Lowenstein Sandler

Client Alert

# Investment Management

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# Material Investment Management Developments and Template Annual Compliance Checklists for Registered Investment Advisers, Exempt Reporting Advisers, Commodity Pool Operators, Commodity Trading Advisors, and Private Fund Managers

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In the past 2 years, the U.S. Securities and Exchange Commission ("SEC") (and other regulatory authorities) have been very busy with new rules, proposals, examination, and enforcement under the Investment Advisers Act of 1940 (the "Advisers Act"), and other applicable statutes. This client update summarizes where recent key rulemaking changes are in the process, highlights issues investment advisers, fund managers, and other financial institutions should be thinking about at this time, describes relevant regulatory guidance, recent litigation, enforcement activities, and provides checklists for investment advisers, commodity pool operators and commodity trading advisors.

The checklists appear after the legal developments summaries.  For more information regarding any matter covered in this update, please contact one of the attorneys in our Investment Management Group.

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**FINAL RULEMAKING**

**SEC Enacts Wide-Sweeping Private Fund Adviser Rules which Fifth Circuit Vacates**

**Synopsis:** On August 23, 2023, the SEC announced the enactment of a series of new and amended rules under the Advisers Act (the "Private Fund Adviser Rules"). According to the SEC, the new rules were designed to address conflicts of interest and adviser practices that may impose significant risks and harms on investors and private funds. As adopted, the rules would have a significant impact on the way advisers operate their businesses, and interface with investors. However, on June 5, 2024, the United States Court of Appeals for the Fifth Circuit vacated the Private Fund Adviser Rules.

**Status:** The SEC set forth a timeline as to when a Private Fund Manager must come into compliance with each applicable Private Fund Adviser Rule, which varies based on the specific Private Fund Adviser Rule and whether the manager of private funds ("Private Fund Manager") is a "Larger Private Fund Adviser" or a "Smaller Private Fund Adviser." This timeline called for a compliance date of March 14, 2025, in most cases (September 14, 2023, for Large Private Fund Advisers in respect of certain rules).

However, on June 5, 2024, the Private Fund Adviser Rules were vacated by the Fifth Circuit Court of Appeals as a result of litigation brought by a number of industry groups (National Association of Private Fund Managers, Alternative Investment Management Association, Limited, American Investment Council, Loan Syndications, Trading Association, Managed Funds Association, and National Venture Capital Association) challenging the SEC's authority. It remains to be seen whether the SEC will seek to appeal the Fifth Circuit's decision to the Supreme Court or propose alternate rules. Private Fund Managers should continue to monitor developments in the case.

The adopting release suggested continued scrutiny of Private Fund Managers in a number of areas in which there is no new rulemaking, including with respect to the fiduciary duty owed by Private Fund Managers. Even though the SEC chose not to proceed with rulemaking to address these concerns, and the Private Fund Adviser Rules were themselves vacated, we expect these areas to continue to invite scrutiny in SEC examinations and investigations.

The Private Fund Adviser Rules and associated amendments to the Compliance Rule and Section 204-(2) of the Advisers Act (the "Recordkeeping Rule"), if ultimately taking effect, will necessitate changes to the fund documents and compliance programs of all Private Fund Managers.

The Lowenstein Sandler Investment Management Group alert analyzing fiduciary duty aspects of the Private Fund Adviser Rules is available here.

The final rule is available here, and the SEC's press release discussing the adoption of the final rule is available here. The Lowenstein Sandler Investment Management Group alert analyzing the Private Fund Adviser Rules is available here. The Fifth Circuit's decision is available here.

### Amendments to Form PF for Private Fund Advisers

**Synopsis:** Through three separate sets of amendments adopted in May 2023, July 2023 and February 2024, the SEC (jointly with the Commodity Futures Trading Commission ("CFTC") in respect of the February 2024 amendments) has adopted amendments to Form PF, the confidential form by which certain SEC-registered investment advisers report information pertaining to the private funds they advise.

The amendments (i) require certain advisers to hedge funds and private equity funds to provide current reporting of certain significant events and other information, (ii) align the reporting required of large liquidity fund advisers with reporting required in respect of money market funds and (iii) expand private fund reporting by requiring advisers to report new or additional identifying information about their private funds and their assets, the sources of financing for such funds, and fund performance.

The amendments demonstrate an evolution in the SEC's and CFTC's knowledge regarding private funds since the introduction of Form PF more than a decade ago. The updated Form PF will solicit much more granular detail regarding private fund strategies, investments, counterparty exposures, risk metrics, and performance data. The updated Form PF also reflects specific areas of continuing concern to the SEC and CFTC.

**Status:** The current and quarterly event reporting requirements became effective December 11, 2023. Amendments in respect of large private equity fund annual reporting and large liquidity fund reporting become effective June 11, 2024. The remaining February 2024 updates to Form PF will become effective March 12, 2025.

As we discussed in our client alert regarding the SEC's May 2023 Form PF amendments, regulators are demonstrating a commitment to enhancing their information-sharing relationship with respect to monitoring private funds. Regulators could use the new Form PF data to inform additional rulemaking, prepare interpretive guidance, inform the selection of examination targets and topics, and bring enforcement actions in a more aligned manner.

The SEC's May 2023 final rule is available here. The Lowenstein Sandler Investment Management Group alert analyzing the May 2023 final rule is available here. The SEC's July 2023 final rule is available here. The SEC's February 2024 final rule is available here. The Lowenstein Sandler Investment Management Group alert analyzing the February 2024 final rule is available here.

### SEC Expands Definitions of 'Dealer' and 'Government Securities Dealer' to Adapt to Modern Market Practices

**Synopsis:** On February 6, 2024, the SEC announced two new rules that expanded the definition of "dealer" and "government securities dealer" under the Exchange Act. These updates mark a significant broadening of the definitions, aiming to adapt to evolving market practices, and enhance oversight in the securities industry. Under the new rules, any person who engages in activities as described will, absent an applicable exemption, be required to: (i) register with the SEC under Section 15(a) or Section 15(c) of the Exchange Act, as applicable; (ii) become a member of a self-regulatory organization ("SRO") such as the Financial Industry Regulatory Authority ("FINRA"); and (iii) comply with federal securities laws and regulatory obligations as well as applicable SRO and U.S. Treasury rules and requirements.

