

ANNUAL INVESTMENT ADVISER COMPLIANCE AND REGULATORY REVIEW

The beginning of each year provides an opportunity for investment advisers to review annual compliance and regulatory matters, including issues related to private investment funds and commodity pools. Many of these issues apply to unregistered advisers as well as registered advisers. This alert briefly summarizes some of the primary issues that advisers should consider in their annual review and update process.

Investment Adviser Registration and Disclosure Issues

Form ADV Annual Update. Investment advisers registered with the Securities and Exchange Commission ("SEC") are required to amend their Form ADV each year within 90 days after the end of their fiscal year electronically on the IARD system. Before filing the amendment, the filer's IARD account must be funded with an amount sufficient to cover the IARD filing fees for investment adviser registration. For amendments filed from January 1, 2010 through December 31, 2010, the applicable fees are: \$40.00 for advisers with assets under management below \$25,000,000; \$150.00 for advisers with assets under management from \$25,000,000 to \$100,000,000; and \$200.00 for advisers with assets under management over \$100,000,000. Part II of Form ADV does not need to be updated unless it becomes materially inaccurate and advisers must retain an updated paper copy in their files and provide a current version to the SEC upon request.

Form ADV Ongoing Updates. In addition to the annual update to Form ADV, SEC-registered advisers must amend Part I of their Form ADVs promptly during the year if (a) any information provided in response to Item 1, 3, 9 or 11 of Part 1A or items 1, 2.A. through 2.F or 2.I of Part 1B becomes inaccurate in any way or (b) any information provided in response to Item 4, 8 or 10 (including Schedules A and B) of Part 1A or Item 2.G or Part 1.B become materially inaccurate.

Annual Offer of Part II of Form ADV. Part II of Form ADV must be delivered or offered in writing at least annually to each advisory client (with limited exceptions). It is also a customary practice of many advisers to make this offer or actually deliver Form ADV Part II to investors in private investment funds managed by such advisers. This information may be offered in writing or delivered by providing the Form ADV Part II itself or a brochure containing equivalent information. The delivery or offer may be given along with other information provided by the adviser so the beginning of the year is a good time for delivery (e.g. along with a bill or annual performance report). Advisers should also consider actual delivery of Form ADV Part II rather than a mere offer to deliver in cases where Part II has been amended in a material way.

Withdrawal of SEC Registration. If an SEC-registered investment adviser's assets under management as reported on its annual Form ADV amendment decreased to below \$25,000,000, unless the adviser otherwise qualifies for SEC registration, it will be required to withdraw its SEC investment adviser registration within 180 days of the adviser's fiscal year end. If an adviser is required to withdraw its SEC registration, appropriate state registration may be necessary within a reasonable time in advance.

State Filings. In states where an investment adviser has clients or a place of business, SEC-registered advisers may have notice filing and fee obligations in addition to the federal filing and fee obligations. Advisers typically receive instructions for making such filings and fee payments through the IARD system during the fall. While certain states require only an update and filing of the Part I of Form ADV,

other states may require the filing of Part II of Form ADV and other documents in addition to their separate fees. Links to the applicable state regulations are available through the North American Securities Administrators Association's website at <http://www.nasaa.org>.

State Registration of Investment Adviser Representatives. In each state where a representative of an SEC-registered adviser has clients or a place of business, the adviser may be required to make applicable state registrations of such representative. Investment advisers should review all personnel and determine: (a) in which states such personnel have clients or a place of businesses and (b) whether such personnel should be registered as investment adviser representatives in those states. Where applicable, those investment adviser representatives should be registered in the appropriate states.

Review of Policies and Procedures

Code of Ethics. SEC-registered investment advisers are required to adopt a code of ethics that establishes a standard of conduct in accordance with the adviser's fiduciary duties and that requires that supervised persons comply with the federal securities laws including restrictions on insider trading. SEC-registered investment advisers must review their code of ethics annually for sufficiency and evaluate current business practices for consistency with the code of ethics. In completing this review and evaluation, the adviser should modify the code of ethics as necessary and develop training and/or policies to increase the effectiveness of its implementation. Given the SEC's recent focus on insider trading, particular emphasis may be placed on insider-trading prevention in adopting new policies, procedures and training for employees.

