

# Chapter 24A

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## Investment Adviser Compliance Obligations and Regulatory Filings

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**§ 24A:1 Introduction**

The beginning of each year brings a variety of registration, disclosure, and other regulatory deadlines for investment advisers. It also provides an opportunity for investment advisers to review annual compliance and regulatory matters. This chapter summarizes some of the annual efforts that investment advisers should consider as part of their compliance and regulatory review efforts. Most of these topics are discussed in greater detail in other chapters within this treatise.

**§ 24A:2 Annual Registration and Disclosure Updates**

Investment advisers should review the registration status of their firm and investment adviser representatives on both an annual and ongoing basis. Based on those reviews, advisers should make sure to properly register their firm and applicable personnel with the U.S. Securities and Exchange Commission (SEC) and/or applicable states, as appropriate. As part of the process firms should ensure that they have properly updated disclosure documents related to their firm and any applicable pooled investment vehicles.

**§ 24A:2.1 Review of Adviser Registration Status and Eligibility**

Investment adviser firms may be obligated to register with the SEC or one or more states. Registration obligations, registration eligibility, and the availability of exclusions from the definition of investment adviser and exemptions from registration may change over time with changes to regulation, along with changes to an investment adviser's business and assets under management levels. Firms should review their registration status and eligibility, along with continued eligibility for any exemptions or exclusions, on an ongoing basis and at least annually, and make adjustments to their registrations, compliance programs, and disclosure documents, as appropriate.

**[A] Federal Versus State Registration Eligibility**

Investment advisers should review at least annually whether they are eligible and/or required to register with the SEC or one or more states. As part of that review process, advisers should consider whether they:

- are eligible to be registered with the SEC;
- are required to be registered with the SEC;
- are required to be registered in one or more states;
- are excluded from the definition of investment adviser by the SEC and/or states;
- qualify for an exemption from registration by the SEC and/or states; and/or
- are required to report as an “exempt reporting adviser” where they qualify for an exemption from registration but are required to engage in certain reporting on Form ADV.

Firms that are registered with the SEC are not required to register in individual states, but may be obligated to make notice filings in states where they have clients and places of business. Firms should review their registration status on an ongoing basis and at least annually. A firm’s status and eligibility for certain exclusions and exemptions may change over time. Additionally, the SEC has adopted a series of rules and policies applying to firms that are transitioning between state, federal, and/or no registration. These rules and policies can have a significant impact on a firm’s regulatory and compliance obligations.

Some of the key factors that can lead to potential registration, reporting, or notice filing status changes are:

- changes in assets under management (particularly above and below the \$25- and \$100-million levels);
- opening or closing of offices in one or more states;
- new clients causing a firm to have six or more clients in any individual state;
- lost clients causing a firm to have fewer than six clients in any individual state;
- becoming or ceasing to be a manager to any private investment funds;
- becoming or ceasing to be a manager solely to “venture capital funds”; and
- becoming or ceasing to be a “family office.”

In addition, effective July 1, 2017, the state of Wyoming began requiring an investment adviser to register in Wyoming where the adviser has less than \$100 million in assets under management. Previously, Wyoming had not regulated investment advisers, and as a result, all advisers with a principal office and place of business in Wyoming had been required to register with the SEC absent some other exception or exclusion. Many Wyoming-based investment advisers will no longer be eligible to register with the SEC. In light of these changes, advisers in Wyoming should review their registration status.

### **[B] Umbrella (Relying Adviser) Registration**

Advisers to many private funds are organized as a group of related advisers that are separate legal entities, but effectively operate as a single advisory business. Many advisers currently rely on a 2012 SEC Division of Investment Management no-action letter<sup>1</sup> providing certain conditions where a related investment adviser (a “relying adviser”) may rely on the registration of a registered investment adviser (the “filing adviser”) rather than registering on its own separate Form ADV. The conditions for this form of registration include:

- The filing adviser and each relying adviser advise only private funds and clients in separately managed accounts (SMAs) that are “qualified clients” (as defined in Investment Advisers Act Rule 205-3) and are otherwise eligible to invest in private funds advised by the filing adviser or a relying adviser, and whose SMAs pursue investment objectives and strategies substantially similar or otherwise related to those private funds;
- The filing adviser has its principal office and place of business in the United States and all of the substantive provisions of the Investment Advisers Act and rules thereunder apply to the filing adviser and each relying adviser’s dealings with each of its clients;
- Each relying adviser, its employees, and persons acting on its behalf are subject to the filing adviser’s supervision and control, and are “persons associated with” the filing adviser as defined in the Investment Advisers Act;
- The advisory activities of each relying adviser are subject to the Investment Advisers Act and rules thereunder and are subject to examination by the SEC; and

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1. American Bar Association, Business Law Section, SEC No-Action Letter (Jan. 18, 2012), <http://www.sec.gov/divisions/investment/noaction/2012/aba011812.htm>.

- The filing adviser and each relying adviser operate under a single code of ethics and written policies and procedures that are administered by a single CCO in accordance with the Investment Advisers Act.

Umbrella registration is not currently available to exempt reporting advisers. Updates to Form ADV that went into effect on October 1, 2017, include certain items and questions specifically focused on advisers relying on umbrella registration including items specific both to relying advisers and filing advisers. This should simplify the process of using umbrella registrations on Form ADV.

### **§ 24A:2.2 Federal and State Adviser Filing Requirements**

#### **[A] Form ADV<sup>2</sup>**

Form ADV is used to:

- Register as an investment adviser with the SEC;
- Register as an investment adviser with one or more state securities authorities;
- Amend those registrations;
- Report to the SEC as an exempt reporting adviser;
- Report to one or more state securities authorities as an exempt reporting adviser;
- Amend those reports; and
- Submit a final report as an exempt reporting adviser.

Except for limited exemptions, Form ADV must be filed electronically on the Investment Adviser Registration Depository (IARD) system. Answers to frequently asked questions about Form ADV and the IARD filing process are available at the SEC's website.<sup>3</sup>

Amendments to Form ADV went into effect on October 1, 2017, along with other changes to certain aspects of the reporting, disclosure, and recordkeeping obligations of registered investment advisers. For most advisers, their first filing using the amended Form ADV will occur in 2018. Among other things, the amendments to Form ADV

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2. Form ADV, including instructions, is available at <https://www.sec.gov/files/formadv.pdf>.

