Client Alert

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CURRENT ISSUES RELEVANT TO OUR CLIENTS FEBRUARY 1, 2012

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. This Alert briefly summarizes some of the primary issues that advisers might consider in their 2012 annual review and update processes. *Many of these issues apply to unregistered advisers as well as registered advisers.*

Dodd-Frank Act: Impact on Investment Advisers

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") makes significant changes to the existing legal framework affecting nearly every aspect of the financial services industry. This includes substantial changes for investment advisers, including numerous changes to the registration, reporting, and recordkeeping obligations of investment advisers. During the past year, the Securities and Exchange Commission (the "SEC") has been engaged in extensive rulemaking under the Dodd-Frank Act affecting investment advisers. This summary discusses this rulemaking, but a more complete summary of the impact of the Dodd-Frank Act on the asset management industry is available at http://www.chapman.com/media/news/media.901.pdf. If you have any questions about how the Dodd-Frank Act impacts you, please contact us.

Private Adviser Exemption (Fewer Than 15 Clients) Eliminated

Prior to the Dodd-Frank Act amendments, Section 203(b)(3) of the Investment Advisers Act of 1940 ("Advisers Act") exempts from registration investment advisers who, during the last twelve months, had fewer than fifteen clients and who do not hold themselves out generally to the public as investment advisers or act as investment advisers to a registered investment company or a business development company. The Dodd-Frank Act eliminates this exemption, which is frequently relied upon by private fund managers as well as certain advisers with a small number of client accounts. Certain family offices also relied on this exemption (or certain SEC exemptive relief) but many family offices will qualify for the "family office" exclusion from the "investment adviser" definition discussed below. The SEC finalized rulemaking related to this issue on June 22, 2011. Investment advisers that previously relied on this exemption will be required to be registered with the SEC effective March 30, 2012, absent some other exemption. The SEC has suggested that it might take up to 45 days for the SEC to process an initial application for registration, so newly registering advisers should submit their application for registration on Form ADV to the SEC by mid-February 2012.

Private Fund Advisers Excluded From Intrastate Adviser Exemption

The Dodd-Frank Act makes the Advisers Act Section 203(b)(1) registration exemption inapplicable to investment advisers to private funds. That exemption relates to an investment adviser whose clients are all residents of the state within which the investment adviser maintains its principal place of business, and who does not furnish advice or issue analyses or reports with respect to securities listed or admitted to unlisted trading privileges on any national securities exchange.

New Exemptions

The Dodd-Frank Act adds several new registration exemptions for certain advisers. It is important to note that these provisions are exemptions from registration with the SEC for firms that fall within the statutory definition of "investment adviser". As a result, advisers exempt from registration remain subject to the antifraud provisions of the Advisers Act (Section 206 and certain rules thereunder). This is also generally the case for advisers not permitted to register with the SEC (discussed below).

Attorney Advertising Material

These registration exemptions should be distinguished from exclusions from the definition of “investment adviser” (e.g., the “family office” exclusion discussed below).

Foreign Private Advisers. The Dodd-Frank Act adds an exemption from registration for certain “foreign private advisers”. A “foreign private adviser” is:

- any investment adviser who has no place of business in the US,
- has fewer than 15 clients and investors in the US in private funds advised by the adviser,
- has assets under management attributable to clients in the US and US investors in private funds of less than $25 million (or such higher amount adopted by the SEC), and
- neither holds itself out generally to the public in the US as an investment adviser nor acts as an adviser to a US registered investment company or business development company.

On June 22, 2011, the SEC adopted rules addressing several issues arising under this new exemption for details on these rules, please see our Client Alert which is available at http://www.chapman.com/media/news/media.1038.pdf. As a practical matter, many unregistered non-US advisers will likely be required to register under the new rules because non-US advisers will need to count assets attributable to US investors in non-US funds they manage for purposes of the $25 million assets under management test.

