expense of the private fund, as required by the private fund’s governing documents, that is in excess of 10% of a private fund’s aggregate capital commitments<ul style="list-style-type: none">— Triggered the first year and each subsequent year the first LP clawback and subsequent LP clawbacks, in aggregate, exceed the 10% threshold	April 2025 Annual Filing May 2023 Amendment

Legislative, Rulemaking and Other Regulatory Developments

Other Regulatory Updates – Regulation S-P Amendments

Regulation S-P Amendments (Adopted on May 16, 2024)

Overview of Material Changes	Expands Regulation S-P's existing requirements for covered institutions (which includes RIAs) by (i) broadening the scope of information covered by the safeguards and disposal rules; (ii) requiring them to adopt incident response programs that include procedures for providing timely notice to impacted persons; and (iii) creating additional recordkeeping requirements that align with the expanded rule
Compliance Date	<p>Compliance date depends on whether covered institution is a "Larger Entity"</p> <p>December 3, 2025 for Larger Entities, which are:</p> <ul style="list-style-type: none">• RIAs with \$1.5 billion or more in AUM• BDs and transfer agents that are not small entities under the Securities Exchange Act for purposes of the Regulatory Flexibility Act• Investment companies together with other investment companies in the same group of related investment companies (see 17 CFR 270.0-10 for "group of related investment companies" definition) with net assets of \$1 billion or more as of the end of the most recent fiscal year <p>June 3, 2026 for all other covered institutions</p>
Action Required	PE sponsors will need to amend privacy and customer safeguarding policies and practices prior to the applicable compliance effective date of December 3, 2025 (for Larger Entities) and June 3, 2026 (for all other entities)

Legislative, Rulemaking and Other Regulatory Developments

Other Regulatory Updates – Regulation S-P Amendments

Key Terms	Definitions as Amended	Rule References
Consumer	An individual who obtains or has obtained a financial product or service from the entity that is to be used primarily for personal, family, or household purposes, or that individual's legal representative	Disposal Rule and Related Records
Consumer Information	A record in any form about an individual that is a consumer report (as defined in the FCRA) or is derived from a consumer report, or a compilation of such records that a covered institution maintains or otherwise possesses for a business purpose regardless of whether such information pertains to: (a) individuals with whom the covered institution has a customer relationship, or (b) to the customers of other financial institutions where such information has been provided to the covered institution (Regulation S-P used to refer to this as “consumer report information”)	Disposal Rule and Related Records
Customer	<p>A consumer who has a customer relationship (i.e., a continuing relationship between a consumer and the entity under which the entity provides one or more financial products or services to the consumer that are to be used primarily for personal, family, or household purposes) with the entity</p> <ul style="list-style-type: none">• Includes fund limited partners and investment company shareholders	Privacy Notice Delivery
Customer Information	A record in any form containing nonpublic personal information as defined in § 248.3(t) about a customer of a financial institution that is in the possession of a covered institution or that is handled or maintained by the covered institution or on its behalf regardless of whether such information pertains to: (a) individuals with whom the covered institution has a customer relationship, or (b) to the customers of other financial institutions where such information has been provided to the covered institution (there's a separate definition for transfer agents)	<p>Safeguarding Rule (including Incident Response Program) and Related Records</p> <p>Disposal Rule and Related Records</p>
Sensitive Customer information	Any component of customer information alone or in conjunction with any other information, the compromise of which could create a reasonably likely risk of substantial harm or inconvenience to an individual identified with the information	Incident Notices and Related Records

Legislative, Rulemaking and Other Regulatory Developments

Other Regulatory Updates – Regulation S-P Amendments

► Regulation S-P Amendments (Adopted on May 16, 2024)

— New Incident Notice Requirement

- Notify impacted customers as soon as practicable, but within 30 days of becoming aware that unauthorized access to or use of such customers' sensitive customer information has occurred or is reasonably likely to have occurred
 - Notices must include details about the incident, the breached data, and how affected individuals can respond to the breach to protect themselves
 - An RIA is not required to provide the notification if it determines that the sensitive customer information has not been, and is not reasonably likely to be, used in a manner that would result in substantial harm or inconvenience