By broadening the definitions of "dealer" and "government securities dealer," the SEC aims to enhance regulatory coverage and oversight over securities market participants. This move is likely to lead to increased scrutiny and enforcement actions, as the SEC seeks to ensure compliance with these new regulatory requirements.

The new rules are intended to provide greater clarity and transparency regarding the regulatory obligations of entities engaged in securities trading and dealing activities. Market participants can now better understand their regulatory responsibilities and take appropriate steps to ensure compliance with the updated definitions.

**Status:** Many different types of market participants are potentially implicated by these expanded definitions, including (but not limited to) family offices and investment fund managers that have more than $50 million in assets under management. These market participants should carefully review the new rules and assess the potential impact on their operations and whether they now need to register as a dealer or a government securities dealer. Becoming a registered dealer or government securities dealer can result in heightened regulatory scrutiny and additional compliance costs.

The final rules became effective April 29, 2024, and have a compliance date of April 29, 2025. However, the new rules remain subject to litigation, including a suit brought March 18, 2024, in the U.S. District Court for the Northern District of Texas by a number of industry groups (National Association of Private Fund Managers, Alternative Investment Management Association, Limited, and Managed Funds Association) challenging the new rules.

The Lowenstein Sandler Investment Management Group alert analyzing these new SEC rules is available here.

### SEC Adopts Amendments to Rules Governing Beneficial Ownership Reporting on Schedules 13D and 13G

**Synopsis:** On October 10, 2023, the SEC adopted amendments to certain rules that govern beneficial ownership reporting. The amendments generally shorten the filing deadlines for initial and amended beneficial ownership reports filed on Schedules 13D and 13G. The amendments also clarify the disclosure requirements of Schedule 13D with respect to derivative securities. Schedules 13D and 13G may now be filed until 10 p.m. ET each business day, and Schedule 13D and 13G filings will need to be made using a structured machine-readable data language.

All Schedule 13D filers now have to file an initial Schedule 13D within five (5) business days after either acquiring beneficial ownership of more than 5% of a class of voting equity securities registered under Section 12 of the Securities Exchange Act of 1934, as amended ("covered securities"), or losing eligibility to file on Schedule 13G. An amended Schedule 13D to disclose material changes is now due within two (2) business days of the applicable change. "Qualified Institutional Investors" and "Exempt Investors" will have to file an initial Schedule 13G no later than forty-five (45) calendar days after the calendar quarter in which they beneficially own more than 5% of a class of covered securities (or within five (5) business

days after month-end for Qualified Institutional Investors exceeding 10% beneficial ownership). "Passive Investors" will have to file an initial Schedule 13G no later than five (5) business days after exceeding 5% beneficial ownership. All Schedule 13G filers will be required to file a Schedule 13G amendment to disclose material changes no later than forty-five (45) calendar days after each calendar quarter. A "material change" includes, but is not limited to, any material increase or decrease in the percentage of the class of covered securities beneficially owned. A change in beneficial ownership by 1% or more of the class of covered securities is considered to be "material" for these purposes; provided, that an amendment is not required for 13G filers if the change in beneficial ownership results solely due to a change in the outstanding shares of the issuer. A change in beneficial ownership of less than 1% may be material, depending on the facts and circumstances. In addition, (a) Qualified Institutional Investors will be required to file a Schedule 13G amendment within five (5) business days after month-end if exceeding 10% beneficial ownership or in the event of a 5% increase or decrease in beneficial ownership and (b) Passive Investors will be required to file a Schedule 13G amendment within two (2) business days if exceeding 10% beneficial ownership or in the event of a 5% increase or decrease in beneficial ownership.

**Status:** The new rule became effective February 5, 2024. However, compliance with the amended Schedule 13G filing deadlines is not required until September 30, 2024, and compliance with the structured data requirement is not mandatory until December 18, 2024.

The Lowenstein Sandler Investment Management Group alert analyzing the proposed rule is available here. The text of the final rule can be found here.

### SEC Adopts Amendments to Narrow Internet Adviser Exemption

**Synopsis:** On March 27, 2024, the SEC adopted amendments to the internet adviser exemption under Section 203A of the Advisers Act which allows internet-based investment advisers to federally register if not otherwise eligible.

Advisers relying on the exemption must provide their investment advice exclusively through a "website, mobile application, or similar digital platform through which the investment adviser provides digital investment advisory services on an ongoing basis to more than one client (except during temporary technological outages of a de minimis duration)." All services must be provided exclusively through such digital platforms (a previous de minimis exception for non-internet clients has been eliminated). Advisers with non-internet clients must rely on another exemption for SEC registration (or register with individual states).

**Status:** The new rule became effective July 8, 2024.

The text of the final rule can be found here.

### SEC Adopts Rules to Combat Fraud and Undue Influence in the Security-Based Swap Market

**Synopsis:** On June 7, 2023, the SEC adopted, pursuant to the Securities Exchange Act of 1934 (the "Exchange Act"), (i) new Rule 9j-1 to combat fraud, manipulation, and deception in connection with security-based swap ("SBS") transactions and (ii) new Rule 15Fh-4(c) to prohibit coercion, manipulation, and fraudulent influence of the chief compliance officer ("CCO") of SBS dealers and major SBS participants (each, an "SBS Entity"). Rule 9j-1 addresses certain characteristics of SBSs that generally provide market participants with opportunities and incentives for misconduct. Rule 15Fh-4(c) protects CCOs in furtherance of their duties to ensure their respective SBS Entities establish and maintain appropriate written policies and procedures designed to achieve compliance with the federal securities laws.

The conduct for which persons may be held liable under the new rules is broad and encompasses activities involving the exercise of a right or performance of an obligation under the SBS. The parties to an SBS will be well advised to appreciate that their conduct over the life of their position in the SBS and not just their conduct related to the initial purchase or ultimate sale of their SBS position could trigger liability.