Commodity Futures Trading Commission (“CFTC”)-Registered Commodity Trading Advisors that Advise Private Funds. The Advisers Act currently contains an exemption for any investment adviser that is registered with the CFTC as a commodity trading advisor whose business does not consist primarily of acting as an investment adviser (as defined under the Advisers Act) and that does not act as an investment adviser to a registered investment company or a business development company. The Dodd-Frank Act adds an exemption for any investment adviser that is registered with the CFTC as a commodity trading advisor and advises a private fund, provided that such an adviser must register with the SEC if the business of the adviser later becomes predominately the provision of securities-related advice.

Venture Capital Fund Advisers. The Dodd-Frank Act provides a new exemption from registration and reporting for investment advisers with respect to the provision of investment advice to a “venture capital fund or funds” with such term to be defined by the SEC. On June 22, 2011, the SEC adopted new rules defining “venture capital fund” and providing for certain requirements regarding recordkeeping, reporting, and examination of venture capital fund advisers. New Advisers Act Rule 203(l)-1 defines a “venture capital fund” as a private fund that has the following characteristics:

- Represents itself as pursuing a venture capital strategy: The fund must represent itself to investors and potential investors as pursuing a venture capital strategy.
- Invests primarily in qualifying investments and short-term holdings: Immediately after the acquisition of any asset, the fund must hold no more than 20 percent of the amount of the fund’s aggregate capital contributions and uncalled committed capital in assets that are not “qualifying investments” or “short-term holdings”. “Qualifying investments” generally consist of any equity security issued by a “qualifying portfolio company” that is directly acquired by the fund and certain equity securities exchanged for the directly acquired securities. “Short-term holdings” include cash and cash equivalents and US Treasuries with a remaining maturity of 60 days or less.
- Very limited use of borrowing: The fund must not borrow, issue debt obligations, provide guarantees, or otherwise incur leverage in excess of 15 percent of the fund’s aggregate capital contributions and uncalled committed capital, and any such borrowing, indebtedness, guarantee, or leverage is for a non-renewable term of no longer than 120 calendar days (excluding certain guarantees of qualifying portfolio company obligations).
- No investor withdrawal rights: The fund must only issue securities the terms of which do not provide a holder with any right, except in extraordinary circumstances, to withdraw, redeem, or require the repurchase of such securities but may entitle holders to receive distributions made to all holders pro rata.
- Not a registered investment company: The fund must not be registered under the Investment Company Act of 1940 (the “Investment Company Act”) and may not have elected to be treated as a business development company under that Act.

For additional details on the final rules, including the definition of "qualifying portfolio company" and a discussion of SEC reporting requirements, please see our Client Alert which is available at http://www.chapman.com/media/news/media.1038.pdf.

Smaller Private Fund Advisers (US AUM less than $150 million). The Dodd-Frank Act requires the SEC to adopt a separate exemption from registration for investment advisers that act solely as advisers to private funds and that have assets under management in the US of less than $150 million. Advisers falling under this exemption will be subject to annual reporting and record keeping requirements. On June 22, 2011, the SEC adopted new Advisers Act Rule 203(m)-1 to provide a registration exemption for these advisers. The rule provides an exemption from Advisers Act registration for the following investment advisers:

- US Advisers: an investment adviser with its principal office and place of business in the US if the adviser (1) acts solely as an adviser to one or more qualifying private funds and (2) manages private fund assets of less than $150 million.

- Non-US Advisers: an investment adviser with its principal office and place of business outside of the US if (1) the adviser has no client that is a US person except for one or more qualifying private funds and (2) all assets managed by the adviser from a place of business in the US are solely attributable to private fund assets, the total value of which is less than $150 million.

For additional details on the final rules, including how to determine the location of an adviser's principal office and place of business, how to determine assets under management, the definition of "qualifying private fund", and a discussion of SEC reporting requirements, please see our client alert which is available at http://www.chapman.com/media/news/media.1038.pdf.

Advisers to Small Business Investment Companies. The Dodd-Frank Act adds an exemption as Advisers Act Section 203(b)(7) which exempts from registration any investment adviser (other than an entity that has elected to be regulated as a business development company pursuant to section 54 of the Investment Company Act) who solely advises (a) small business investment companies licensed under the Small Business Investment Act of 1958 (the "SBIA"), (b) entities that have received notice to proceed to qualify for a license as a small business investment company under the SBIA, or (c) applicants that are affiliated with one or more licensed small business development company under the SBIA and have themselves applied for a license under the SBIA.