Pursuant to the applicable code of ethics, certain supervised persons may be required to report current securities holdings to the investment adviser's chief compliance officer upon becoming an "access person" and at least once during each 12-month period thereafter along with making quarterly reports of transactions. Additionally, the applicable code of ethics may require (or, if not, advisers should consider adding a policy requiring) that all employees attest to acknowledgement, receipt and continued compliance with the code of ethics annually. The code of ethics must be provided to any client or potential client upon request.

Regardless of whether an entity is registered with the SEC, maintaining and regularly reviewing a code of ethics is an advisable practice.

Compliance Policies and Procedures. SEC-registered advisers must complete a review of their compliance policies and procedures annually, document such review, require their employees to certify their compliance with all policies and procedures annually and modify the policies and procedures as necessary to ensure their effectiveness. The review should address any compliance matters that arose in the last year, any new participation or withdrawal in activities by the company, changes to applicable law and any other developments that may impact the appropriateness of current policies and procedures.

Advisers should keep in mind the SEC's recent adoption of amendments to the custody rules in Rule 206(4)-2 under the Investment Adviser's Act of 1940 ("Advisers Act") which becomes effective on March 12, 2010 in completing their 2010 review. The amendments update the custody rules to reflect modern custodial practice and provide clarification of what constitutes "custody". For SEC-registered advisers to separately managed accounts holding private investment securities, these amendments likely mean contracting with an independent accountant for an annual surprise audit of private investment securities. For assets held with a qualified custodian, the qualified custodian will now be required to deliver statements to the SEC-registered investment adviser's clients directly. SEC-registered investment advisers who use related persons as qualified custodians will be required to obtain an internal control report.

SEC-registered advisers to hedge funds and other pooled investment vehicles will continue to be exempt from annual surprise audit and quarterly delivery requirements for those clients if audited financial statements are delivered to investors within 120 days or 180 days (for funds of funds) after the end of the fund's fiscal year. Starting with audits relating to fiscal years beginning January 1, 2010 and after, an independent accountant registered and subject to inspection by the Public Company Accounting Oversight Board ("PCAOB") must audit the financial statements of the fund. SEC-registered investment advisers will be required to conduct audits upon fund dissolution and promptly deliver audited financial statements after such audits are completed.

To assist hedge fund managers in their updates of policies and procedures, the Managed Fund Association has published "Sound Practices for Hedge Fund Managers" which provides updates on valuation, risk management, responsibilities to investors, framework of internal policies, practices and controls and may provide considerable assistance in updating internal policies and procedures. The Asset Managers' Committee of the President's Working Group on Financial Markets and the Alternative Investment Management Association have also published guidelines for best compliance practices for fund managers.

Regardless of whether an entity is required by federal or state law, maintaining and regularly reviewing compliance policies and procedures is a good practice.

Business Continuity and Disaster Recovery Plans. All advisers should review and test business continuity and disaster recover plans at least annually.

Notice of Privacy Policy. The SEC, Commodity Futures Trading Commission ("CFTC") and/or Federal Trade Commission ("FTC") regulations governing the privacy of consumer financial information (the "Privacy Regulations"), as applicable, require every investment adviser and fund domiciled in the U.S. or having U.S. clients or investors, commodity pool operators ("CPOs") and commodity trading advisors ("CTAs") to establish policies and procedures to protect the confidentiality of clients and investor records. Such policies and procedures should be reviewed annually and updated according to privacy laws and regulations. Annual notice must be given to each client or investor who is an individual disclosing the types of non-public personal information that the adviser, fund, CPO or CTA collects and the extent of disclosure. Notice of privacy policies and procedures is required under the Privacy Regulations and must be delivered to clients or investors at least once during any twelve-month period. The notice may be provided along with other information so the beginning of the year is generally a good time for delivery (e.g. along with a bill or annual report). The Privacy Regulations were amended in 2009 and now include a model privacy form. Persons subject to the Privacy Regulations are provided a safe harbor for the privacy notice delivery requirement if they deliver a privacy notice that conforms to the model privacy form. Such safe harbors provided under the sample clauses employed in many current privacy notices will expire for notices posted or delivered on or after January 1, 2011. Covered persons may continue to use the forms outside the safe harbor so long as they contain the disclosures and opportunity to opt out required by the Privacy Regulations. After providing a notice to such client or investor, you may not disclose any non-public information about clients or investors other than as described in the notice without first giving notice to the client or investor describing the proposed disclosure. Parties should obtain legal consultation before obtaining consumer credit reports on clients or sharing investor information with anyone including affiliated entities.