**Status:** The new rules became effective on August 7, 2023.

The Lowenstein Sandler Investment Management Group alert analyzing this proposed rule is available here. The text of the proposed rule can be found here.

### Amendments to Proxy Rules Governing Proxy Voting Advice

**Synopsis:** On July 13, 2022, the SEC voted to adopt amendments to its rules governing proxy voting advice. However, on June 26, 2024, the United States Court of Appeals for the Fifth Circuit vacated the amendments (with certain limited exceptions) finding that the SEC engaged in arbitrary and capricious rulemaking.

The final amendments aim to avoid burdens on proxy voting advice businesses that may impair the timeliness and independence of their advice. The amendments also address misperceptions about liability standards applicable to proxy voting advice, while preserving investors' confidence in the integrity of such advice.

The final amendments rescind two rules applicable to proxy voting advice businesses that the SEC adopted in 2020. Specifically, the final amendments rescind conditions to the availability of two exemptions from the proxy rules' information and filing requirements on which proxy voting advice businesses often rely. Those conditions require that (a) registrants who are the subject of proxy voting advice have such advice made available to them in a timely manner and (b) clients of proxy voting advice businesses are provided with a means of becoming aware of any written responses by registrants to proxy voting advice. The final amendments also delete the 2020 changes made to the proxy rules' liability provision. Although the 2020 changes were intended to clarify the application of this liability provision to proxy voting advice, they instead created a risk of confusion regarding the application of this provision to proxy voting advice, undermining the goal of the 2020 changes. The final amendments address the confusion while affirming that proxy voting advice generally is subject to liability under the proxy rules. Finally, the adopting release rescinds an explanatory note and supplemental guidance that the SEC issued in 2020 to investment advisers regarding their proxy voting obligations. The Fifth Circuit's decisions vacate all of the foregoing amendments with the limited exception of

the rescission of the explanatory note and supplemental guidance, which remain rescinded.

**Status:** The amendments became effective September 19, 2022, but were vacated in most material respects by the Fifth Circuit's June 26, 2024 decision. Proxy voting advisors should continue to monitor developments in the case and may expect continuing scrutiny in these areas from the SEC.

The final rule is available here, and the SEC's press release discussing the adoption of the final rule is available here. The Fifth Circuit's decision is available here.

### Amendments to Form N-PX and Say-on-Pay Vote Disclosure

**Synopsis:** On November 2, 2022, the SEC adopted rule and form amendments to: (i) enhance the information registered funds currently report on Form N-PX about their proxy votes; and (ii) require institutional investment managers to report on Form N-PX how they voted proxies relating to certain executive compensation matters, or "say-on-pay" votes, as required by the Dodd-Frank Act.

The SEC originally adopted the requirement for registered funds to disclose their proxy votes on Form N-PX in 2003. Prior to these amendments, however, investors have faced difficulties analyzing these reports because of a lack of standardization in the order and manner in which the information is presented, as well as the fact that such reports were not previously required to be filed in a machine-readable, or "structured," data language. The amendments will increase the consistency and usefulness of proxy voting information that funds report on Form N-PX.

In addition, the amendments will require advisers that exercise investment discretion over securities with an aggregate value of at least $100 million to report annually their say-on-pay votes consistent with the Dodd-Act.

**Status:** The rule is effective July 1, 2024. Advisers and funds were required to file their first reports on amended Form N-PX by August 31, 2024, with these reports covering the period of July 1, 2023, to June 30, 2024.

The final rule is available here, and the SEC's fact sheet discussing the adoption of the final rule is available here.

### SEC Adopts Securities Lending Reporting Rule

**Synopsis:** On October 13, 2023, the SEC adopted a new rule under the Exchange Act to increase the transparency and efficiency of the securities lending market by requiring certain persons to report information about securities loans to a registered national securities association ("RNSA"). The new rule also requires certain confidential information to be reported to an RNSA to enhance an RNSA's oversight and enforcement functions. Further, the new rule requires that an RNSA make certain information it receives, along with daily information pertaining to the aggregate transaction activity and distribution of loan rates for each reportable security, available to the public.

**Status:** The new rule became effective January 2, 2024. The compliance date for reporting of information to an RNSA is January 2, 2026, and the RNSA must begin to make information publicly available April 1, 2026. The new rule remains subject to litigation challenging the rule in the Fifth Circuit.

The text of the final rule can be found here.

### SEC Adopts Short Position and Short Activity Reporting Rule

**Synopsis:** On October 13, 2023, the SEC adopted a new rule and a new Form SHO to impose short-selling disclosure requirements on certain institutional investment managers. The new rule and Form SHO are designed to provide greater transparency through the publication of short sale-related data to investors and other market participants. Under the new rule, institutional investment advisers that are at or above specified reporting thresholds are required to report, on a monthly basis, short position data and short activity data for equity securities (gross short positions" and daily "net" activity). The SEC will publish aggregated short sale-related information based on the information from Form SHO.

**Status:** The new rule became effective January 2, 2024. The new rule remains subject to litigation challenging the rule in the Fifth Circuit.

The text of the final rule can be found here.

### SEC Adopts Rule re: Conflicts of Interest in Certain Securitizations

**Synopsis:** On November 27, 2023, the SEC adopted new Rule 192 to implement Section 27B of the Securities Act. For a specified period of time and subject to certain exceptions, the rule prohibits "securitization participants" from engaging in any transaction that would involve or result in certain material conflicts of interest between the securitization participant and an investor in the relevant asset-backed security. As required by Section 27B, Rule 192 provides exceptions to the prohibition for certain risk-mitigating hedging activities, liquidity commitments, and bona fide market-making activities. To rely on these exceptions securitization participants must comply with specific conditions as set forth in the new rule.

**Status:** The new rule became effective February 5, 2024. A securitization participant must comply with the prohibition and the requirements of the exceptions to the final rule, as applicable, with respect to any securitization having a first closing on or after June 9, 2025.

The text of the final rule can be found here.