3. See SEC, FREQUENTLY ASKED QUESTIONS ON FORM ADV AND IARD (last updated June 12, 2017), <https://www.sec.gov/divisions/investment/iard/iardfaq.shtml>.

require investment advisers to collect additional information regarding separately managed accounts and allow for private fund advisers operating a single advisory business through multiple entities to register using a single Form ADV. For more information about the amendments, please see the SEC's final rule release adopting the new form,<sup>4</sup> along with the updated ADV and instructions.<sup>5</sup>

### **[A][1] SEC Annual ADV Updates**

Investment advisers registered with the SEC are required to amend their Form ADV each year within ninety 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 investment advisers registered with the SEC, for amendments filed from January 1, 2017 through December 31, 2017, the applicable fees are: \$40 for advisers with regulatory assets under management below \$25 million; \$150 for advisers with regulatory assets under management of at least \$25 million but less than \$100 million; and \$225 for advisers with regulatory assets under management of \$100 million or more.

The Investment Advisers Act and SEC rules require certain initial and ongoing reporting on Form ADV for these "exempt reporting advisers." As a result, exempt reporting advisers, although not registered, are required to file Form ADV and amend their Form ADV each year within ninety days after the end of their fiscal year (or more frequently if required) electronically on the IARD system and pay a filing fee of \$150. Exempt reporting advisers are only required to provide information relating to certain items in Form ADV. Firms should review their entire Form ADV for accuracy as part of the annual submission process.

### **[A][2] SEC Other-Than-Annual ADV Updates**

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

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4. Form ADV and Investment Advisers Act Rules, SEC Release No. IA-4509 (Aug. 25, 2016), <https://www.sec.gov/rules/final/2016/ia-4509.pdf>.
  5. Form ADV, <https://www.sec.gov/files/formadv.pdf>.

materially inaccurate. The brochure and supplement must be updated promptly during the year if any information becomes materially inaccurate, except if the material inaccuracies are solely the result of changes in the amount of client assets managed or because the fee schedule has changed.

### **[B] State Filings**

Certain state filings are required both of firms that are registered with the SEC and firms that are registered in individual states. Additional state-level filings may be required of investment adviser representatives, but those requirements vary by state.

#### **[B][1] State Filings for SEC Registered Adviser Firms**

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 Form ADV, other states may require the filing of other documents (including the brochure and/or brochure supplement) in addition to their separate fees.<sup>6</sup>

#### **[B][2] State Filings for State Registered Adviser Firms**

In each state where a non-SEC-registered investment adviser has clients or a place of business, the adviser should review applicable state laws to determine whether registration is necessary. Firms may be required to register in more than one state.

#### **[B][3] Investment Adviser Representative Registration**

In each state where a representative of an SEC-registered adviser has clients or conducts business, the adviser may be required to make applicable state registrations of such representative. Investment advisers should review all personnel and determine (1) in which states such personnel have clients or conduct business, and (2) 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.

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6. Links to the applicable state regulations are available through the North American Securities Administrators Association's website at <http://www.nasaa.org/>.

**[C] Updating Disclosure Documents**

Advisers should review disclosure documents related to the adviser and any pooled investment vehicles (for example, private funds and registered investment companies) on an ongoing basis to ensure that they reflect current information about the adviser and its managed accounts or funds. These documents might include the adviser's brochure and brochure supplements, registered investment company prospectuses and statements of additional information (SAIs), and private fund offering documents.

**[C][1] Adviser Brochure and Brochure Supplement Update**

SEC and state rules require that advisers file an updated Form ADV Part 2A (the "brochure") annually as part of their Form ADV filing. A Form ADV Part 2B (the "brochure supplement") for each applicable investment adviser representative should be updated annually and maintained in a firm's files.

**[C][2] Private Fund Offering Documents**

Advisers should update offering documents for any private investment fund at least annually to reflect any changes in the business or operations of the fund, such as changes in investment strategies, personnel, risks, performance data, annual financial information, soft dollar arrangements and other brokerage practices, and tax and legal matters. Advisers should also review subscription agreements and related subscription materials to reflect changes in legal and compliance requirements and to ensure that funds continue to meet registration exemption requirements.

**[C][3] Registered Investment Company Prospectuses and SAIs**

Investment advisers to registered investment companies should review offering documents and other materials related to those funds at least annually to verify the accuracy of all information.

**§ 24A:3 Review of Compliance Policies and Procedures**

Investment Advisers Act Rule 206(4)-7 requires all registered investment advisers to adopt and implement written policies and procedures reasonably designed to prevent violation of the Investment Advisers Act and its rules by the adviser and its supervised persons. The SEC has noted that, at a minimum, the written policies and procedures should address:

- portfolio management processes, including compliance with investment objectives and stated disclosures, applicable regulatory requirements, and allocation of investment opportunities among clients;
- trading practices, including best execution, soft dollars, and trade allocation;
- proprietary trading by the firm and its supervised persons;
- disclosure accuracy;
- recordkeeping practices;
- marketing practices;
- use of solicitors;
- portfolio valuation processes including fee assessments based on those valuations;
- privacy protection; and
- business continuity plans.<sup>7</sup>

Some of these areas are discussed briefly below and in greater detail in other chapters throughout this treatise. While state-registered investment advisers are not subject to all of the provisions of the Investment Advisers Act, most states have their own compliance program requirements for state-registered investment advisers.

Compliance policies and procedures need to be reviewed and updated in response to, among other things, changes in an adviser's business practices; changes in market conditions; changes in rules, regulations, and regulator focus; and areas where compliance deficiencies have been identified in the past.

### **§ 24A:3.1 Annual Review Process**

Advisers are required to review the adequacy and effectiveness of their policies at least annually under Investment Advisers Act Rule 206(4)-7. SEC-registered advisers should complete a formal review of their compliance policies and procedures, document such reviews, require their employees to certify their compliance with all policies and procedures at least 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

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7. See SEC, INFORMATION FOR NEWLY-REGISTERED INVESTMENT ADVISERS [Nov. 23, 2010], <https://www.sec.gov/divisions/investment/advoverview.htm>.

appropriateness of current policies and procedures. Advisers should document the review process carefully, as any examination by the SEC will typically include a request for documentation related to an adviser's recent annual review(s).

### **[A] Summary of SEC Examination Process for Investment Advisers**

While there are many reasons for firms to create robust compliance programs and to conduct thorough annual reviews, one motivation is to address regulatory and compliance issues and to take appropriate corrective measures to avoid having the issues raised for the first time during examinations by the SEC. The SEC's examinations typically focus on:

- Higher risk activities;
- Compliance program effectiveness and controls;
- Correction of compliance issues identified by the investment adviser firm or the SEC (in previous examinations);
- Reviews of compliance with new rules applicable to investment advisers; and
- Thorough reviews followed by immediate and thoroughly documented corrective measures.