— New Incident Response Program Requirements

- Adopt an incident response program reasonably designed to detect, respond to and recover from unauthorized access to or use of customer information, and maintain records documenting compliance
- Include procedures to assess the nature and scope of any such incident and to take appropriate steps to contain and control such incidents to prevent further unauthorized access or use
- Include the establishment, maintenance, and enforcement of written policies and procedures reasonably designed to require oversight, including through due diligence and monitoring, of service providers

Legislative, Rulemaking and Other Regulatory Developments

Other Regulatory Updates – Regulation S-P Amendments

► Regulation S-P Amendments (Adopted on May 16, 2024)

— Broadened Scope and Recordkeeping Requirements

- Broadens the scope of information covered under the safeguards and disposal rules to cover **both** (i) nonpublic personal information an RIA collects about its own customers and (ii) nonpublic personal information it receives from another financial institution about that institution's customers
- Creates new "customer information" definition and modifies "consumer information" definition
 - The disposal rule had applied only to consumer information (previously referred to as consumer report information) and now applies to consumer information and customer information
 - The safeguards rule had applied to customer records and information, which had not been defined, and now applies to customer information
- Requires RIAs to make and maintain written records documenting compliance with the requirements of the safeguards rule and disposal rule

— Privacy Notice Delivery Requirements

- Conforms annual privacy notice delivery provisions to the terms of an exception provided by the 2015 FAST Act (i.e., an annual notice does not have to be delivered if nonpublic personal information is provided to nonaffiliated third parties only in certain specified circumstances and the entity has not changed its disclosure policies and procedures since the most recent privacy notice was delivered)

Legislative, Rulemaking and Other Regulatory Developments

Other Regulatory Updates – AML

FinCEN: Anti-Money Laundering/Countering the Financing of Terrorism Program and Suspicious Activity Report Filing Requirements for RIAs and ERAs (adopted August 28, 2024)

Overview of New Rule	<p>Financial Crimes Enforcement Network (FinCEN), a bureau of the U.S. Department of Treasury, adopted a long-anticipated rule that designates most RIAs and ERAs as “financial institutions”* under the Bank Secrecy Act (BSA) and requires them to, among other things, adopt anti-money laundering / countering the financing of terrorism (AFL / CFT) programs</p> <ul style="list-style-type: none">• Bringing certain advisers within the scope of the BSA’s “financial institutions” definition was one of the necessary first steps to the SEC and FinCEN proceeding with a proposal to require certain advisers to implement customer identification programs (see later discussion regarding that rule proposal)• FinCEN designated examination authority to the SEC
Compliance Date	January 1, 2026
Action Required	<p>The Rule’s practical impact on many clients’ day-to-day operations may be limited</p> <ul style="list-style-type: none">• Under the Rule, a private fund adviser’s clients are its funds, not the investors in its funds• Many clients have already adopted and implemented AML programs that address all or large portions of the Rule’s substantive requirements; however, AML Programs should be reviewed and modified as necessary before the effective date

*Private funds have been covered as “financial institutions” since AML requirements were imposed by the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA Patriot Act)

Legislative, Rulemaking and Other Regulatory Developments

Other Regulatory Updates – AML

FinCEN: Anti-Money Laundering/Countering the Financing of Terrorism Program and Suspicious Activity Report Filing Requirements for RIAs and ERAs (adopted August 28, 2024)

Advisers Within Scope (i.e., Financial Institutions)	Advisers Outside Scope of AML Rule
<ol style="list-style-type: none">1. SEC RIAs, unless within an exception2. SEC ERAs, unless within an exception	<ol style="list-style-type: none">1. SEC-Registered Mid-Sized Advisers (between \$25 million and \$100 million in RAUM)2. SEC-Registered Pension Consultants3. SEC-Registered Multi-State Advisers (advisers that would otherwise have to register in more than 15 states)4. SEC-Registered Advisers that do not report any AUM on Form ADV (must be an RIA, not an ERA)5. Foreign-Located Advisers (depending on location of business and clients). Foreign-located RIAs and ERAs are only required to comply with the Rule in connection with that portion of their business that (i) takes place within the United States, including through the involvement of any of its U.S. personnel; or (ii) provides advisory services to U.S. persons or to non-U.S. private funds with U.S. investors6. Certain Sub-Advisers. An SEC-registered adviser does not have to comply with the Rule when it provides sub-advisory services to another SEC-registered adviser (the “primary adviser”) pursuant to a direct contractual relationship and not to an underlying client of the primary adviser7. State-registered investment advisers8. Family Offices9. Foreign Private Advisers