### SEC Adopts Treasury Clearing Rule

**Synopsis:** On December 13, 2023, the SEC adopted rule changes to amend the standards applicable to covered clearing agencies for U.S. Treasury securities to require that such covered clearing agencies have written policies and procedures reasonably designed to require that every direct participant of the covered clearing agency submit for clearance and settlement all eligible secondary market transactions in U.S. Treasury securities to which it is a counterparty. Additional rule changes are designed to reduce the risks faced by a clearing agency and incentivize and facilitate additional central clearing in the U.S. Treasury market.

**Status:** The amendments became effective March 18, 2024. Compliance will be required in phases beginning March 31, 2025.

The text of the final rule can be found here.

### SEC Adopts Amendments to Regulation S-P

**Synopsis:** On May 16, 2024, the SEC adopted final amendments to Regulation S-P designed to address recent technological advances and corresponding risks since the original adoption of Regulation S-P in 2000. Among other things, the amendments address (1) incident response programs, (2) 30-day notifications of data breaches, (3) service provider oversight, (4) rules relating to safeguarding and disposing of customer records and information, (5) recordkeeping, and (6) annual privacy notices. Covered institutions are required to adopt written policies and procedures that provide for an incident response program to protect customer information from unauthorized access, including to (a) assess the nature and scope of any incident, (b) take appropriate steps to contain and control the incident, and (c) notify (as soon as practicable, but generally within 30 days) affected individuals whose sensitive customer information was, or is reasonable likely to have been, accessed or used without authorization unless after a reasonable investigation, the covered institution determines that the sensitive customer information has not been, and is not reasonably likely to be, used in a manner that would result in substantial harm or inconvenience.

**Status:** The final rule became effective August 2, 2024. Compliance is required by December 3, 2025 (or by June 3, 2026 for registered investment advisers ("RIAs") with under $1.5 billion in assets under management or investment companies with under $1 billion in net assets).

The text of the final rule can be found here.

### SEC Adopts SPAC Rules

**Synopsis:** On January 24, 2024, the SEC adopted rules intended to enhance investor protections in initial public offerings by special purpose acquisition companies ("SPACs") and in subsequent business combination transactions between SPACs and private operating companies ("de-SPAC transactions"). The rules include disclosure requirements with respect to, among other things, compensation paid to sponsors, conflicts of interest, dilution, and the determination, if any, of the board of directors (or similar governing body) of a SPAC regarding whether a de-SPAC transaction is advisable and in the best interests of the SPAC and its security holders. The rules require a minimum dissemination period for the distribution of security holder communication materials in connection with de-SPAC transactions. The rules require the re-determination of smaller reporting company status in connection with de-SPAC transactions. The rules deem any business combination transaction involving a reporting shell company, including a SPAC, to be a sale of securities to the reporting shell company's shareholders, and include amendments to a number of financial statement requirements applicable to transactions involving shell companies. The rules include guidance in a number of related areas.

**Status:** The final rules became effective July 1, 2024.

The text of the final rule can be found here.

### FTC Approves Non-Compete Ban Which Fifth Circuit Court Vacates

**Synopsis:** On April 23, 2024, the Federal Trade Commission ("FTC") approved the final version of a new rule (the "Non-Compete Rule") to ban essentially all post-employment noncompete agreements that employers impose on their employees or independent contractors. However, on August 20, 2024, the United States District Court for the Northern District of Texas vacated the Non-Compete Rule (with such decision applicable nationwide). It is likely that the FTC will appeal this decision.

The Non-Compete Rule would have broadly banned any term or condition of employment that prohibits a worker from, penalizes a worker for, or functions to prevent a worker from (i) seeking or accepting work in the United States after the conclusion of employment; or (ii) operating a business in the United States after the conclusion of employment. The Non-Compete Rule included a limited exception for pre-existing non-compete agreements with "senior executives" defined as those earning over $151,164 and serving in a policy-making position. The Non-Compete Rule would also require employers to notify employees that their existing non-competes are no longer valid.

**Status:** The Non-Compete Rule was slated to become effective on September 4, 2024, prior to the district court decision. Advisers should continue to monitor developments in this case.

The Lowenstein Sandler Employee Benefits and Executive Compensation alerts analyzing the final rule and discussing the impact of the district court stays are available here and here.

### DOL Issues New ERISA Fiduciary Rule Which Fifth Circuit Stays

**Synopsis:** On April 23, 2024, the U.S. Department of Labor ("DOL") finalized its latest effort to expand the definition of "investment advice fiduciary" under the Employee Retirement Income Security Act of 1974 ("ERISA") to cover certain one-off recommendations and expand who is subject to compliance with the impartial conduct standards. However, in response to suits challenging the new rule, two district courts in the Fifth Circuit have stayed the effective date of the final rule pending resolution of those suits and all appeals therefrom. The decisions by both courts are not limited to the plaintiffs in their respective cases, and therefore apply nationwide.

The final rule will replace long-standing DOL regulations that have governed the determination of fiduciary status since 1975. The final rule expands the definition of "investment advice fiduciary" and therefore those who will be considered fiduciaries under ERISA.

The final rule focuses on the relationship between an adviser and an investor in determining who is an "investment advice fiduciary." Under the final rule, an adviser will be considered an investment advice fiduciary under ERISA if they provide a recommendation to a retirement investor for a fee or other compensation and either (A) represent or acknowledge that they are acting as

a fiduciary under ERISA or (B) directly or indirectly "makes professional investment recommendations to investors on a regular basis as part of their business and the recommendation is made under circumstances that would indicate to a reasonable investor in like circumstances that the recommendation:

- is based on a review of the retirement investor's particular needs or individual circumstances;
- reflects the application of professional or expert judgment to the retirement investor's particular needs or individual circumstances; and
- may be relied upon by the retirement investor as intended to advance the retirement investor's best interest."

Investment advisers should review the components of the final rule and determine whether any services they perform will be considered investment fiduciary advice and, if so, what they will need to do to comply with ERISA.

**Status:** The new fiduciary rule was slated to become effective on September 23, 2024, prior to the district court stays. Advisers should continue to monitor developments in these cases.