Family Offices Excluded from "Investment Adviser" Definition

To prevent typical family offices from being treated as investment advisers under the Advisers Act after the Dodd-Frank Act changes discussed above, the Dodd-Frank Act adds a new exclusion from the definition of "investment adviser" for family offices as defined by rule, regulation, or order of the SEC. On June 22, 2011, the SEC adopted a new rule under the Advisers Act defining a "family office" as a company that (a) has no clients other than family clients, (b) is wholly owned and controlled (directly or indirectly) by family members, and (c) does not hold itself out to the public as an investment adviser. The rule also provides that the "family office" definition includes a company's directors, partners, trustees, and employees acting within the scope of their position or employment and that comply with the requirements of the rule. The rule also includes grandfathering of certain family offices; however, these family offices may remain subject to the antifraud provisions of the Advisers Act. For additional details, please see our related Client Alert which is available at: http://www.chapman.com/media/news/media.1034.pdf.

Small and Mid-Sized Advisers Not Permitted to Register with SEC

Under pre-Dodd-Frank Act law, investment advisers with less than $25 million in assets under management ("AUM") are generally not permitted to register as investment advisers with the SEC if the adviser was regulated or required to be regulated as an investment adviser in the state in which it maintains its principal office and place of business. These advisers generally were required to register with one or more states. Under pre-Dodd-Frank SEC rules, advisers with between $25 and $30 million in AUM could generally register with the SEC or applicable states. Effective July 21, 2011, the Dodd-Frank Act effectively increased the AUM dollar amount threshold for SEC investment adviser registration to $100 million from the current $25 million. In doing so, however, the Dodd-Frank Act retains a $25 million threshold and generally creates two classes of advisers:

- Small Advisers: advisers with AUM of less than $25 million that are regulated or required to be regulated as investment advisers in the state in which the adviser maintains its principal office and place of business and

- Mid-Sized Advisers: advisers with AUM of between $25 million and $100 million that are required to be registered as an investment adviser in the state in which the adviser maintains its principal office and place of business and, if registered, would be subject to examination as an investment adviser by such state.

Under the Dodd-Frank Act changes, these small and mid-sized advisers are generally not permitted to register with the SEC but will register with one or more states, subject to certain exceptions and exemptions. Investment advisers that are advisers to registered investment companies or to business development companies are excluded from this prohibition and must register with the SEC.

On June 22, 2011, the SEC adopted new rules that, among other things, include provisions related to the changes in the foregoing statutory thresholds for SEC adviser registration, additional exclusions from the prohibition from registration for advisers not meeting statutory thresholds, and amendments to Form ADV related to these issues. For additional details regarding the new SEC rules, please see our client alert which is available at http://www.chapman.com/media/news/media.1038.pdf. After giving effect to these final SEC rules, the distinction between small advisers and mid-sized advisers does not matter for purposes of determining eligibility for state or SEC registration for advisers in most states. The distinction generally only matters for states that (1) require investment adviser registration but (2) do not have an investment adviser examination program. Based on current SEC guidance, this appears to be the case only in New York (some confusion initially existed with respect to Minnesota, but the state has clarified that it does examine advisers). Wyoming is the sole state that does not require investment adviser registration or examination, and all advisers that maintain their principal office and place of business in Wyoming will continue to be eligible for SEC registration. The Dodd-Frank Act also makes a distinction between small advisers and mid-sized advisers in that under the statutory changes mid-sized advisers that are required to register with 15 or more states as a result of the statutory prohibition are permitted to register with the SEC. Under pre-Dodd-Frank SEC rules, a small adviser that is required to register with 30 or more states is permitted to register with the SEC. However, the SEC is essentially eliminating this distinction in its new rules. As a result, advisers that maintain their principal office and place of business in states other than New York can generally treat the Dodd-Frank Act and related rules as raising the current $25 million threshold to $100 million and ignore the distinction between small and mid-sized advisers.