Legislative, Rulemaking and Other Regulatory Developments

Other Regulatory Updates – AML

- ▶ **FinCEN: Anti-Money Laundering/Countering the Financing of Terrorism Program and Suspicious Activity Report Filing Requirements for RIAs and ERAs (adopted August 28, 2024)**
 - **Client Relationships Covered by the Rule**
 - ▶ A private fund adviser's clients are its funds
 - ▶ Advisers do not need to apply their programs to clients that are mutual funds, collective investment funds, and other investment advisers so long as such clients are advised by an adviser that must comply with the Rule
 - **Reporting and Information Sharing Requirements**
 - ▶ *Suspicious Activity Reports (SAR)*. RIAs must file an SAR in connection with suspicious transactions of at least \$5,000 conducted or attempted by, at, or through the RIA
 - ▶ *Information Sharing*. RIAs must also receive and share (in response to FinCEN requests) certain AML information with government agencies, banks, and other financial institutions
 - ▶ *Currency Transaction Reports (CTRs) and Recordkeeping and Travel Rules*. RIAs must create and retain records for certain transmittals of funds exceeding \$3,000 and ensure that certain information accompanies the transmission to the next financial institution in the payment chain, subject to certain exceptions, and must report transactions in currency over \$10,000

Legislative, Rulemaking and Other Regulatory Developments

Other Regulatory Updates – AML

► **FinCEN: Anti-Money Laundering/Countering the Financing of Terrorism Program and Suspicious Activity Report Filing Requirements for RIAs and ERAs (adopted August 28, 2024)**

— **General AML / CFT Program Requirements**

- Adopt and implement a risk-based AML / CFT program that, at a minimum: (1) establishes and implements internal policies, procedures and controls reasonably designed to prevent the adviser from being used for money laundering, terrorist financing, and other illicit finance activities and to achieve compliance with applicable BSA provisions; (2) provides for independent testing for compliance by the adviser's personnel or a qualified third party; (3) designates one or more persons responsible for implementing and monitoring the operations and controls of the program; (4) provides for ongoing training for appropriate persons; and (5) implements appropriate risk-based procedures for conducting ongoing customer due diligence, to include, but not be limited to understanding the nature and purpose of customer relationships for the purpose of developing customer risk profiles and conducting ongoing monitoring to identify and report suspicious transactions and maintain applicable records
 - The release suggests a private fund adviser, as part of determining its risk profile, consider its funds' minimum subscription amounts, restrictions on types of investors, restrictions on redemptions or withdrawals, and the types of currency transactions conducted with investors
- An RIA does not have to apply its AML / CFT Program to its non-advisory services (e.g., an RIA's personnel making managerial / operational decisions about portfolio company activities would not be "advisory activities") and should be able to satisfy reporting requirements with respect to a portfolio company through information it already has (e.g., as a result of its investment due diligence)
- Dual-registrants and advisers that are banks or affiliates of banks do not need to adopt separate AML/CFT programs so long as a comprehensive AML/CFT program covers all of their relevant activities

Legislative, Rulemaking and Other Regulatory Developments

Other Regulatory Updates – Proxy Voting

Proxy Voting Rule Amendments (Adopted November 2, 2002; Effective Date July 1, 2024)