The Lowenstein Sandler Employee Benefits and Executive Compensation alerts analyzing the final rule and discussing the impact of the district court stays are available here and here.

**U.S. Treasury Makes Certain Investment Advisers Subject to the BSA**

**Synopsis:** On August 28, 2024, FinCEN issued its final rule subjecting certain RIAs and exempt reporting advisers ("ERAs") to the AML requirements and the Countering the Financing of Terrorism ("CFT") programs of the Bank Secrecy Act (the "BSA").

Unlike the proposed rule which would have made all RIAs subject to the BSA, the final rule excludes RIAs which register solely as midsize advisers, multistate advisers and pension consultants, along with RIAs lacking any client assets under management.

The final rule requires subject RIAs and ERAs to, among other obligations:

- establish a BSA-compliant AML/CFT program (which may require expanding existing AML/CFT programs). FinCEN emphasizes that AML/CFT programs will expectedly vary based on the size and complexity of each investment adviser's business;
- file Suspicious Activity Reports ("SARs") with FinCEN and otherwise report suspicious activity (this requirement is triggered when the activity involves or aggregates to at least $5,000 in assets); and
- keep transmission records such as those relating to the transmittal of funds (this requirement is triggered when the transmission equals or exceeds $3,000).

The final rule subjects investment advisers to the information-sharing provisions of the BSA (requiring the sharing of information about suspected terrorist or money laundering activities with law enforcement).

**Status:** Investment advisers that are now subject to the BSA have until January 1, 2026, to implement and operationalize a BSA compliance program.

Lowenstein Sandler client alerts related to the final rule and AML best practices for Private Fund Managers are available here, here, here, and here.

**IRS Regulations Impose New Reporting Requirements on Transactions Involving Cryptocurrency and Other Digital Assets**

**Synopsis:** On August 25, 2023, in response to a provision in the 2021 Infrastructure Investment and Jobs Act, the U.S. Treasury and the Internal Revenue Service (the "IRS") issued proposed regulations that would impose new tax reporting requirements for digital asset brokers, with respect to sales and exchanges of digital assets. The final regulations were issued on June 28, 2024.

The final regulations apply to brokers that take possession of the digital assets being sold by their customers, including operators of custodial digital asset trading platforms, certain digital asset hosted wallet providers, digital asset kiosks and certain processors of digital asset payments (PDAPs). The final regulations do not include reporting requirements for brokers commonly known as decentralized or non-custodial brokers that do not take possession of the digital assets being sold or exchanged. The Treasury Department and the IRS indicate that they intend to provide rules for these brokers in a different set of final regulations.

The regulations provide gain (and loss) computation rules, basis determination rules and backup withholding rules applicable to digital asset sale and exchange transactions.

For purposes of the regulations, a digital asset is "any digital representation of value that is recorded on a cryptographically secured distributed ledger (or similar technology)." The IRS has indicated that this definition is intended to be expansive and cover "all types of digital assets," including not just cryptocurrencies, like bitcoin and ether, but also other digital assets, such as stablecoins and non-fungible tokens.

A new tax reporting form called Form 1099-DA will help brokers satisfy these reporting requirements.

**Status:** The new tax reporting requirements for digital asset brokers will generally be effective starting with the 2026 tax filing season, with respect to sales and exchanges of digital assets taking place on or after Jan. 1, 2025.

The Lowenstein Sandler Tax alert analyzing this proposed rule is available here. The text of the final rule can be found here. The IRS's fact sheet in reference to the final rule can be found here. A draft of Form 1099-DA is available here.

**FinCEN Deadlines for New Companies Reporting Beneficial Ownership Information**

**Synopsis:** On November 29, 2023, the U.S. Treasury's Financial Crimes Enforcement Network ("FinCEN") issued a final rule extending the deadline for companies created or registered in 2024 to file beneficial owner information ("BOI") reports with FinCEN from 30 calendar days to 90 calendar days. The 90-day period starts on the earlier of the date when (1) the company receives actual notice that has been created or registered or (2) a secretary of state or similar office first provides public notice of the company's

creation or registration. There are several exceptions to the BOI filing requirement.

The BOI filing requirement is part of a federal initiative to limit money laundering, terrorist financing, fraud, corruption, and other illicit activities through shell companies and other opaque ownership structures. It is one component of the Corporate Transparency Act (the "CTA"), which was enacted through bipartisan efforts as part of the National Defense Authorization Act for Fiscal Year 2021.

However, on Friday, March 1, 2024, U.S. District Court Judge Liles Burke ruled that the CTA was unconstitutional because Congress exceeded its powers to regulate interstate commerce, oversee foreign affairs and national security, and impose taxes. *See Nat'l Small Business United d/b/a Nat'l Small Business Assoc. v. Janet Yellen*, 5:22-cv-01448 (LCB), Dkt. No. 51 (N.D. Ala. Mar. 1, 2024) (Memorandum Opinion). The court's injunction is explicitly limited to the plaintiffs in the case. It is also highly likely that the government will appeal to the Eleventh Circuit, and whether the opinion will be stayed pending any such appeal remains to be seen. Furthermore, as the opinion itself states, there are potential legislative fixes to the constitutional shortcomings that were found by the court.

**Status:** Until there is further clarity on the litigation, it would be prudent for entities subject to the CTA to continue to collect beneficial ownership and company applicant information and to file the required reports by the deadlines specified by FinCEN.

Per the FinCEN deadlines:

- Companies created or registered before the start of 2024 will still have until January 1, 2025, to file their BOI reports (giving them a later deadline than companies formed in the first three quarters of 2024).
- Companies created or registered in 2024 will have 90 calendar days to file their BOI reports.
- Companies created or registered on or after January 1, 2025, will still only have 30 calendar days to file their BOI reports.

The Lowenstein Sandler client alert discussing the deadline extension is available here and the client alert analyzing the court ruling is available here, and prior Lowenstein Sandler client alerts related to CTA and BOI reporting requirements are available here, here, and here.