For additional details on implementation of the new state/SEC threshold, please see our Client Alert available at http://www.chapman.com/media/news/media.1038.pdf and our Dodd-Frank Act summary available at http://www.chapman.com/media/news/media.901.pdf.

The new rules also amend Advisers Act Rule 203A-1 to provide newly registering advisers with a choice between state and SEC registration when they have $100 million to $110 million in AUM. Once registered, advisers will not be required to withdraw registration unless they have less than $90 million in AUM. Thus, the SEC has created a buffer range from $90 million to $110 million in AUM to prevent advisers from having to switch between SEC and state registration. However, the final rules also eliminate the current $5 million buffer for small advisers with $25-$30 million in AUM. Under the new rules, if an adviser is registered with a state security authority, it must apply for registration with the SEC within 90 days of filing an annual Form ADV amendment reporting that it is eligible for SEC registration and not relying on an exemption from registration. If an adviser is registered with the SEC and files an annual Form ADV update reporting that it is not eligible for SEC registration (and is not relying on an exemption), it must withdraw from SEC registration within 180 days of its fiscal year end. During a period where an adviser is registered with both the SEC and one or more state securities authorities, the Advisers Act and applicable state law will apply to such adviser’s advisory activities.

Reporting for “Exempt Reporting Advisers”

New Dodd-Frank Act rules require certain reporting related to private funds for registered investment advisers and advisers relying on the venture capital fund and smaller private fund adviser exemptions discussed above (“exempt reporting advisers”). As a result, exempt reporting advisers, although not registered, are required to file a Form ADV and pay a filing fee of $150. Exempt reporting advisers are only required to provide information relating to certain items in Form ADV. Exempt reporting advisers will be required to file their initial Form ADV no later than March 30, 2012, and will be subject to an annual filing requirement of an updated Form ADV within 90 days of the end of the adviser’s fiscal year and more frequently as required by Form ADV. Exempt reporting advisers will be subject to certain recordkeeping requirements under the Dodd-Frank Act as determined by the SEC.

“Qualified Client” Threshold Updated
To comply with new Dodd-Frank Act requirements, the SEC has issued an order revising the dollar amount tests for the “qualified client” definition in Advisers Act Rule 205-3 providing exemptions from the general Advisers Act prohibition on performance-based compensation for registered investment advisers. The SEC order changed the previous $750,000 assets under management test to $1 million and changed the current net worth test to $2 million. Either of these tests must be met at the time of entering into the advisory contract. To the extent they have not already done so, registered investment advisers that impose performance fees should prepare to amend form advisory agreements to account for the new thresholds for contracts entered into after September 19, 2011. In addition, registered advisers that manage hedge funds, private equity funds, or other private funds that impose performance fees or incentive/carried interest allocations should revise subscription documents as necessary to account for the new thresholds for investors admitted to funds after September 19, 2011.

Changes to the Accredited Investor Definition
The Dodd-Frank Act requires the SEC to adjust the net worth standard applicable to natural persons in the definition of “accredited investor” used in Regulation D and Rule 215 under the Securities Act of 1933 (the “Securities Act”) to exclude the value of a person’s primary residence from the net worth calculation. This primary residence exclusion was effective as of July 21, 2010, and the SEC has since adopted amendments to Regulation D and Rule 215 under the Securities Act to implement the exclusion. The net worth standard of the “accredited investor” definition in Rules 215(e) and 501(a)(5) under the Securities Act has been amended to include any natural person whose individual net worth, or joint net worth with that person’s spouse, exceeds $1 million except that the person’s primary residence may not be included as an asset for purposes of calculating net worth under this rule. Additionally, the final amendments include (1) provisions addressing the treatment of debt secured by the primary residence for purposes of the accredited investor standard and (2) a grandfathering provision that permits application of the former accredited investor net worth test in certain limited circumstances. Issuers relying on the definition of “accredited investor” should revise their disclosure and subscription documents to the extent necessary to reflect these changes. For information about the SEC amendments implementing the changes, see our client alert available at http://www.chapman.com/media/news/media.1129.pdf.