As advisers conduct their annual reviews, they should consider the SEC examinations process along with recent areas of focus by the SEC's Office of Compliance Inspections and Examinations (OCIE). On an annual basis, OCIE releases its examination priorities for the coming year, and these serve as a helpful tool as firms consider what updates should be made to their compliance programs.<sup>8</sup> In 2008, the OCIE staff published a list of information typically requested by OCIE in its initial request for information during investment adviser reviews.<sup>9</sup> In 2017, OCIE also published a list of the five most frequent compliance issues identified in OCIE examinations of investment advisers.<sup>10</sup>

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8. See OCIE, NAT'L EXAM PROGRAM, EXAMINATION PRIORITIES FOR 2017, <https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2017.pdf>.

9. For a copy of the list, see OCIE, INVESTMENT ADVISER EXAMINATIONS: CORE INITIAL REQUEST FOR INFORMATION (last updated Nov. 13, 2008), <https://www.sec.gov/info/cco/requestlistcore1108.htm>.

10. See OCIE, *The Five Most Frequent Compliance Topics Identified in OCIE Examinations of Investment Advisers*, NAT'L EXAM PROGRAM RISK ALERT, vol. VI, issue 3 (Feb. 7, 2017), <https://www.sec.gov/ocie/Article/risk-alert-5-most-frequent-ia-compliance-topics.pdf>.

**[B] Report to Management**

While not specifically required under the Investment Advisers Act, it is an accepted best practice for an adviser's chief compliance officer (CCO) to submit an annual written summary of the investment adviser firm's compliance policies and procedures and annual findings to the firm's senior management for review. Investment adviser senior management should consider holding a special meeting to review the annual findings and resulting corrective measures. To the extent senior management finds an annual review to be inadequate, significant compliance deficiencies and/or inadequate responses by the CCO and compliance department, senior management should conduct its own examination. Firms should document this process along with the annual compliance program review and take corrective actions as necessary.

**[C] Annual Certifications**

All supervised persons of an investment adviser should be required to certify annually that they have read, understand, and have complied with the firm's written compliance policies and procedures and code of ethics. Firms should consider highlighting compliance focus items as part of that annual certification and also consider combining annual certifications with focused testing.

**§ 24A:3.2 Specific Areas to Consider**

The following are high-level overviews of areas advisers should consider as part of their annual compliance reviews. These areas are discussed in greater detail in other chapters of this treatise. The amount of time and attention focused on a particular area will vary by firm, and reviews should be designed to focus on changes in an adviser's business practices; changes in market conditions; changes in rules, regulations and regulator focus; and areas where compliance deficiencies have been identified in the past.

**[A] Client Suitability and Portfolio Management**

As part of their annual compliance review of suitability assessments, firms should review the adequacy of their inquiry process into a client's financial situation, investment experience, and investment objectives. This includes both the client onboarding process and ongoing methods for assessing a client's financial situation and investment objectives to make informed suitability decisions. Firms should ensure that as client investment experience and investment objectives change, steps are taken to ensure that investments and strategies remain appropriate or are changed as necessary. Firms

should particularly scrutinize assessments of recommendation suitability for more vulnerable classes of investors, such as seniors.

As part of the annual review process, firms should ensure that actual portfolio management is occurring in a manner consistent with:

- The financial situations, investment experiences, and investment objectives of a client;
- All disclosures provided to the client in disclosure documents and agreements; and
- Any other instructions or restrictions otherwise communicated by a client.

To the extent inconsistencies are found, in addition to reviewing control processes, firms should consider the need to update disclosures and notify clients.

### **[B] Recordkeeping**

Advisers should consider whether regulatory changes or new businesses or practices by an investment adviser necessitate any changes to the adviser's recordkeeping obligations. Firms should use their annual compliance review as an opportunity to thoroughly examine the effectiveness of their books and recordkeeping processes, including:

- That all required books and records are being properly maintained;
- That books and records are sufficiently accessible;
- That books and records are being protected from access by unauthorized persons; and
- That books and records are being stored in a manner that protects them from destruction.

### **[C] Privacy Issues**

The SEC, U.S. Commodity Futures Trading Commission (CFTC), and Federal Trade Commission (FTC) regulations governing the privacy of consumer financial information (Privacy Regulations) require every investment adviser and fund domiciled in the United States, or having U.S. clients or investors, commodity pool operators (CPOs), or 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 that periodically change. As part of the annual review process, in addition to reviewing the privacy safeguards and providing required notices, firms should assess the adequacy of their response and notification procedures where a privacy breach occurs.

**[D] Advertising (Including Social Media)**

As part of their annual review process, firms should review advertising materials to ensure that all information is accurate and up-to-date. Additionally, firms should review the control mechanisms in place for advertising review on an ongoing basis, including:

- Sufficiency of internal process for approval of advertisements and other marketing communications;
- Review of firm and personnel communications to identify non-compliant advertising materials;
- Review of firm and personnel communications to identify advertising materials that were not submitted through the internal approval process; and
- Sufficiency of corrective measures and discipline for use of non-compliant advertisements and other marketing communications.

Firms should consider regulatory changes and changes in business practices as part of that review.

An increasing focus for all investment adviser firms are advertising issues arising out of social media usage. The SEC has suggested that SEC-registered investment advisers that use social media should adopt, and periodically review the effectiveness of, policies and procedures regarding social media as part of their obligations related to compliance policies and procedures. In 2012, the SEC issued a Risk Alert to highlight certain observations and suggestions that may be helpful to advisers when reviewing compliance policies associated with social media.<sup>11</sup> In 2014, the SEC published additional guidance for advisers relating to third-party testimonials on social media sites.<sup>12</sup>

Updates to Form ADV that went into effect on October 1, 2017, require reporting of all of an adviser's websites, usage of websites for publicly available social media platforms, and all publicly available social media addresses where the adviser controls the content. Investment advisers should review their policies and practices regarding social media as part of their annual review process and in light of guidance on social media from the SEC.

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11. See OCIE, *Investment Adviser Use of Social Media*, NAT'L EXAM PROGRAM RISK ALERT, vol. II, issue 1 (Jan. 4, 2012), <https://www.sec.gov/about/offices/ocie/riskalert-socialmedia.pdf>.

12. Guidance on the Testimonial Rule and Social Media, IM Guidance Update No. 2014-04 (Mar. 2014), <https://www.sec.gov/investment/im-guidance-2014-04.pdf>.

## **[E] Performance Reporting**

### **[E][1] General**

Where adviser advertisements include performance information, advisers must include appropriate disclosures and maintain appropriate supporting books and records. As part of their annual compliance review, firms should review the sufficiency of disclosures connected to any performance information, the appropriateness of the performance information, compliance of such information with the Investment Advisers Act and other requirements, and the sufficiency of recordkeeping supporting the performance.