### New York LLC Transparency Act

**Synopsis:** On December 22, 2023, New York Governor Kathy Hochul signed the New York Limited Liability Company Transparency Act into law with a new, amended version adopted March 1, 2024 ("NY LLC Transparency Act"). The NY LLC Transparency Act is modeled on the CTA which took effect January 1, 2024.

The NY LLC Transparency Act purportedly targets "anonymous LLCs," where true owners of LLCs have created shell companies as exploitation vehicles for money laundering, tax evasion, organized crime, corruption, and other forms of financial crimes. Historically, bad actors have been able to conceal their identities because, by design, very little personal information is required to form an LLC. Moreover, true owners can further conceal their identities by nesting between layers of corporate intermediary entities, allowing assets to effectively become washed through anonymous legal entities.

The NY LLC Transparency Act requires the reporting entity to file certain information for any individual who is a beneficial owner as defined in the act including, but not limited to full legal name, date of birth, current business address, and unique FinCEN identifying number. For LLCs that make CTA filings with the federal government, the NY LLC Transparency Act permits the LLC to file a copy of the same form with the New York Department of State. Failing to comply with the NY LLC Transparency Act can result in a civil fine of $250 per entity and a public listing of noncompliance.

**Status:** The NY LLC Transparency Act goes into effect on January 1, 2026 , and unless one of the 23 exemptions that track the statutory exemptions in the CTA apply, such as for large operating companies, broker-dealers, publicly traded companies, insurance companies, registered investment advisers, and certain subsidiaries of such exempt entities, it will require LLCs formed or authorized to do business in New York to file documentation with the Secretary of State. Businesses in New York should use 2024 and 2025 to get ahead of the implementation of the NY LLC Transparency Act and analyze and prepare for their filing obligations.

The Lowenstein Sandler client alert discussing the NY LLC Transparency Act is available here.

### SEC Modifies Section 3(c)(1) of the 1940 Act Exemption for Certain Private Funds

**Synopsis:** On August 21, 2024, the SEC adopted a final rule increasing the threshold for what is considered a "qualifying venture capital fund" from $10 million to $12 million.

A 2018 amendment to Section 3(c)(1) of the Investment Company Act of 1940 (the "1940 Act") introduced the concept of a "qualifying venture capital fund," which is a "venture capital fund" that has no more than $10 million in aggregate capital contributions and uncalled committed capital. Furthermore, the amendment permitted "qualifying venture capital funds" that rely on Section 3(c)(1) to have up to a maximum of 250 beneficial owners (as opposed to 100, as is otherwise required).

**Status:** The threshold change is effective thirty (30) days after publication in the Federal Registre.

At the margin, the new rule may encourage market competition by lowering barriers to entry for emerging venture capital managers. Specifically, it could lower compliance costs for eligible funds by exempting them from certain regulatory requirements such as registration as an investment company and make it easier for their managers to raise smaller amounts of capital from a larger number of accredited investors.

The Lowenstein Sandler Investment Management Group alert analyzing the proposed rule is available here.

## PROPOSED RULES

### SEC and FinCEN Propose Customer Identification Obligations for Investment Advisers

**Synopsis:** On May 13, 2024, FinCEN and the SEC jointly issued a proposed rule that would require registered investment advisers and ERAs to establish, document and maintain written customer identification programs ("CIPs").

Under the proposed rule, investment advisers would be required to implement reasonable procedures to identify and verify the identity of their customers. Notably, the proposed rule arguably would only apply to advisory clients (i.e., the fund itself rather than underlying investors in a fund) but we expect further clarity on this point.

The proposed rule would require that investment advisers implement a risk-based CIP appropriate for their size and business. Helpfully, investment advisers will be able to rely on another financial institution's CIP for its customers if the customer is opening or has established a relationship with that financial institution.

**Status:** While it remains a proposed rule at this time, Lowenstein Sandler encourages investment advisers to become familiar with the proposed rule now in order to be adequately prepared. FinCEN has indicated that it intends for the CIP final rule to be effective as of the January 1, 2026 compliance date for investment advisers subject to the BSA to implement and operationalize a BSA compliance program.

Lowenstein Sandler client alert analyzing the proposed rule is available here.

### CFTC Proposes Amendments to CFTC Regulation 4.7 re: Exemptions for Commodity Pool Operators, Commodity Trading Advisors and Commodity Pools

**Synopsis:** On October 2, 2023, the CFTC proposed to amend CFTC Regulation 4.7, a provision that provides exemptions from certain compliance requirements for commodity pool operators ("CPOs") with respect to commodity pool offerings to qualified eligible persons ("QEPs") and for CTAs with respect to trading programs advising QEPs.

Commodity Exchange Act ("CEA") Section 4m(1) generally requires each person whose intermediary activities satisfy either the CPO or CTA definition to register as such with the CFTC. Part 4 of the CFTC's regulations specifically govern the operations and activities of CPOs and CTAs. Regulation 4.7 makes available exemptions from certain part 4 compliance requirements regarding disclosure, periodic reporting, and recordkeeping for registered CPOs and CTAs, whose prospective and actual pool participants and/or advisory services are restricted to individuals and entities considered "Qualified Eligible Persons'.

The CFTC proposes to amend various provisions of CFTC Regulation 4.7 that have not been updated since the rule's original adoption in 1992, including the following:

1. Increases to the financial/monetary thresholds in CFTC Regulation 4.7(a)(1)(v) to approximately account for the effects of inflation over the last three decades (doubling the threshold in the "Securities Portfolio Test" in Regulation 4.7(a)(1)(v)(A) to $4,000,000, and doubling the threshold for the "Initial Margin and Premium Test" in Regulation 4.7(a)(1)(v)(B) to $400,000);
2. New minimum disclosure requirements for CPOs and CTAs operating pools and trading programs under CFTC Regulation 4.7 (Specifically, the general disclosures listed in Regulations 4.24 and 4.34 (information on principal risk factors, investment programs, use of proceeds, custodians, fees and expenses, and conflicts of interest) and performance disclosures described in Regulations 4.25 and 4.35);
3. Amendments designed to codify routinely issued exemptive letters allowing CPOs of Funds of Funds operated under CFTC Regulation 4.7 to choose to distribute monthly account statements within 45 days of the month-end; and
4. Technical amendments to CFTC Regulation 4.7 designed to improve its efficiency and usefulness for intermediaries and their prospective and actual QEP pool participants and advisory clients, as well as the general public.