Proxy Voting Policy. SEC-registered investment advisers are required to adopt policies and procedures on proxy voting designed to ensure that securities are voted in accordance with the best interest of their clients and that material conflicts of interest are addressed. Advisory clients must be given a description of such policies, a copy of such policies upon request and informed as to how they can obtain a list of such proxy votes relating to such client's securities.

Anti-Money Laundering Policy. Anti-money laundering policies and procedures are recommended and should be maintained, updated periodically and adhered to. Additionally, compliance programs should be reviewed to ensure compliance with the economic sanctions programs administered by the

Office of Foreign Assets Control ("OFAC"). Maintaining an effective anti-money laundering program may be considered as a positive factor in assessing penalties for a violation of OFAC regulations.

Other Selected State and Federal Filing Issues

SEC Form D and State Blue Sky Filing Requirements. Form D must be filed with the SEC by all issuers that sell securities in reliance on an exemption provided in Regulation D or Section 4(2) of the Securities Act of 1933 ("Securities Act"). This includes interests in hedge funds, private equity funds or other privately-offered pooled investment vehicles. Form D must be amended on or before the anniversary of the issuer's filing if the offering is continuing at that time. Form D must also be amended to correct any material mistake or error along with certain other changes. Form D and amendments thereto must be filed with the SEC using its electronic filing system pursuant to the 2009 amendments to its filing rules. Additionally, Form D and some combination of a Form U-2 and filing fee are generally required to be filed in states where a fund sells interest to U.S. persons. Certain states require the filing of additional disclosure documents while other states may have additional blue sky filing requirements (and exemptions thereto). These requirements should be evaluated and fulfilled prior to offering or selling any interests in a fund to U.S. investors in any new states to ensure compliance.

Schedule 13D and 13G and Form 13F Filings. Persons (individuals or entities) with the right to exercise investment discretion or voting power over five percent or more of any class of outstanding equity securities of a public U.S. company may be required to file Schedule 13D or Schedule 13G with the SEC. The eligibility, filing thresholds, amendment requirements and timing requirements for each such Schedule varies and persons should review the requirements if they have or are about to cross such threshold with respect to any security. If a person, whether or not a registered adviser, exercised investment discretion over \$100,000,000 or more invested in "13(f) securities" (as included on the list published by the SEC) as of the last day of any calendar month, those holdings must be reporting to the SEC by filing a Form 13F. Such reports must be filed for year-end holdings for the first year this occurs and quarterly thereafter. Such reports must be filed quarterly within 45 days after the relevant reporting date.

Section 16 Filings. Persons (individuals or entities) that hold a beneficial ownership of ten percent of any class of equity securities registered under Section 12 of the Securities Exchange Act of 1934 ("Exchange Act"), if the person is an officer or director of such issuer may be required to file Form 3, 4 or 5 regarding crossing certain thresholds, reporting certain sales and making certain annual reports.

Change of Address or Agent Filings. Upon moving office locations, amendments to an entity's certificates of limited partnership, articles of incorporation, articles of formation and all other documents on file with the applicable state of organization should be updated to ensure accuracy.

Hart-Scott-Rodino Filings. Parties to certain transactions (including purchases of publicly traded securities) that meet certain thresholds to file premerger notification forms with the FTC and Department of Justice Antitrust Division may be required to make filings under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "HSR Act"). If a fund is making an acquisition that would result in the ownership of voting securities or assets valued at \$63.4 million or more using the HSR Act's valuation mechanics, legal consultation should be obtained regarding the filing obligations or applicable exemptions.