Overview of New Rule	<p>The SEC adopted new rules related to proxy voting reporting requiring all Form 13(f) filers (large institutional managers with \$100M or more in Form 13(f) public securities) to file an annual Form N-PX (previously had applied only to registered funds)</p> <p><u>Filing Details</u></p> <ul style="list-style-type: none">• Disclose how voted on public company “say-on-pay,” “say-on-frequency,” and golden parachutes proposals• Required disclosures include numbers of shares voted, how voted on the proposal, a check box if have a policy of not voting and did not vote, and any shares loaned out and not recalled for voting• Joint filings with other advisers to avoid duplicative reporting permissible to the extent permitted under the rule and deemed appropriate by the CCO, and in such event make such additional required disclosures to allow identification of the adviser’s full voting record
Compliance Dates	<ul style="list-style-type: none">• Form N-PX for shareholder meeting votes during the period July 1, 2023 through June 30, 2024 was due August 31, 2024• For shareholder meeting vote during each subsequent annual period ended June 30, the filing is due by August 31<ul style="list-style-type: none">— 13F filers that filed in 2024, but not 2023, are not required to file until 2025
Action Required	<p>Advisors should confirm they have updated their proxy voting policies and procedures to reflect these new s</p>

Legislative, Rulemaking and Other Regulatory Developments

Status of SEC Proposed Rules		
Topic	Description	Relevant Dates
AML	<i>Customer Identification Programs for Registered Investment Advisers and Exempt Reporting Advisers (S7-2024-02)</i> : Proposed new rules implementing section 326 of the Patriot Act of 2001 with regard to certain investment advisers would require, among other things, investment advisers to implement reasonable procedures to verify the identities of their customers	Proposed: May 13, 2024 Comments Due: July 22, 2024
Predictive Data Analytics	<i>Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers (S7-12-23)</i> : Proposed new rules would address certain conflicts of interest associated with investment advisers' or broker-dealers' use of predictive data analytics in investor Interactions	Proposed: July 26, 2023 Comments Due: Oct. 10, 2023
Custody	<i>Safeguarding Advisory Client Assets (S7-04-03)</i> : Proposed rule changes would significantly amend and redesignate Rule 206(4)-2 under the Advisers Act and make related recordkeeping and reporting changes to address how investment advisers safeguard client assets	Proposed: Feb. 15, 2023 Comments Due: May 8, 2023 Comment Period Re-Opened: Aug. 23, 2023 Comments Due: Oct. 30, 2023 Proposed Transition Period: One Year, or for advisers with AUM \$1B or less, 18 months
Adviser Outsourcing	<i>Outsourcing by Investment Advisers (S7-25-22)</i> : A new rule would require SEC-registered advisers to undertake due diligence assessments before engaging service providers for certain core advisory-related services and functions and to periodically monitor the service provider's performance and reassess the appropriateness of the outsourcing arrangement. Related books and records requirements include a provision specifically addressing the retention of outsourced recordkeepers	Proposed: Oct. 26, 2022 Comments Due: Dec. 27, 2022 Proposed Transition Period: 10 months

Legislative, Rulemaking and Other Regulatory Developments

Status of SEC Proposed Rules

Topic	Description	Relevant Dates
ESG Investment Practices	<i>Enhanced Disclosures by Certain Investment Advisers and Investment Companies About Environmental, Social, and Governance Investment Practices (S7-17-22)</i> : SEC-registered advisers and ERAs would be required to include new narrative disclosures in brochures and census-like information in Part 1-A of their Form ADVs regarding ESG factors the adviser considers in implementing its investment strategies, with separate ESG reporting for each private fund the adviser is required to identify in Part 1A	Proposed: May 25, 2022 Comments Due: Aug. 16, 2022 Comment Period Re-Opened: Oct. 7, 2022 Comments Due: Nov. 1, 2022 Proposed Transition Period: One Year
Cybersecurity	<i>Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies (S7-03-22)</i> ; Proposed rule would require registered investment advisers and investment companies to adopt and implement written cybersecurity policies and procedures reasonably designed to address cybersecurity risks, disclose information about cybersecurity risks and incidents, report information confidentially to the SEC about certain cybersecurity incidents, and maintain related records	Proposed: Feb. 9, 2022 Comments Due: April 11, 2022 Comment Period Re-Opened: Mar. 15, 2023 Comments Due: May 22, 2023