**Status:** The amendments to CFTC Regulation 4.7 remain a proposed rule at this time.

The text of the proposed rule is available here and the CFTC's press release regarding the proposed rule is available here.

### Agencies Issue Proposal on Incentive-Based Compensation

**Synopsis:** On May 6, 2024, The Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Federal Housing Finance Agency adopted a proposed rule to address incentive-based compensation arrangements, as required under section 956 of Dodd-Frank. The National Credit Union Administration is expected to take similar action in the near future.
The proposed rules are intended to prohibit financial institutions with assets of at least $1 billion from providing excessive compensation or compensation that could lead to material financial loss to the institutions.

**Status:** The SEC and Federal Reserve have yet to act on these proposed rules, and unified action by all of these regulatory bodies will be required to enact final rules.

The text of the proposed rule is available here.

### New State Privacy Legislation – New General Privacy and Specialty Data Protection Statutes Keep Coming; More Expected in 2024

**Synopsis:** Between the end of 2023 and October of 2024 six additional states will begin enforcing state-specific privacy laws. They include Colorado, Connecticut, Utah, Oregon, Texas, and Montana. Each law outlines the rights of consumers and the obligations of covered businesses, often referred to as the data controller. The second quarter of 2023 also saw the effective date of the Washington My Health My Data Act.

**Status:** The Colorado Privacy Act, Utah's Consumer Privacy Act went into effect on December 31st, 2023, Oregon's Consumer Privacy Act and the Texas Data Privacy and Security Act went into effect on July 1st, 2024, and the Montana Consumer Data Protection Act goes into effect on October 1st, 2024. These laws provide rights to the

consumer around the collection and use of their personal information and create obligations for subject businesses, those organizations doing business in the state that meet the processing thresholds established by the laws. There are generally two types of exemptions one at the entity level (generally, entities subject to HIPAA or GLBA) and another that is data specific, generally collected pursuant to certain statutes such as HIPAA, GLBA/FCRA, DCRA, DPPA, or is categorical information such as information for employees and commercial business to business relationships. The Washington My Data My Health Act became effective on July 23, 2023, requiring subject businesses to publish a link to their consumer health data privacy policy on the homepage, if the entity collects consumer health data.

More statutes are expected to come online in 2025 and we expect clients to review privacy policies more frequently over the coming few years as new laws and the associated regulations become effective.

**Proposed New Safeguarding Rule Under the Investment Advisers Act**

**Synopsis:** In February 2023, the SEC issued a rule release proposing to redesignate the current Custody Rule, Rule 206(4)-2, as the new Safeguarding Rule under the Advisers Act. The proposed rule seeks to enhance protections relating to advisory client assets by, among other things, dramatically expanding the scope of the Custody Rule to apply to a broader array of assets and advisory activities and enhancing the custodial protections that assets currently receive under the rule.

**Status:** The new Safeguarding Rule remains a proposed rule at this time.

The Lowenstein Sandler Investment Management Group alert analyzing this proposed rule is available here. The text of the proposed rule can be found here. An SEC fact sheet accompanying the proposed rule can be found here.

**Proposed New Rules Regarding Service Provider Due Diligence and Monitoring**

**Synopsis:** On October 26, 2022, the SEC issued a rule release proposing a new rule under the Advisers Act that seeks to establish an oversight framework across registered investment advisers that outsource "covered functions" to third-party service provider.

The SEC has identified certain risks presented by advisers outsourcing necessary advisory functions without appropriate oversight. Those risks include, among others, the disruption or interruption of outsourced services, an adviser's poor oversight of such outsourced services, and compliance gaps that could enable fraudulent activity. The proposed rule would apply to covered functions that are outsourced to third-party service providers. The proposed rule defines "covered functions" as services or functions that (1) are necessary to provide advisory services in compliance with the federal securities laws and (2) would be reasonably likely to cause a material negative impact on the adviser's clients or on the adviser's ability to provide investment advisory services if not performed or if performed negligently. "Service providers" are defined as persons or entities that (1) perform one or more covered functions and (2) are not "supervised persons" of the adviser.

The adviser would also need to make and keep records of the covered functions that it has outsourced, along with the providers' names and documentation supporting its decisions to outsource to them. The proposed rule would also amend Form ADV to include a new Item 7.C. in Par 1A and Section 7.C. in Schedule D, where the advisers would identify outsourced covered functions and provide certain information about the corresponding service providers.

**Status:** The new rules regarding service provider due diligence and monitoring remain proposed rules at this time.

The Lowenstein Sandler Investment Management Group alert analyzing this proposed rule is available here. The text of the proposed rule can be found here.

**Proposed New Rules to Enhance ESG Disclosures**

**Synopsis:** On May 25, 2022, the SEC proposed rules to (i) enhance and standardize the disclosures made by advisers and registered funds related to the incorporation of ESG factors in their investment strategies and (ii) expand Rule 35d-1 under the Investment Company Act of 1940 (the "Names Rule") to further prevent the misleading use of names by registered funds.

The SEC's new proposed rules would impose new disclosure requirements on advisers, registered investment companies, and business development companies pursuant to the Advisers Act and the 1940 Act.

**Status:** The new proposed rules around ESG disclosures remain proposed rules at this time.

The Lowenstein Sandler Investment Management Group alert analyzing these proposed rules is available here. The proposed rules can be found here.

**CA Publishes Cyber Audit Regulations**

**Synopsis:** In August 2023 and December 2023, the California Privacy Protection Agency issued draft regulations on risk assessments and cyber security audits. If adopted, these regulations will require organizations collecting or otherwise processing personal data from California residents to perform annual risk assessments and cyber audits if that "processing presents a significant risk to consumer security."