FBAR Reporting. Persons having financial interests in, or signatory or other authority over financial accounts (including bank and securities accounts) in a foreign country must file a Form TD F 9-22.1 (Report of Foreign Bank and Financial Accounts or "FBAR") reporting such relationship by June 30th of the year following that in which the relationship exists. The IRS informally stated that U.S. investors in offshore investment companies (both registered and unregistered) and those with signatory authority over such investments must file an FBAR. The Treasury Department extended to June 30, 2010

the deadline for the FBAR filings for 2008 and prior years for persons with no financial interest in a foreign financial account but with signatory or other authority over such foreign account and/or those with a financial interest in, or signatory authority over, a foreign commingled fund. Absent other relief, such persons need to file FBARs for 2008 and prior years by the deadline. The Treasury Department has also stated that it is considering further guidance clarifying certain issues relating to FBAR. As a result, important changes in the FBAR requirements may be made prior to this June 30, 2010 filing date.

Commodity Pool Operator and Commodity Trading Advisor Issues

Annual NFA Registration Update. Registered CPOs and CTAs are required to update their National Futures Association (“NFA”) registration information and pay annual NFA dues on or before the anniversary date the CPO’s or CTA’s registration became effective. As of the date due, failure to file the update will be deemed a request for withdrawal from registration which will be effective in 30 days after the failure to complete the update.

CPO and CPA Questionnaire. Registered CPOs and CTAs must complete and retain the NFA’s “self-examination questionnaire” annually including for any pools that have liquidated. This includes CPOs and CTAs that qualify for disclosure exemptions under CFTC Regulation 4.7. As part of this review, CPOs and CTAs should review compliance policies and procedures, confirm whether amendments to those procedures are necessary and determine whether additional procedures may be warranted in light of the occurrences of the previous year.

Commodity Pool Annual Reports. Registered CPOs are required to file annual reports with the NFA and distribute those reports to the pool’s participants within 90 days of the pool’s fiscal year end. This includes CPOs that qualify for disclosure exemptions under CFTC Regulation 4.7. Filing must be completed electronically through the NFA’s EasyFile system. If a CPO that invests in other collective investment vehicles cannot obtain the required information to complete reports such CPO may file notice with the NFA to delay the filing for 90 days. Such notice shall continue to be effective in future years until the CPO files a certificate that it is no longer a fund of funds. Additionally, disclosure documents must be updated regularly as required by CFTC rules and may need to be filed with the CFTC and the NFA. Annual reports may be distributed in hard copy; however, a CPO must obtain a participant’s consent prior to distributing the annual report in electronic format.

The CFTC recently amended its rules regarding annual and periodic report contents for registered CPOs including CPOs that qualify for disclosure exemptions under CFTC Regulation 4.7. CPOs preparing annual reports under CFTC Regulation 4.7 or 4.22 for pools with multiple classes or series with limitations on liability between such classes or series must include only information for the class or series being reported. Net asset value and other financial information must be presented for both the pool as a whole, as well as for each pool with a separate series or classes that are not structured with a limitation on liability. Additionally, reports of registered CPOs of nonexempt pools and pools for which disclosure relief was granted in accordance with Rule 4.7, subject to certain conditions set forth in prior staff interpretive letters, may now use International Financial Reporting Standards (“IFRS”) in annual financial reports if such pools are organized under the laws of a foreign jurisdiction. CFTC Regulations 4.7 and 4.22 now codify required disclosure in the notes to the financial statements of the amount of management and incentive fees and expenses indirectly incurred as a result of investing in any fund where the investment in the notes to the financial statements exceeded five percent of the pool’s net asset value. CFTC Regulations 4.7 and 4.22 now also require a “statement of operations” or “statement of operations and change in net assets”, respectively, in annual reports that separately reflect any special allocation to a general partner or similar interest as an expense of the pool or as a separate allocation and that combines gains and losses from commodities trades with related non-commodities trades.

In addition to the above changes, pools operated by CPOs under CFTC Regulation 4.7 may now disclose either the net asset value per outstanding participation unit in the pool or the total value of a participant's interest or share in the pool. Registered CPOs providing annual reports under CFTC Regulation 4.22 are now required to file the report within 90 days after the end of trading which may consist of an estimate with a later report. The CFTC also amended Regulation 4.13 to eliminate requirements that exempt funds: (a) have the report be certified consistent with CFTC regulations (if certified by an accountant) and (b) present and compute the numbers in the report in accordance with generally accepted accounting principles.