Legislative, Rulemaking and Other Regulatory Developments

SEC Proposed Rules

► **Proposed Customer Identification Program Rule (proposed May 2024)**

- The SEC and the U.S. Department of the Treasury’s Financial Crimes Enforcement Network (FinCEN) jointly proposed a new rule to require RIAs and ERAs to implement a customer identification program (CIP) as part of their AML programs
 - This rulemaking is part of a broader overhaul of the U.S. AML regime that now includes the Corporate Transparency Act and the new FinCEN rule, adopted in August 2024, designating RIAs and ERAs as “financial institutions” under the Bank Secrecy Act and subjecting them to AML/CFT program requirements, as well as obligations to file suspicious activity reports
- The proposed rule would require RIAs and ERAs to, among other things:
 - Conduct identity verification of each customer that seeks to open an account to the extent reasonable and practicable;
 - Provide notice to clients of identification requests (e.g., by posting a notice on its website or in account applications);
 - Maintain records of substantiating information used to conduct each customer verification, including names, addresses, etc.; and
 - Screen against certain Treasury-designated lists of blocked persons (e.g., the OFAC “SDN List”)
- Under the proposal, the private fund is the customer, not the individual investors in the private fund

Legislative, Rulemaking and Other Regulatory Developments

SEC Proposed Rules

► Proposed Predictive Data Analytics Rule (proposed July 2023)

- The proposal generally would apply to a firm's use of a covered technology to the extent it is used in connection with the firm's engagement or communication with an investor, including by exercising discretion with respect to an investor's account, providing information to an investor, or soliciting an investor
- Under the proposal, a firm would be required to:
 - Eliminate or neutralize the effect of conflicts of interest associated with the firm's use of covered technologies in investor interactions that place the firm's or its associated person's interest ahead of investors' interests;
 - If it has any investor interaction using covered technology, have written policies and procedures reasonably designed to prevent violations of (in the case of RIAs) or achieve compliance with (in the case of BDs) the proposed rules; and
 - Maintain recordkeeping related to the proposed conflicts rules
 - Covered technology means an analytical, technological, or computational function, algorithm, model, correlation matrix, or similar method or process that optimizes for, predicts, guides, forecasts, or directs investment-related behaviors or outcomes

Legislative, Rulemaking and Other Regulatory Developments

SEC Proposed Rules

► Proposed Amendments to Custody Rule (proposed February 2023)

- The proposed amendments would redesignate the current Custody Rule (Rule 206(4)-2) as new Rule 223-1 under the Advisers Act (the “Safeguarding Rule”)
- The proposed amendments would expand the scope of certain requirements and add additional protections:
 - Expand the scope of the current Custody Rule beyond client funds and securities to include any client assets of which an adviser has custody
 - “Assets” would mean “funds, securities, or other positions held in a client’s account” and would include all other assets that investment advisers custody for their clients
 - Explicitly include an adviser’s discretionary authority to trade client assets within the definition of custody

Legislative, Rulemaking and Other Regulatory Developments

SEC Proposed Rules

► **Proposed Amendments to Custody Rule (proposed February 2023) (continued)**

- Require that an adviser enter into a written agreement with and obtain certain reasonable assurances from qualified custodians to ensure clients receive certain standard custodial protections when an adviser has custody of their assets
- Modify the current Custody Rule's exception from the obligation to maintain client assets with a qualified custodian for certain privately offered securities, including expanding the exception to include certain physical assets
- Retain the current Custody Rule's requirement for an adviser to undergo a surprise examination by an independent public accountant to verify client assets, but expand the availability of the current Custody Rule's Audit Provision as a means of satisfying the surprise examination requirement
- Amend the books and records rule to require advisers to keep additional, more detailed records of trade and transaction activity and position information for each client account of which it has custody
- Amend Form ADV to align advisers' reporting obligations with the proposed Safeguarding Rule's requirements and to improve the accuracy of custody-related data