SEC Whistleblower Program
The Dodd-Frank Act requires the SEC to adopt rules that provide for the payment of rewards to individuals who provide the SEC with original information that leads to successful enforcement actions. Prior to Dodd-Frank, the SEC’s reward-paying program was limited to insider trading cases and the amount of an award was capped at 10 percent of the penalties collected. The SEC adopted new rules implementing the whistleblower program that became effective in August 2011. Under the new rules, persons who provide information to the SEC about a violation of any securities law may be eligible to receive between 10 percent and 30 percent of amounts that the SEC recovers through enforcement actions resulting in monetary sanctions of more than $1 million. For advisers that have not done so already, this would be a good time to consider adopting or strengthening internal policies to promote employee reporting of violations of firm policies and procedures along with regulatory violations. For additional information about the adopted whistleblower rules, please see our client alert available at http://www.chapman.com/media/news/media.1022.pdf.

Investment Adviser Registration and Disclosure Issues

Form ADV Annual Update
Investment advisers registered with the 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, 2012, through December 31, 2012, the applicable fees are: $40 for advisers with assets under management below $25 million; $150 for advisers with assets under management of at least $25 million but less than $100 million; and $225 for advisers with assets under management of $100 million or more.

New Form ADV Part 1
Part 1 of Form ADV has been amended, in part to align with the new eligibility requirements and exemptions under the Dodd-Frank Act described above. The revised Form ADV also changes the instructions to the Form to implement a uniform method of calculating AUM. Rule 203A-3 is amended to require that the calculation of “assets under management” for purposes of Section 203A be the calculation of the securities portfolios with respect to which an investment adviser provides continuous and

regular supervisory or management services, regardless of whether these assets are proprietary assets, assets managed without receiving compensation, or assets of foreign clients. Form ADV generally defines "securities portfolio" to include an account that has at least 50 percent of its total value represented by "securities" with cash and cash equivalents treated as "securities" solely for this purpose. Form ADV now eliminates adviser discretion in including (or excluding) these assets from the AUM calculation, which effectively gave certain advisers the ability to opt into or out of state or federal regulation. The new rules also alter the reference to an adviser's "regulatory assets under management" in Part 1A of Form ADV to differentiate it from the amount of AUM disclosed to clients in Part 2 of Form ADV (which do not necessarily need to meet Section 203A requirements). The updates to Form ADV also require advisers to provide additional information on Form ADV about three primary areas: (i) private funds advised by the adviser; (ii) the adviser's employees, clients, and advisory activities; and (iii) other business activities and financial industry affiliations of the adviser.

Annual Filing and Delivery Requirements for Form ADV Part 2

All advisers registered with the SEC are required to file an updated Form ADV Part 2A (the "brochure") annually as part of their Form ADV filing. Form ADV Part 2B (the "supplement") should be updated annually and maintained in a firm's files. Both the brochure and supplement should generally be delivered to new and prospective clients before or at the time of entering into an advisory contract. The brochure must also be delivered to existing clients within 60 days of filing. 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 supplement, and information on how a client may obtain the brochure and supplement instead of providing a copy of the updated brochure and supplement. Such a summary would need to be filed on IARD as an exhibit to the brochure as part of the annual updating amendment. It has been a customary practice of many advisers to private investment funds to make an offer or actual delivery of the brochure and supplement to investors in private investment funds managed by the adviser. Advisers should consider delivering the entire brochure and supplement to investors in private investment funds managed by the adviser.

Form ADV Ongoing 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 (a) any information provided in response to Item 1, 3, 9 (except 9.A.(2), 9.B.(2), and 9.F), 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 of Part 1.B become 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.

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 Form ADV, other states may require the filing of other documents (including the brochure and/or brochure supplement) 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.