Other Annual Requirements. At least annually, CPOs and CTAs must also test disaster recovery plans and adjust as necessary, deliver privacy policies to every current participant, provide ethics training as described in the CPO/CTA's written ethics training procedures, update disclosure documents and file all new exemptive notices with the NFA.

Other Issues

Restricted New Issues. Members of the Financial Industry Regulatory Authority, Inc. ("FINRA") are prohibited from selling "new issues" to any client unless such member receives a representation from the client within the past 12 months that the client is not a "restricted person" and restricted persons do not have more than a de minimis ownership interest in the client (e.g., a hedge fund) pursuant to FINRA Rule 5130 (formerly NASD Conduct Rule 2790). Investment advisers must reconfirm the "restricted person" status at least annually. This annual certification may be obtained through a negative consent letter.

Private Investment Funds. In addition to the foregoing, offering documents for any private investment fund should be updated at least annually to reflect changes in the business or operations of the fund, such as changes in investment strategies, personnel, risks, performance data, annual financial information, soft dollar arrangement and other brokerage practices and tax and legal matters. If registered investment companies are owners of a fund, such registered investment companies should be reviewed at least annually to determine if such funds are "affiliated persons" under the Investment Company Act of 1940 (the "Investment Company Act") (e.g., if they own five percent or more of the fund). Exceptions from the definition of "investment company" under section 3(c)(1) of the Investment Company Act should be reviewed on an ongoing basis to confirm that investors do not exceed the 100 beneficial owner limit for section 3(c)(1) purposes (including the application of look-through rules for certain corporations, partnerships, trusts, funds and other companies) for section 3(c)(1) purposes.

Pending Hedge Fund Adviser Registration Legislation. On December 11, 2009, the U.S. House of Representatives approved the Wall Street Reform and Consumer Protection Act of 2009, which includes the Private Fund Investment Advisers Registration Act of 2009. If enacted, this legislation would require many investment advisers to private investment funds to register with the SEC under the Advisers Act, expand reporting requirements for investment advisers and expand the SEC's discretion to interpret the Advisers Act. The U.S. Senate is also contemplating legislation that would include similar registration requirements. While it is not clear as to the ultimate language and timing of such legislation, unregistered investment advisers to private investment funds should consider devoting resources to their compliance efforts now. In particular, investment advisers should consider (if they have not done so already) appointing or determining which party would serve as their chief compliance officer, reviewing existing disclosure documents to determine what disclosures would be required upon registration, conducting a compliance risk assessment and reviewing and revising existing compliance policies and procedures to ensure that required compliance measures are in place.

New York Power of Attorney. New York amended its law in 2009 to change the requirements for powers of attorney signed by individuals in New York to address certain perceived abuses in elder-care connected to financial matters. The changes adopted appear to have the unintended conse-

quence of invalidating a wide variety of common corporate and commercial documents. The amendment applies to any power of attorney signed by an individual (or an individual signing as trustee of a trust) who is physically present in New York when he/she signs such power of attorney, unless the individual is signing on behalf of an entity and not in his/her personal or fiduciary capacity. The amended New York statute defines a power of attorney as “a written document by which a principal with capacity designates an agent to act on his or her behalf”, and an “agent” as “a person granted authority to act as attorney-in-fact for the principal under a power of attorney”. The amendments to the New York statute impact advisers that manage an investment fund that uses a power of attorney in its subscription agreement or limited partnership agreement and receives a subscription agreement signed in New York by an individual subscriber or a trustee or custodian who is an individual. It will also impact those who enter into an investment advisory agreement that includes a power of attorney with a client who is an individual or a trustee or custodian who is an individual and is in New York when he/she signs the agreement. Entities that are general partners of a domestic private investment fund that has a subscriber, a trustee or a custodian under a Uniform Transfers to Minors Act or Uniform Gifts to Minors Act account who is an individual and who signs subscription documents that include a power of attorney in New York on or after September 1, 2009, will need a new power of attorney for that subscription. It is essential that such powers of attorney be effective and binding so subscription agreements and investment advisory agreements should be updated if they have not been already.

If you would like to discuss any of the issues discussed in this Client Alert, please contact any attorney in our Investment Management Group or visit us online at chapman.com.

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