### **[E][2] GIPS® Compliance and Annual Reviews**

Claiming compliance with Global Investment Performance Standards (GIPS®) requires rigorous adherence to the GIPS standards and firms should focus on adherence to all requirements and compliance practices as part of their annual compliance review process. This includes reviewing composite descriptions and definitions for accuracy, changes in actual strategy management to determine whether new composites are necessary, the benchmark and description for continued appropriateness and accuracy, changes to the adviser firm and whether there is an impact to GIPS compliance and disclosure requirements and updates to GIPS standards to determine whether changes in practices or disclosures are necessary. In addition, on an annual basis, the GIPS standards indicate that firms should provide to each existing client, on an annual basis, a compliant presentation of the composite in which the client's portfolio is included.

## **[F] Business Continuity, Disaster Recovery and Transition Plans**

All advisers should review and test business continuity and disaster recovery plans at least annually. In 2013, the SEC, the CFTC, and the Financial Industry Regulatory Authority, Inc. (FINRA) issued a joint advisory regarding best practices for business continuity planning.<sup>13</sup> In June 2016, the SEC proposed a new rule and rule amendments that would require investment advisers to adopt and implement written business continuity and transition plans. These written plans would be required to address business continuity after a significant business disruption and business transition in the event an investment adviser

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13. CFTC, SEC & FINRA, Joint Review of Business Continuity and Disaster Recovery of Firms (Aug. 16, 2013), <https://www.sec.gov/about/offices/ocie/jointobservations-bcps08072013.pdf>.

is unable to continue providing investment advisory services to clients. The content of a business continuity and transition plan would need to be based upon risks associated with the adviser's operations and include policies and procedures designed to minimize material service disruptions.<sup>14</sup> Whether or not the rule is adopted, business continuity, disaster recovery, and transition planning are essential parts of any investment adviser compliance program. Firms should review written plans as part of their annual review process, test for sufficiency, consider whether any firm business lines or practices have changed throughout the year requiring updates, and make updates to plans as necessary.

### **[G] Best Execution and Soft Dollars**

Firms' compliance programs will vary significantly in the area of best execution and soft dollars depending on business practices. Annual compliance reviews should focus significant attention on the firm's best execution and soft dollar compliance policies and procedures, as well as on developments in adviser practices, to ensure that policies and procedures are up-to-date and compliant with applicable securities regulations. In particular, firms should ensure that disclosures are accurate and that brokerage arrangements are consistently evaluated with those evaluations properly documented.

### **[H] Trading Conflicts**

Where an investment adviser engages in trading activities raising potential conflicts of interest (for example, principal transactions, agency cross transactions, cross-trades, and trade aggregation), an annual compliance review should ensure adequate controls are in place, where required accurate disclosures have been made, where required appropriate notice has been given and consents have been obtained, and all applicable conditions to an exception, no-action position, and/or exemptive relief have been complied with. Firms should monitor any changes to existing trading practices in the prior year and those planned for the coming year, and adjust written policies and procedures as necessary.

### **[I] Proxy Voting**

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

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14. Proposed Rule: Adviser Business Continuity and Transition Plans, SEC Release No. IA-4439 (June 28, 2016), <https://www.sec.gov/rules/proposed/2016/ia-4439.pdf>.

material conflicts of interest are addressed. In 2014, the SEC's Division of Investment Management and Division of Corporate Finance jointly issued a Staff Legal Bulletin providing guidance on the proxy voting responsibilities of advisers.<sup>15</sup> The guidance provides examples of how advisers can comply with their fiduciary duties to clients when voting proxies. The guidance also provides SEC staff interpretations of when voting a proxy is not required, the considerations an adviser should take into account when selecting a proxy advisory firm, and an adviser's ongoing duty to oversee any proxy advisory firm it retains. Investment advisers should periodically review their proxy voting policies and should include a review of existing policies, practices, and disclosures as part of their annual compliance reviews.

### **[J] Anti-Money Laundering**

In September 2015, the Financial Crimes Enforcement Network ("FinCEN") proposed rule changes requiring SEC-registered investment advisers to establish anti-money laundering (AML) programs and report suspicious activity to FinCEN.<sup>16</sup> If these rules are ultimately adopted, investment advisers would need to establish AML programs and adopt written policies and procedures reasonably designed to comply with Bank Secrecy Act regulations and to detect and report suspicious transactions. These rules would also require that investment advisers appoint an AML compliance officer, provide AML training for personnel, and annually test their AML program. FinCEN has not yet proposed a customer identification program requirement for investment advisers but anticipates addressing requirements via a joint rulemaking effort with the SEC.

Many investment advisers take on AML obligations by contract pursuant to a series of no-action positions.<sup>17</sup> As part of their annual compliance review, firms should review their AML obligations under existing regulations or by contract, and ensure they are complying with applicable requirements, including appropriate client onboarding

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15. Div. of Inv. Mgmt., Div. of Corp. Fin., SEC, *Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms*, STAFF LEGAL BULLETIN No. 20 (IM/CF) (June 30, 2014), <https://www.sec.gov/interps/legal/cfsfb20.htm>.

16. FinCEN, Dep't of the Treasury, Notice of Proposed Rulemaking: Financial Crimes Enforcement Network: Anti-Money Laundering Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers, 31 C.F.R. ch. X (Aug. 24, 2015), [https://www.fincen.gov/sites/default/files/shared/1506-AB10\\_FinCEN\\_IA\\_NPRM.pdf](https://www.fincen.gov/sites/default/files/shared/1506-AB10_FinCEN_IA_NPRM.pdf).

17. For the most recent no-action letter, see Division of Trading and Markets, SEC No-Action Letter (Dec. 12, 2016), <https://www.sec.gov/divisions/marketreg/mr-noaction/2016/securities-industry-financial-markets-association-120916.pdf>.

processes, annual reviews, and reporting. Investment advisers should also review existing practices to determine the impact of the proposed FinCEN rule.

### **[K] Cybersecurity**

OCIE made cybersecurity a focus of its investment adviser examinations again in 2017 by continuing its cybersecurity examination initiative focused on testing and assessing firms' implementation of cybersecurity procedures and controls. Among other things, OCIE has focused on examinees' governance and risk assessment processes, access rights and controls, data loss prevention, vendor management, training, and incident response. In 2015, as an appendix to a Risk Alert, OCIE released a sample list of information that it would request from firms and review as part of examinations relating to cybersecurity.<sup>18</sup> That document provides a useful model for firms conducting their own annual reviews of cybersecurity-related policies and procedures. Because this is an area of growing threat to investment adviser firms and also rapidly evolving, it is important that firms thoroughly review and test their practices for cybersecurity attack prevention, detection, and response. Firms should also review their practices for notifying clients of cybersecurity attacks as part of their annual compliance review process.