Registration Requirements for Certain Special Purpose Vehicles of Investment Advisers

In January 2012, in response to a request by the American Bar Association, Business Law Section, the staff of the SEC provided its views on various issues regarding registration requirements for certain investment advisers that are related to investment advisers that are registered with the SEC. In particular, the SEC staff confirmed that, subject to certain conditions, it would not recommend enforcement action to the SEC under Section 203(a) or 208(d) of the Advisers Act against a registered adviser or a related special purpose vehicle ("SPV") established to act as the general partner or managing member of a

private fund managed by the registered adviser if the SPV does not separately register as an investment adviser. While the SEC staff previously commented on this issue in a letter addressed to the American Bar Association's Subcommittee on Private Investment Entities in 2005, the SEC staff clarified certain of these views in light of recent amendments to the Advisers Act pursuant to the Dodd-Frank Act. For more information about the SEC letters including the specific conditions please see our client alert available at http://www.chapman.com/media/news/media.1142.pdf.

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.

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.

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.

Policies Relating to Use of Social Media

The SEC has recently suggested that SEC-registered investment advisers which 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. Use of social media must comply with the antifraud provisions of the securities laws as well as the compliance and recordkeeping provisions of the Advisers Act. The SEC staff recently completed a review of several registered investment advisers of varying sizes and strategies which use social media and issued a Risk Alert to highlight certain observations and suggestions that may be helpful to advisers when reviewing compliance policies. For more information please see our Client Alert available at http://www.chapman.com/media/news/media.1132.pdf.

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, CFTC, and/or Federal Trade Commission ("FTC") regulations governing the privacy of consumer financial information (the "Privacy Regulations") require every investment adviser and fund domiciled in the US or having US 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 notice 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 notice form. Such safe harbors provided under the sample clauses employed in many current privacy notices expired for notices posted or delivered on or after January 1, 2011. Covered persons must convert to the new model privacy notice form to take advantage of the safe harbor protection. 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 information as to how they can obtain a list of such proxy votes relating to such client's securities.

Anti-Money Laundering ("AML") Policy
AML 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 AML program may be considered a positive factor in assessing penalties for a violation of OFAC regulations.

During recent remarks at the American Bankers Association/American Bar Association Money Laundering Enforcement Conference, the Director of the Treasury Department's Financial Crimes Enforcement Network ("FinCEN"), James H. Freis Jr., announced that the Treasury Department is currently working on a regulatory proposal that would require investment advisers to establish AML programs and report suspicious activity. Current FinCEN regulations apply to banks, broker-dealers, and open-end mutual funds, but not to investment advisers. If FinCEN ultimately adopts rules requiring investment advisers to establish AML programs, investment advisers (who have not already done so) will likely be required to adopt written policies and procedures reasonably designed to comply with Bank Secrecy Act regulations and to detect and report suspicious transactions (including customer identification requirements). These rules would also likely require that investment advisers appoint an AML compliance officer, provide AML training for personnel, and annually test the AML program. For more information please see our client alert available at http://www.chapman.com/media/news/media.1125.pdf.

Other Selected State and Federal Filing Issues

SEC Form D and 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 ("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 mistakes or errors 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 interest to US 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 US investors in any new states to ensure compliance.

Form 13H "Large Trader" Reporting Obligations
In 2011, the SEC adopted Rule 13h-1 under Section 13(h) of the Securities Exchange Act of 1934 ("Exchange Act"). Effective October 3, 2011, this new rule requires "large traders" meeting certain definitional thresholds in transactions in NMS securities to identify themselves to the SEC and make certain disclosures to the SEC on Form 13H. In addition to an initial filing, all large traders must submit an annual filing on Form 13H within 45 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, the SEC will (or in the case of large traders who have already filed, may have already) assign large traders an identification number (an “LTID”). Large traders are required to provide their LTIDs to all registered broker-dealers carrying its accounts and/or effecting transactions in NMS securities on its behalf. Effective April 30, 2012, registered broker-dealers will be required to maintain certain 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 will also be required to perform monitoring of accounts to identify potential large traders that have not identified themselves to the SEC.

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 US 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 million 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 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.