Legislative, Rulemaking and Other Regulatory Developments

SEC Proposed Rules

► **Proposed Adviser Oversight Rule (proposed October 2022)**

- The Proposed Adviser Oversight Rule would prohibit RIAs from outsourcing certain services and functions (“Covered Functions”) without first meeting minimum requirements (see next page)
 - Covered Functions means: (1) a function or service that is necessary for the adviser to provide its investment advisory services in compliance with the Federal securities laws and (2) if not performed or performed negligently, would be reasonably likely to cause a material negative impact on the adviser’s clients or on the adviser’s ability to provide investment advisory services
 - Clerical, ministerial, utility, or general office functions or services are explicitly excluded from the definition of Covered Functions
 - Service provider is a person (other than a supervised person) or entity that performs one of more Covered Functions
 - The proposed rule makes no distinction between affiliated and unaffiliated service providers; both are covered under the proposed rule
- The proposal also requires RIAs to:
 - Retain certain records documenting the periodic monitoring of service providers
 - Conduct due diligence and monitoring of third-party recordkeepers and to obtain reasonable assurances that the recordkeeper will be able to meet certain standards in connection with its recordkeeping services
 - Disclose certain census-like information about the Covered Functions and outsourced service providers on Form ADV

Legislative, Rulemaking and Other Regulatory Developments

SEC Proposed Rules

► **Proposed Adviser Oversight Rule (proposed October 2022) (continued)**

— Proposal's Diligence and Monitoring Requirements

- The proposal would require RIAs to reasonably identify and determine through due diligence that outsourcing the Covered Function to that service provider would be appropriate by considering:
 - The nature and scope of the covered function;
 - Potential risks resulting from the service provider performing the covered function, including how to mitigate and manage such risks;
 - The service provider's competence, capacity, and resources necessary to perform the covered function;
 - The service provider's material subcontracting arrangements related to the covered function;
 - Coordination with the service provider for Federal securities law compliance; and
 - The orderly termination of the performance of the covered function
- The proposal also requires RIAs periodically to monitor the service provider's performance and reassess the appropriateness of the outsourcing arrangement

Legislative, Rulemaking and Other Regulatory Developments

SEC Proposed Rules

► **Proposed ESG Rules for Investment Advisers (proposed May 2022)**

- The SEC proposed ESG rules with the stated objective of promoting consistent, comparable, and reliable information for investors and clients on ESG investment practices
 - According to the SEC, the enhanced disclosures will allow clients and investors to better compare ESG strategies across managers and better protect themselves from “greenwashing” practices
 - The proposed rules take a comparatively lighter touch for advisers to private funds and separately managed accounts than corresponding ESG rule proposals for registered investment companies and BDCs
- Compliance Program Updates. SEC intends to require RIAs’ compliance programs to address the accuracy of ESG disclosures and to ensure portfolio management processes are consistent with disclosures
- Form ADV Disclosure. RIAs would be required to specifically address ESG practices in Form ADV Part 1A and Part 2A
 - SEC does not define “E,” “S” or “G” in the proposed rule, and, absent further guidance, RIAs will be tasked with assessing and potentially disclosing a panoply of factors regardless of whether they are actively marketing ESG strategies
 - For example, an RIA that considers flood plain or hurricane data in making a real estate investment may be required to disclose these as environmental factors it uses in selecting its investments

Legislative, Rulemaking and Other Regulatory Developments

SEC Proposed Rules

► Proposed ESG Rules for Investment Advisers (proposed May 2022) (continued)

— Form ADV Disclosure (continued)

- Form ADV Part 2A. For each strategy for which an RIA considers any ESG factor, a description of each ESG factor it considers and how it incorporates those factors in the advice it provides to clients (including private funds) would need to be disclosed
 - For each strategy or method of analysis, an RIA must include an explanation of whether the strategy is one of three SEC-defined strategies: (1) ESG-integration – i.e., ESG factors no more significant than other non-ESG factors; (2) ESG-focused – i.e., ESG factor is significant or main consideration; or (3) ESG-impact – i.e., a subset of a focused strategy designed to achieve a specific ESG impact
 - ESG impact strategies would require additional disclosure, including how an adviser measures its progress in meeting ESG goals, such as the key performance indicators and time horizons the adviser uses in its analysis
 - An RIA must also describe any criteria or methodology used to evaluate, select or exclude investments and how it uses these criteria or methodologies
 - Disclosure must also address the adviser's utilization of any internal or third-party methodologies or frameworks, scoring or rating providers, inclusionary or exclusionary screens or ESG indexes
 - Advisers also would be required to describe any securities voting policies and procedures that include ESG considerations, and any material arrangement with a related-person ESG consultant or ESG service provider
- Form ADV Part 1A. An adviser would have to identify whether it uses an ESG-integration, -focused, or -impact strategy in providing services to its private fund or SMA clients and which factors it considers (E, S and/or G)