### **[L] Custody**

Investment Advisers Act Rule 206(4)-2 provides that it is a fraudulent, deceptive, or manipulative act under the Investment Advisers Act for an SEC-registered investment adviser to have custody of client funds or securities unless they are maintained in accordance with the requirements of the custody rule. The custody rule has been a frequent source of confusion for investment advisers, along with creating significant regulatory and compliance issues including action by the SEC. In a recent Risk Alert from the SEC, the staff included custody rule violations among the five compliance topics most frequently identified in deficiency letters to advisers following exams.

The SEC issued three new pieces of guidance on custody in 2017 that advisers should carefully assess to ensure that they are not deemed to have "custody" of client assets even though the adviser does not have actual custody of assets:

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18. See OCIE, *OCIE's 2015 Cybersecurity Examination Initiative*, NAT'L EXAM PROGRAM RISK ALERT, vol. IV, issue 8 (Sept. 15, 2015), <https://www.sec.gov/ocie/announcement/ocie-2015-cybersecurity-examination-initiative.pdf>.

- “*Inadvertent custody*” created by broad authority in custodial agreements. In an IM Guidance Update,<sup>19</sup> the SEC staff clarified that broad authority granted to advisers under certain client custodial agreements can create “inadvertent custody” even where the advisory agreement between an adviser and its client provides narrower authority dealing with the inadvertent custody requires affirmative action by the adviser, client, and custodian, and even if the adviser is not aware of the broad grant of authority;
- *Guidance on custody created by standing letters of instruction (SLOAs)*. In a recent no-action letter,<sup>20</sup> the SEC staff clarified that an adviser may have custody and a corresponding surprise exam requirement when an SLOA or other similar asset transfer authorization arrangement is established by a client with a qualified custodian unless the adviser meets the conditions in the no-action letter.
- *Guidance on adviser authority to transfer funds or securities between two or more of a client’s accounts*. In a modified FAQ,<sup>21</sup> the SEC staff clarified that the staff does not view an adviser as having custody where it has the limited authority to transfer a client’s assets between the client’s accounts maintained at one or more qualified custodians subject to certain conditions.

Firms should consider this guidance along with all existing guidance in determining whether they have custody under the custody rule. As part of their annual compliance review, firms should review all existing and new business practices to ensure that they are not engaged in business practices deemed to be custody and, to the extent they do, take the necessary steps required under the custody rule.

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19. Inadvertent Custody: Advisory Contract Versus Custodial Contract Authority, IM Guidance Update No. 2017-01 (Feb. 2017), <https://www.sec.gov/investment/im-guidance-2017-01.pdf>.
  20. Investment Adviser Association, SEC No-Action Letter (Feb. 21, 2017), <https://www.sec.gov/divisions/investment/noaction/2017/investment-adviser-association-022117-206-4.htm>.
  21. SEC, Staff Responses to Questions About the Custody Rule, at Question II.4 (last updated Feb. 12, 2017), [https://www.sec.gov/divisions/investment/custody\\_faq\\_030510.htm](https://www.sec.gov/divisions/investment/custody_faq_030510.htm).

**[M] Dealing with Governmental Entities: Pay-to-Play Practices and Tracking of Political Contributions**

Advisers that currently, or may in the future, provide advisory services to a government entity should periodically review their current recordkeeping and other practices in light of the applicable rules. As part of their annual review process, firms should make sure that political contributions by all executives, employees, and the firm are adequately tracked. Additionally, firms should ensure that their existing practices require the review of any potential government entities against the tracked political donations as part of the new client process. Firms should also consider payments to third-party solicitors as part of the annual review process. The Investment Advisers Act prohibits an investment adviser from paying a FINRA member firm to solicit a government entity for investment advisory services unless the FINRA member firm is subject to an equivalent FINRA pay-to-play rule or otherwise meets the definition of a “regulated person” under the Investment Advisers Act rule. FINRA pay-to-play rules to regulate FINRA members’ distribution or solicitation activities with government entities on behalf of investment advisers went into effect on August 20, 2017.

**[N] Whistleblower Policies**

As part of their annual review process, advisers should review their compliance programs and applicable documents to ensure that they are not violating whistleblower protections. Additionally, firms should consider how whistleblowers might be encouraged to report regulatory and compliance violations internally to enhance the effectiveness of compliance programs. In 2016, OCIE released a Risk Alert announcing that it was examining registered investment advisers’ compliance manuals, codes of ethics, employment agreements, and severance agreements to determine whether provisions in those documents pertaining to confidentiality of information and reporting of possible securities law violations may raise concerns under Securities Exchange Act of 1934 (the “Exchange Act”) Rule 21F-17.<sup>22</sup> In particular, OCIE focused on problematic language in these documents that:

- require an employee to represent that he or she has not assisted in any investigation involving the registrant;

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22. For a copy of the Risk Alert, see OCIE, *Examining Whistleblower Rule Compliance*, NAT’L EXAM PROGRAM RISK ALERT, vol. VI, issue 1 (Oct. 24, 2016), <https://www.sec.gov/files/ocie-2016-risk-alert-examining-whistleblower-rule-compliance.pdf>.

- prohibit any and all disclosures of confidential information, without any exception for voluntary communications with the SEC concerning possible securities laws violations;
- require an employee to notify and/or obtain consent from the registrant prior to disclosing confidential information, without any exception for voluntary communications with the SEC concerning possible securities laws violations; or
- purport to permit disclosures of confidential information only as required by law, without any exception for voluntary communications with the SEC concerning possible securities laws violations.

Firms should review all employment, confidentiality, and severance agreements to ensure that they do not violate whistleblower rules.

### **[O] Solicitors**

Where an adviser makes payments to third-party solicitors, as part of its annual compliance review, it should confirm that such payments and related agreements are in compliance with Investment Advisers Act Rule 206(4)-3 and pay-to-play rules (if a solicitor solicits government entity clients).

### **[P] Robo-Advisers**

Automated investment advisers, known as “robo-advisers,” represent a fast-growing part of the investment advisory industry with unique client relationships that often occur with limited, if any, human interaction and asset management that makes significant use of algorithms. In 2017, the Division of Investment Management issued a Guidance Update focused on robo-advisers providing services directly to clients over the Internet but that was also designed to help other categories of robo-advisers.<sup>23</sup> As part of their annual compliance review, firms engaging in robo-adviser activity as some or all of their advisory business should review their disclosures, practices, and compliance policies and procedures in light of the staff’s guidance. This is likely to be both an area of continued growth and development and, as a result, continued SEC focus.