Form PF
On October 31, 2011, the SEC and CFTC adopted new reporting rules under the Advisers Act and Commodity Exchange Act. The new SEC rule requires 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 to file Form PF with the SEC. The new CFTC rule requires commodity pool operators and commodity trading advisors 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 Advisers Act. The new 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. The information contained in Form PF is designed, among other things, to assist the Financial Stability Oversight Council in its assessment of systemic risk in the US financial system. Under the new reporting requirements, private fund advisers are divided by size into two broad groups: large advisers and smaller advisers. Large private fund advisers would 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. There will be a two-stage phase-in period for compliance with Form PF filing requirements. Most private fund advisers will be required to begin filing Form PF following the end of their first fiscal year or fiscal quarter, as applicable, to end on or after December 15, 2012. Advisers with $5 billion or more in private fund assets must begin filing Form PF following the end of their first fiscal year or fiscal quarter, as applicable, to end on or after June 15, 2012.

Form SLT and Form SHC
In 2011, the Department of Treasury adopted Form SLT designed to gather information on cross-border ownership of long-term securities by US foreign residents for use in forming US international financial and monetary policies. The form is required to be filed by all US individuals or entities who qualify as US resident custodians, issuers, and/or end-investors and whose consolidated long-term reportable securities exceed $1 billion as of the last business days of the reporting month. Where the securities are held by a US-resident custodian, the 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 starting September 30, 2011, and as of the last business day of each month in which the $1 billion

threshold is exceed, and monthly thereafter in 2012. The form must be submitted no later than 23 calendar days of the month following the applicable reporting date. Advisers should review whether they have any reporting obligations with respect to Form SLT with respect to any accounts where they act as adviser and/or custodian.

Form SHC is a mandatory survey of the ownership of foreign securities, including selected money market instruments, by US residents as of December 31, 2011. Form SHC is a benchmark survey of all significant US resident custodians and end-investors held every five years. The data to be reported for Form SHC is as of December 31, 2011, and the form must be submitted by fund managers (and other entities required to report) to the Federal Reserve Bank of New York no later than March 2, 2012.

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 above the minimum threshold ($68.2 million for 2012) using the HSR Act’s valuation mechanics, legal consultation should be obtained regarding the filing obligations or the availability of applicable exemptions.

FBAR Reporting

US persons having financial interests in or signatory or other authority over bank securities or other financial accounts in a foreign country must file a Form TD F 90-22.1 (Report of Foreign Bank and Financial Accounts or “FBAR”) reporting such relationship by June 30th of the year following that in which the relationship existed. Final regulations governing FBAR were promulgated in 2011. Under these regulations, financial accounts subject to FBAR include accounts with a mutual fund or similar pooled fund which issues shares available to the general public that have a regular net asset value determination and regular redemptions. The final regulations reserve on the treatment of “other investment funds”; however, under the current regulations, hedge funds and private equity funds that do not issue shares to the general public do not fall within the scope of FBAR. The final 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, and certain entities that have equity securities listed on any US national securities exchange or registered under Section 12(g) of the Securities Act, in each case that have signature authority over, but not financial interests in, foreign financial accounts owned or maintained by such entity.

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 CTA 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.

Changes to the FINRA Entitlement Program

In 2010, FINRA began introducing changes to the FINRA Entitlement Program which provides access to investment advisers’ IARD accounts. One change is that each adviser is required to designate an authorized employee or officer

as the Super Account Administrator ("SAA") who is able to create, modify, and delete account administrator and user accounts for FINRA applications used by the adviser. Additionally, the SAA can manage his or her own access to those FINRA applications. More information about the FINRA Entitlement Program along with information available to account administrators, system users, and SAAs is available at http://www.finra.org/Industry/Compliance/Entitlement/.

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.

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.

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. Investment advisers must reconfirm the "restricted person" status at least annually. This annual certification may be obtained through a negative consent letter.

Prohibition on "Spinning": FINRA Rule 5131
New FINRA Rule 5131 (New Issue Allocations and Distributions) became effective on May 27, 2011. Among other things, FINRA Rule 5131 prohibits quid pro quo and "spinning" allocations of new issues of securities and addresses the book-building, new issue pricing, penalty bids, trading, and waivers of lock-up agreements by member firms and associated persons. For details about the final rule as adopted please see our Client Alert available at http://www.chapman.com/media/news/media.895.pdf. Advisers that manage hedge funds should ensure that their offering documents provide the necessary disclosures and elicit the proper information so that advisers can provide a FINRA Rule 5131 certification to broker dealers where necessary.