Legislative, Rulemaking and Other Regulatory Developments

SEC Proposed Rules

► **Proposed Cybersecurity Rule (proposed February 2022)**

- SEC proposed Cybersecurity Rule would require RIAs to:
 - Adopt and implement written policies and procedures that are reasonably designed to address cybersecurity risks for the RIA and its funds
 - Confidentially report significant cybersecurity incidents to SEC through new Form ADV-C
 - Enhance disclosures to investors related to cybersecurity risks and incidents
- The proposed Cybersecurity Rule also includes corresponding amendments to the Advisers Act's Books and Records Rule

SEC Examination Update

SEC Examination Update

Recent Developments and Outlook

► SEC Examination Priorities for FY 2024 (October 2023)

— Private Fund Advisers

- Continue focusing on private fund sponsors and prioritize topics, such as:
 - Adherence to contractual requirements regarding LPACs, including any contractual notification and consent processes
 - Accurate calculation and allocation of fund-level and investment-level fees and expenses, including valuation of illiquid assets, post-commitment period management fee calculations, adequacy of disclosures, and potential offsetting of such fees and expenses
 - Consistency of due diligence practices with policies, procedures, and disclosures, particularly with respect to PE and VC fund assessments of prospective portfolio companies
 - Conflicts, controls, and disclosures regarding private funds managed side-by-side with RICs and use of affiliated service providers
 - Custody Rule compliance, including accurate Form ADV reporting, timely completion of audits by qualified auditors and distribution of audited financial statements
 - Form PF reporting policies and procedures, including reporting triggered by the occurrence of certain events
 - Portfolio management risks present when there is exposure to recent market volatility and higher interest rates, private funds experiencing poor performance, significant withdrawals and valuation issues and private funds with more leverage and illiquid assets

SEC Examination Update

Recent Developments and Outlook

► SEC Examination Priorities for FY2024 (October 2023)

— Compliance Programs

- Focus on advisers' compliance programs, including whether policies and procedures reflect the various aspects of an adviser's business, compensation structure, services, client base, and operations, and address applicable current market risks, including:
 - Review advisers' annual reviews of the effectiveness of their compliance programs to assess whether the advisers' conflicts of interests are addressed in the advisers' compliance programs, including those conflicts created by the advisers' business arrangements or affiliations and related to adviser and registered investment company fees and expenses
 - Focus on one or more of the areas (from Compliance Rule adopting release): (1) portfolio management processes; (2) disclosures made to investors and regulators; (3) proprietary trading by the adviser and the personal trading activities of supervised advisory personnel; (4) safeguarding of client assets from conversion or inappropriate use by advisory personnel; (5) the accurate creation of required records and their maintenance in a manner that secures them from unauthorized alteration or use and protects them from untimely destruction; (6) safeguards for the privacy protection of client records and information; (7) trading practices; (8) marketing advisory services; (9) processes to value client holdings and assess fees based on those valuations; and (10) business continuity plans
 - Assess whether the policies and procedures are sufficient to support compliance with advisers' fiduciary obligations

SEC Examination Update

Recent Developments and Outlook

► SEC Examination Priorities for FY2024 (October 2023)

— Compliance Programs (continued)