### **[Q] Training**

As part of the annual compliance program review, firms should review the adequacy of training of investment-adviser-supervised

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23. Robo-Advisers, IM Guidance Update No. 2017-02 (Feb. 2017), <https://www.sec.gov/investment/im-guidance-2017-02.pdf>.

persons and other personnel. This training should be conducted on an ongoing basis and should be shaped by the same focus items that guide the annual compliance program review and compliance program updates (for example, high-risk activities, areas of observed deficiencies, new rules and regulations, etc.). Like other parts of the compliance program, training should be well-documented.

### **§ 24A:3.3 Code of Ethics and Personnel Trading Issues**

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. Pursuant to the 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 twelve-month period thereafter, along with making quarterly reports of transactions. The Investment Advisers Act also provides certain exceptions to the personal securities reporting requirements, including for securities holdings or transactions in trusts or accounts over which the access person had no direct or indirect influence or control. Additionally, the code of ethics should require that all employees attest to acknowledgment, 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.

### **§ 24A:4 Selected Other Filings**

Below is a summary of selected filings that certain investment advisers may be required to make periodically and/or on an ongoing basis. Not all investment advisers will be subject to these filing requirements, and this does not cover all regulatory filings an investment adviser firm may be required to make. Firms should view applicable filing requirements and integrate them into their compliance and operational policies and procedures.

#### **§ 24A:4.1 Section 13 Filings**

##### **[A] Schedules 13D and 13G**

Persons (individuals or entities) with the right to exercise investment discretion or voting power over 5% 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 public companies covered by these requirements include listed exchange-traded funds, other exchange-traded portfolios, and closed-end funds. The eligibility, filing thresholds, amendment requirements, and timing requirements for each such schedule varies and persons should review the requirements if they have crossed, or are about to cross, such threshold with respect to any security.

### **[B] Form 13F**

If a person exercised investment discretion over \$100 million or more invested in “13(f) securities” as of the last day of any calendar month, the person must report those holdings to the SEC by filing a Form 13F. The SEC publishes a list of all “13(f) securities.”<sup>24</sup> Reporting persons must file Form 13F reports for year-end holdings for the first year the person crosses the filing threshold and quarterly thereafter. Reporting persons must file these reports quarterly within forty-five days after the relevant reporting date.

### **[C] 13H Large Trader Reporting Obligations**

“Large traders” meeting certain definitional thresholds in transactions in “NMS securities” must identify themselves to the SEC and make certain disclosures to the SEC on Form 13H. “Large traders” generally include any person whose transactions in NMS securities in the aggregate equal or exceed 2 million shares or \$20 million during any calendar day, or 20 million shares or \$200 million during any calendar month. These levels include transactions effected by a person for its own account and for accounts for which the person exercises investment discretion. In general, “NMS securities” include exchange-listed equity securities and standardized options, but do not include exchange-listed debt securities, securities futures, or shares of typical open-end mutual funds, which are not currently reported pursuant to an effective transaction reporting plan. In addition to an initial filing, all large traders must submit an annual filing on Form 13H within forty-five days after the end of the calendar year and submit any amendments promptly after the end of any calendar quarter where information in the form becomes materially inaccurate. Upon receiving Form 13H for the first time, the SEC will assign large traders an identification number (an “LTID”). Large traders are required to provide their LTIDs to all registered broker-dealers carrying their accounts and/or effecting transactions in NMS securities on their behalf. Registered broker-dealers are required to maintain certain

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24. SEC, OFFICIAL LIST OF SECTION 13(f) SECURITIES (last updated July 5, 2017), <https://www.sec.gov/divisions/investment/13flists.htm>.

records in connection with such transactions and provide such information to the SEC upon request if they (1) are large traders, (2) carry accounts of large traders, or (3) effect transactions in NMS securities on behalf of large traders. All registered broker-dealers are also required to perform monitoring of accounts to identify potential large traders that have not identified themselves to the SEC.

### **§ 24A:4.2 SEC Form D and Related State Blue Sky Filing Requirements**

Form D is required to be filed with the SEC by all issuers that sell securities in reliance on Regulation D under the Securities Act of 1933 (the “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. 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 interests 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 as needed prior to offering or selling any interests in a fund to U.S. investors in any new states to ensure compliance.

### **§ 24A:4.3 Section 16 Filings**

If a person (individuals or entities) holds a beneficial ownership of more than 10% of any class of equity securities registered under section 12 of the Exchange Act, and is an officer, director, or beneficial owner of such issuer, the person may be required to file Form 3, 4, or 5 regarding crossing certain thresholds, reporting certain sales, and making certain annual reports.

### **§ 24A:4.4 Form PF Filings**

Investment advisers registered with the SEC that advise one or more private funds and have at least \$150 million in private fund assets under management must file Form PF with the SEC. A CFTC rule also requires CPOs and CTAs registered with the CFTC to satisfy certain CFTC filing requirements with respect to private funds by filing Form PF with the SEC, but only if those CPOs and CTAs are also registered with the SEC as investment advisers and are required to file Form PF under the Investment Advisers Act. The CFTC rule also

allows such CPOs and CTAs to satisfy certain CFTC filing requirements with respect to commodity pools that are not private funds by filing Form PF with the SEC. Advisers must file Form PF electronically, on a confidential basis. Under the reporting requirements, private fund advisers are divided by size into two broad groups: large advisers and smaller advisers. Large private fund advisers include any adviser with \$1.5 billion or more in hedge fund assets under management, \$1 billion in liquidity fund or registered money market fund assets under management, or \$2 billion in private equity fund assets under management. Large private fund advisers must file Form PF on a quarterly basis and must provide more detailed information than smaller advisers. Smaller private fund advisers must file Form PF only once a year within 120 days of the end of the fiscal year, and report only basic information regarding the private funds they advise. The SEC's Division of Investment Management maintains frequently asked questions regarding Form PF to address a variety of issues, including reported borrowings, reverse repos, fund categorization, parallel managed accounts, investments in other unregistered funds, and calculation of a fund's gross assets.