Private Investment Funds
In addition to the foregoing, offering documents for any private investment fund should be updated 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 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 (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. As discussed above, the Dodd-Frank Act makes significant changes that impact advisers to "private funds," including changes to the registration, reporting, and recordkeeping requirements.

FATCA Witholding
Part of the Hiring Incentives to Restore Employment Act (the "HIRE Act") passed into law in 2010 was the introduction of a 30 percent withholding on payments to non-US entities. This is generally referred to as FACTA withholding. FACTA withholding has two major parts:

- Payments to foreign financial institutions ("FFIs"): Payments to FFIs will be subject to withholding unless the FFI enters into an agreement with the IRS to determine whether the entity has any direct or indirect US account holders. The agreement will also obligate FFIs to withhold on pass thru payments made by the FFI.

- Payments to non-financial foreign entities ("NFFEs"): Payments to NFFEs will be subject to the new withholding unless the NFFE certifies that it has no direct or indirect US owners of more than 10 percent of the NFFE's equity (or provides information about those that it has).

Most offshore funds will likely be treated as FFIs and subject to these rules unless further guidance is issued exempting them from the provision. In July 2011, the IRS issued notices delaying the effectiveness with respect to NFFEs and FFIs from 2013 to January 1, 2014. The IRS will begin accepting applications for entering into participating FFI agreements January 1, 2013, and the time by which participating FFI agreement must be entered into (so that payments to the FFIs are not subject to FACTA withholding) has been delayed until June 30, 2013. For more information about FACTA withholding including the delays and effective dates associated with certain provisions, please see our Client Alerts available at http://www.chapman.com/media/news/media.1045.pdf and http://www.chapman.com/media/news/media.1047.pdf.

Annual Audit Requirement

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 US generally accepted accounting principals and audited by an independent public accountant are delivered to investors within 120 days (180 days in the case of funds of funds) after the end of the fund's fiscal year. Advisers relying on this exemption should ensure that financial statements are delivered to investors in the form and at the time required.

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 reviewing existing coverage.

ERISA Review

Investment advisers to 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, as amended ("ERISA"), and whether investments by benefit plan investors result in fund assets being characterized as "plan assets" for purposes of ERISA and the Internal Revenue Code of 1986, as amended (the "Code"). 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" (i.e. whether it qualifies for the 25 percent "significant participation" exemption under ERISA). This may be particularly important where a significant amount of assets have recently been withdrawn or redeemed.

"Pay-to-Play" Practices

On June 30, 2010, the SEC adopted two measures intended to prevent "pay-to-play" practices by investment advisers seeking to manage funds for state and local governments. The rules aim to prevent investment advisers from making campaign contributions and related payments to elected officials in order to influence the awarding of lucrative contracts for the management of public pension plan assets and similar government investment accounts. The new rules prohibit an investment adviser from providing advisory services for compensation (either directly or through a pooled investment vehicle) for two years if the advisers or certain of its executives or employees make a political contribution to an elected official who is in a position to influence the selection of the adviser. The new rules also prohibit an advisory firm and certain executives and employees from soliciting or coordinating campaign contributions from others for elected officials (or to political parties in the state or locality where the adviser is seeking business) in a position to influence the selection of the adviser. The new rules also prohibit an adviser from paying a third party to solicit government clients on behalf of the adviser unless such party is an SEC-registered investment adviser or broker-dealer subject to similar restrictions. In 2011, the SEC adopted amendments to the pay-to-play rules which (1) synchronize the rules with the results of the Dodd-Frank Act by extending the application to exempt reporting advisers and exempt foreign private advisers; (2) added registered municipal advisors as a type of "regulated person" that may be compensated by covered investment advisers for soliciting state or local government entities, provided that they are subject to restrictions at least as stringent as the "pay-to-play" rules; and (3) extended the date by which covered investment advisers must comply with the ban on third-party solicitation to June 13, 2012.

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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