- Assess marketing practices for whether advisers, including advisers to private funds, have: (1) adopted and implemented reasonably designed written policies and procedures to prevent violations of the Advisers Act and the rules thereunder including the new Marketing Rule; (2) appropriately disclosed their marketing related information on Form ADV; and (3) maintained substantiation of their processes and other required books and records
 - Such reviews will also assess whether disseminated advertisements include any untrue statements of a material fact, are materially misleading, or are otherwise deceptive and, as applicable, comply with the requirements for performance (including hypothetical and predecessor performance), third-party ratings, and testimonials and endorsements.
- Assess compensation arrangements focusing on: (1) fiduciary obligations of advisers to their clients, particularly with respect to the advisers' receipt of compensation for services or other material payments made by clients and others; (2) alternative ways that advisers try to maximize revenue, such as revenue earned on clients' bank deposit sweep programs; and (3) fee breakpoint calculation processes, particularly when fee billing systems are not automated
- Assess valuations in connection with advisers' recommendations to clients to invest in illiquid or difficult to value assets, such as commercial real-estate or private placements

SEC Examination Update

Recent Developments and Outlook

► SEC Examination Priorities for FY2024 (October 2023)

— Compliance Programs (continued)

- Conduct safeguarding assessments for advisers' controls to protect clients' material non-public information, particularly when multiple advisers share office locations, have significant turnover of IA representatives, or use expert networks
- Review the accuracy and completeness of disclosures in regulatory filings, with a particular focus on inadequate or misleading disclosures and registration eligibility
- Focus on advisers' policies and procedures for: (1) selecting and using third-party and affiliated service providers; (2) overseeing branch offices when advisers operate from numerous or geographically dispersed offices; and (3) obtaining informed consent from clients when advisers implement material changes to their advisory agreements
 - Such reviews will assess, among other things, whether the advisers' policies and procedures are reasonably designed and implemented and whether the procedures prevent the advisers from placing their interests ahead of clients' interests
- As with previous years, continue to prioritize examinations of advisers that have never been examined, including recently registered advisers, and those that have not been examined for a number of years

SEC Examination Update

Recent Developments and Outlook

► SEC Examination Priorities for FY 2024 (October 2023)

— Information Security and Operational Resiliency

- Cybersecurity remains a focus of the Staff, particularly given the SEC's view that operational disruption risks remain elevated due to the proliferation of cybersecurity attacks, firms' dispersed operations, intense weather-related events, and geopolitical concerns.
- Review RIA practices to prevent interruptions to mission-critical services and to protect investor information, records, or assets, including focusing on the issues noted below:
 - Policies and procedures, internal controls, and governance and other practices, including assessments of the adequacy of training regarding the RIA's identity theft prevention program and policies and procedures designed to prevent account intrusions and safeguard customer records and information, including personally identifiable information, particularly when an RIA has multiple offices
 - Third-party vendor oversight, including: (i) RIA visibility into the security and integrity of third-party products and services and how that impacts an RIA's ability to identify and address risks to essential business operations, and (ii) how RIAs manage concentration risk associated with the use of third-party providers (SEC intends to use this information to assess potential impact of concentration on the U.S. securities markets generally)
 - Responses to cyber-related incidents, including those related to ransomware attacks

SEC Examination Update

Recent Developments and Outlook

► SEC Examination Priorities for FY2024 (October 2023)

— Adherence to Duty of Care and Duty of Loyalty Obligations

- Focus on advisers' adherence to fiduciary duties when providing investment advice to clients with regard to products, investment strategies, and account types, particularly for: (1) complex products (e.g., derivatives and leveraged ETFs); (2) high cost and illiquid products (e.g., variable annuities and non-traded REITs) and (3) unconventional strategies, including those that purport to address rising interest rates
- Focus on advisers' processes for determining that investment advice is provided in clients' best interest, including processes for: (1) making initial and ongoing suitability determinations, (2) seeking best execution, (3) evaluating costs and risks, and (4) identifying and addressing conflicts of interest
- Review disclosures made to investors, including whether they include all material facts relating to conflicts of interest associated with the investment advice sufficient to allow a client to provide informed consent to the conflict

— Crypto Assets and Emerging Financial Technology

- Focus on various issues related to crypto assets and emerging financial technologies, including reviewing, as applicable, compliance policies and procedures, risk disclosures, and custody arrangements of RIAs involved with crypto assets and emerging financial technologies, such as AI