#### **§ 24A:4.5 Treasury International Capital (TIC) Reporting**

The Department of the Treasury's Treasury International Capital (TIC) Form SLT is required to be filed by all U.S. individuals or entities who qualify as U.S. resident custodians, issuers, and/or end investors, and whose consolidated long-term reportable securities exceed \$1 billion as of the last business day of the reporting month. For example, U.S.-based investment advisers with aggregate holdings of reportable long-term securities with a fair market value of at least \$1 billion by the adviser and its clients are likely to be subject to Form SLT reporting. The form is designed to gather timely and reliable information on long-term U.S. securities held by foreign residents and long-term foreign securities held by U.S. residents. The U.S. government uses this information in the formulation of U.S. international financial and monetary policies, and for the preparation of the U.S. balance of payments accounts and the U.S. international investment position. Where the securities are held by a U.S.-resident custodian, Form SLT would be due from the custodian and not from the beneficial owner of the securities. Form SLT is required to be filed based on a reporting date of the last business day of each quarter and as of the last business day of each month in which the \$1 billion threshold is exceeded and monthly thereafter. The form must be submitted no later than the twenty-third calendar day of the month following the applicable reporting date. All Form SLTs must be submitted electronically using the Federal Reserve System's "Reporting Central" system.

Advisers should review whether they have any reporting obligations with respect to Form SLT in connection with any accounts where they act as adviser and/or custodian. As a result of their responses on Form SLT, certain firms may be required to perform additional reporting on annual Forms SHCA and/or SHLA. Firms have no reporting obligations on Form SHCA or Form SHLA unless contacted individually by the Federal Reserve Bank of New York.

The Department of the Treasury now requires certain investment advisers to private funds with significant claims and/or liabilities with non-U.S. entities to report certain information on the TIC Form B series. Investment advisers to private funds are generally required to report on the Form B series if the claims or liabilities of the funds to which they serve as adviser are, on a consolidated basis, at least \$25 million in any individual country or at least \$50 million aggregated across all non-U.S. geographic areas. The specific forms required to be submitted depend on the types of claims or liabilities exceeding the reporting threshold amounts. The extent of information collected and frequency of reporting vary by form.

#### **§ 24A:4.6 Hart-Scott-Rodino Filings**

Parties to certain transactions (including purchases of publicly traded securities) that meet certain thresholds are required to file premerger notification forms with the FTC and Department of Justice Antitrust Division and 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 above the minimum threshold (\$80.8 million for 2017) using the HSR Act’s valuation mechanics, legal consultation should be obtained regarding the filing obligations or the availability of applicable exemptions. The minimum threshold is adjusted on a yearly basis.

#### **§ 24A:4.7 Specified Foreign Financial Assets—FATCA**

The Foreign Account Tax Compliance Act (FATCA) requires U.S. citizens and residents to file Form 8938 under U.S. Internal Revenue Code section 6038D to report an interest in a “foreign financial asset” if the aggregate value of all such assets exceeds certain thresholds. Nonresident aliens are also required to file if they make an election to be treated as a resident alien for purposes of filing a joint income tax return or if they are a bona fide resident of American Samoa or Puerto Rico. A reportable foreign financial asset for this purpose includes financial (deposit and custodial) accounts held at foreign financial institutions, foreign stock or securities not held in a financial account, foreign partnership interests, foreign mutual funds, foreign hedge

funds, and foreign private equity funds. An “interest” exists when any income, gain, loss, deduction, credit, gross proceeds, or distribution from holding or disposing of the account or asset would be required to be reported on an income tax return. The threshold for filing varies based on filing status and whether the individual lives within the United States. For example, an unmarried taxpayer living within the United States must file if the aggregate value of the foreign financial assets is more than \$50,000 on the last day of the tax year or more than \$75,000 at any time during the tax year. The initial penalty for failure to file is \$10,000, plus \$10,000 for each thirty-day period of non-filing occurring ninety days after an Internal Revenue Service (IRS) notice of failure to disclose, with a maximum total penalty of \$60,000.

### **§ 24A:4.8 FBAR Reporting**

U.S. persons having financial interests in or signatory or other authority over bank, securities, or other financial accounts in a foreign country must file a FinCEN Report 114 (Report of Foreign Bank and Financial Accounts or “FBAR”) reporting such relationship by April 15th of the year following that in which the relationship existed if the aggregate value of all foreign financial accounts exceeds \$10,000 at any time during the calendar year. A maximum six-month extension is also available to FBAR filers. FinCEN Report 114 may be filed only through the Treasury’s e-filing system. Financial accounts subject to FBAR include accounts with a mutual fund or similar pooled fund that issues shares available to the general public that have a regular net asset value determination and regular redemptions. Under guidance on the IRS website, hedge funds and private equity funds that do not issue shares to the general public do not fall within the scope of FBAR. Regulations also provide exceptions to reporting for officers and employees of financial institutions, entities registered with and examined by the SEC that provide services to investment companies registered under the Investment Company Act of 1940, and certain entities that have equity securities listed on any U.S. national securities exchange or registered under section 12(g) of the Exchange Act, in each case that they have signature authority over, but not financial interests in, foreign financial accounts owned or maintained by such entity.

### **§ 24A:5 Annual Delivery and Certification Requirements**

#### **§ 24A:5.1 Adviser Brochure and Brochure Supplement Delivery**

Both an adviser’s brochure and applicable brochure supplements should be delivered to new and prospective clients before or at the time

of entering into an advisory contract. SEC-registered advisers must also deliver the brochure to existing clients within sixty days of filing any update. State rules provide similar delivery requirements. After the initial delivery, advisers may provide to each client a summary of material changes, an offer to provide a copy of the updated brochure and brochure supplements, and information on how a client may obtain the brochure and brochure supplements instead of delivering a copy of the updated brochure and brochure supplements. An adviser must file such a summary on the IARD system as an exhibit to the brochure as part of the annual updating amendment. Many advisers to private investment funds have made a practice to offer or actually deliver the brochure and brochure supplements to investors in private investment funds managed by the adviser. Although generally not required, advisers should consider offering or delivering the entire brochure and brochure supplement to investors in private investment funds managed by the adviser.

### **§ 24A:5.2      *Privacy Notices***

Firms subject to the Privacy Regulations must deliver notices of their privacy policies and practices to customers at the time the firm enters into a relationship with the customer and annually thereafter. The Privacy Regulations include a model privacy notice form. The Privacy Regulations provide a safe harbor for the privacy notice delivery requirement if a person delivers a privacy notice that conforms to the model privacy notice form. Investment advisers, funds, CPOs, and CTAs do not need to comply with the annual notice requirement if the firm: (i) only shares non-public personal information with third parties in a manner that does not require an opt-out right be provided to customers (for example, only in limited circumstances to service providers, for fraud detection and prevention purposes, etc.), and (ii) has not changed its policies and practices from those disclosed in the most recent disclosure provided to the customer. After providing a notice to such client or investor, firms 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.

### **§ 24A:5.3      *Annual Custody Audit and Financial Statement Delivery***

SEC-registered advisers deemed to have custody of client assets are generally required to contract with an independent public accountant for an annual surprise audit to verify client assets. SEC-registered advisers to hedge funds and other pooled investment vehicles are generally exempt from the annual surprise audit requirements if

financial statements prepared in accordance with U.S. generally accepted accounting principles and audited by an independent public accountant are delivered to investors within 120 days after the end of a fund's fiscal year (180 days in the case of funds of funds). Advisers relying on this exemption should ensure that financial statements are delivered to investors in the form and at the time required. Firms deemed to have custody of client assets should review the sufficiency of their contracts with independent public accountants under the Investment Advisers Act custody rule and verify that annual surprise audits are actually occurring as required. Firms that are deemed to have custody of client assets for the first time should ensure that they have such arrangements in place.

#### **§ 24A:5.4 New Issue Certifications**

Members of FINRA are prohibited from selling “new issues” to any client unless such member receives a representation from the client within the past twelve 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 (for example, a hedge fund) pursuant to FINRA Rule 5130. Investment advisers must reconfirm the “restricted person” status at least annually. This annual certification may be obtained through a negative consent letter.

### **§ 24A:6 Other Annual Legal and Compliance Considerations**

#### **§ 24A:6.1 Review of Advisory Agreements**

Section 205 of the Investment Advisers Act requires all advisory contracts to include certain provisions and prohibits the contracts from including other provisions entered into by advisers registered with, or required to be registered with, the SEC. These requirements are described in greater detail in other chapters of this treatise. However, as part of their annual compliance reviews, firms should review their advisory agreements and determine if any changes are necessary based on regulatory changes, changes to an adviser's business practices, changes to an adviser's client base, and based on SEC and/or internal reviews.

#### **§ 24A:6.2 CPO and CTA Registration and Exemption Filings**

Registered CPOs and CTAs must update their National Futures Association (NFA) registration information and pay annual NFA dues on or before the anniversary of the date the CPO's or CTA's registration became effective. Failure to file the update as of the due date will

be deemed a request for withdrawal from registration effective thirty days after the failure to complete the update. CFTC regulations require any person claiming an exemption or exclusion from CPO registration under CFTC Regulation 4.5, 4.13(a)(1), 4.13(a)(2), 4.13(a)(3), or 4.13(a)(5), or an exemption from CTA registration under 4.14(a)(8), to annually affirm the applicable notice of exemption or exclusion within sixty days of the calendar year-end. Failure to affirm an exemption or exclusion will be deemed a request to withdraw the exemption or exclusion and result in the automatic withdrawal of the exemption or exclusion. These affirmations can be made through the NFA's website. CPOs and CTAs are subject to certain quarterly and annual reporting requirements absent applicable exemptions.

While a full discussion of CPO and CTA compliance reviews is beyond the scope of this chapter, registered CPOs and CTAs must complete and retain the NFA's "self-examination questionnaire" annually, including with respect to 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. 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, and update disclosure documents.

### **§ 24A:6.3      *Municipal Advisor Exclusion***

Exchange Act Section 15B and Rule 15Ba1-1 exclude registered investment advisers from the definition of "municipal advisor" to the extent that the investment adviser is providing investment advice in its capacity as a registered investment adviser. However, the rule does not exclude registered investment advisers who provide advice concerning whether and how to issue municipal securities, advice concerning the structure, timing, and terms of an issuance of municipal securities, and other similar matters, or advice concerning municipal derivatives. The registered investment adviser exclusion also does not apply to the solicitation of a municipal entity or obligated person for another investment adviser. An "obligated person" is any entity that is committed by contract or other arrangement to support the payment of all or part of the obligations on the municipal securities (such as a borrower under a conduit municipal bond issue). Registered investment advisers that provide any services to municipal entities or obligated persons should review their activities on an ongoing basis

to ensure that they do not inadvertently subject themselves to municipal advisor registration, duties, and compliance requirements.

#### **§ 24A:6.4 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.

#### **§ 24A:6.5 Review of Liability Insurance**

Given the environment of investor lawsuits and increasing focus on the regulation of fund managers, investment advisers should regularly review the adequacy of all their insurance coverage. The annual review is a good time to consider obtaining management liability insurance or review existing coverage.

#### **§ 24A:6.6 ERISA Review**

Investment advisers to private funds should consider whether they need to reconfirm whether any of the investors in their funds are "benefit plan investors" under the Employee Retirement Income Security Act of 1974 (ERISA) and whether investments by benefit plan investors result in fund assets being characterized as "plan assets" for purposes of ERISA. In particular, advisers should review benefit plan investors' investments in investment funds managed by the adviser to determine whether participation in the fund by "benefit plans" is "significant" (that is, whether it qualifies for the 25% "significant participation" exemption under ERISA). This may be particularly important where a significant amount of assets has recently been withdrawn or redeemed.

#### **§ 24A:6.7 Department of Labor Conflict of Interest Rule**

In April 2016, the Department of Labor (DOL) released its final rule to define the term "fiduciary" and address conflicts of interest in providing investment advice to retirement accounts along with related exemptions. The fiduciary rule generally requires anyone who provides investment advice to individual retirement accounts and ERISA-covered employee benefit plans to abide by ERISA's fiduciary standards and prohibited transaction rules, subject to certain limited exceptions. The rule and certain parts of its related prohibited transaction exemptions took effect on June 9, 2017. On August 31, 2017, the DOL proposed a delay of the more onerous requirements of certain exemptions, including the Best Interest Contract exemption, until July 1,

2019. As a result, advisers who provide investment advice to ERISA retirement plans and individual retirement accounts are currently fiduciaries under the rule. Assuming the proposed delay of significant parts of the Best Interest Contract exemption and certain other exemptions are adopted, advisers need only comply with the “Impartial Conduct Standards” of the Best Interest Contract exemption to qualify for the exemption through June 30, 2019. This means that an adviser must (1) act in the best interest of the retirement investor, (2) adhere to the duties of prudence and loyalty, (3) not make any misleading statements regarding the investment, and (4) charge no more than “reasonable compensation.” Advisers should consider appropriate changes to compliance policies and procedures in light of the portions of the rule that are currently in effect, while also monitoring developments that will likely occur during a delay period.

During any delay period, the DOL would continue to reexamine the fiduciary rule and exemptions. The DOL indicated that it will also propose a new and more streamlined prohibited transaction exemption based on recent innovations in the financial services industry. The delay would also give the DOL time to engage constructively with the SEC as the SEC moves forward with its own examination of the standards of conduct of investment advisers and broker-dealers.