**Status:** Under the current draft of the regulations the audit requirement applies to data brokers and other businesses meeting the threshold. The threshold may be tied to the amount of personal information processed and not the size of the company. If adopted, this regulation will impose a fulsome set of cyber security requirements on covered businesses by requiring the annual audit with a written audit report to assess, document and summarize each applicable component of an entity's cybersecurity program, identify gaps and weaknesses, as well as report on the status of gaps and weaknesses identified in prior audits. The regulation specifically identifies the components of the cyber security program that must be present, including, for example, multifactor authentication, privilege restrictions, secure configurations, patch management and logging to name a few controls.

## OTHER REGULATORY GUIDANCE AND DEVELOPMENTS

### SEC Issues Additional Guidance on Investment Adviser Examinations and Compliance with the Marketing Rule

**Synopsis:** On June 8, 2023, the SEC released a risk alert that described additional areas of review related to the SEC's criteria for examining investment advisers and private funds for their compliance with Rule 206(4)-1 under the Advisers Act (the "Marketing Rule"), expanding the exam areas previously identified in a prior September 19, 2022, risk alert.

2022 Risk Alert Areas of Review. The prior risk alert identified four broad initial areas of review:

1. *Policies and procedures.* Whether advisers have adopted and implemented written policies and procedures reasonably designed to prevent violations of the Marketing Rule.
2. *Substantiation requirement.* Whether advisers have a reasonable basis for believing they will be able to substantiate material statements of fact in advertisements.
3. *Performance advertising requirements.* Whether advisers comply with the performance advertising requirements of the Marketing Rule.
4. *Books and records.* Whether advisers comply with the Advisers Act's requirement to keep certain records.

2023 Risk Alert Additional Areas of Review

1. *Testimonials and Endorsements.*

    - Whether an adviser provided a clear and prominent disclosure of whether a person giving the testimonial or endorsement (promoter) is a client or an investor.
    - Whether an adviser disclosed whether a promoter is compensated.
    - Whether an adviser disclosed a promoter's material conflicts of interest.
    - Whether an adviser had a reasonable basis for believing that the testimonials or endorsements comply with the Marketing Rule.
    - Whether a written agreement has been entered into with a promoter unless it was for a de minimis amount.
    - Whether an adviser knew or reasonably should have known the promoter was ineligible to act as a promoter.

2. *Third-Party Ratings.*

    - Whether an adviser provided, or reasonably believed that the third-party rating provides, clear and prominent disclosure of 1) the date on which the rating was given and the period of time upon which the rating was based, 2) the identity of the third party that created and tabulated the rating, and 3) if applicable, that compensation has been provided directly or indirectly by the adviser in connection with obtaining or using the third-party rating.
    - Whether an adviser had a reasonable basis for believing that questionnaires or surveys used in the preparation of a third-party rating 1) made it equally easy for participants to provide favorable and unfavorable responses, and 2) were not designed or prepared to produce a predetermined result.

3. *Form ADV.*

    - The SEC has amended Form ADV to add questions relating to an adviser's marketing practices.
    - An adviser's annual Form ADV amendment will be reviewed for the advisor's responses to questions relating to marketing practices.

**Status:** Advisers should take note of the SEC's guidance in respect of the Marketing Rule.

The new risk alert is available here, and the SEC's prior 2022 risk alert is available here. The Lowenstein Sandler Investment Management Group alert analyzing the new risk alert is available here.

### SEC Releases 2024 Examination Priorities for Registered Investment Advisers

**Synopsis:** In October 2023, the SEC's Division of Examinations released its annual examination priorities report for upcoming examinations of registered investment advisers. The Division's 2024 Examination Priorities are not materially different from its 2023 Examination Priorities. However, adherence by an investment adviser to its fiduciary duties seems to be at the heart of the Division's 2024 focus.

The Division's examination of investment advisers will continue to prioritize an investment adviser's adherence to its duty of care and duty of loyalty obligations. In reviewing an investment adviser's compliance with its fiduciary standard, the Division will focus on:

- Investment advice in connection with certain products, investment strategies, and account types;
- Procedures for determining if investment advice is provided in the client's best interest;
- Conflicts of interest;
- Economic incentives that an investment adviser and/or its financial professionals may have considered in recommending certain products, services, or account types;
- The economic incentives and conflicts of interest associated with investment advisers who are dually registered as broker-dealers;
- Investor disclosures and whether such disclosures contain all material facts relating to all conflicts of interest;
- Policies and procedures for selecting and using third-party and affiliated service providers;
- Policies and procedures for overseeing branch offices;
- Policies and procedures for obtaining informed consent from clients when an investment adviser implements material changes to its advisory agreements;
- Investment advisers not recently examined; and
- Compliance programs enacted by investment advisers.

**Status:** Investment advisers should prioritize these focus areas while also considering the effect of new rulemakings.

The Lowenstein Sandler LLP Investment Management Group alert analyzing the Division of Examinations 2024 Examination Priorities report is available here. The 2024 Examination Priorities report is available here.

### SEC Releases 2024 Examination Priorities for Broker-Dealers

**Synopsis:** In October 2023, the SEC's Division of Examinations released its annual examination priorities report for upcoming examinations of broker-dealers. The priorities are not materially different than the 2023 examination priorities but highlights the SEC's continued focus on Regulation Best Interest ("Reg BI"), Regulations ATS and SHO, as well as more emerging topics such as cybersecurity and crypto assets, blockchain technology and other automated systems.

The Division of Examinations identified the following areas of focus for broker-dealers:

- Regulation Best Interest and their Customer Relationship Summary ("Form CRS");
- Crypto Assets and Emerging Financial Technology;
- Financial Responsibility Rules;
- Broker-Dealer Trading Practices;
- Information Security and Operations; and
- Anti-Money Laundering Programs.

**Status:** Overall, while long-standing requirements for firms remain a key priority, the examination priorities reaffirm that all firms must assess, update, and implement policies and procedures specific to their business and the associated risks, with a particular focus on the areas described above. Broker-dealers should prioritize these focus areas while also considering the effect of new rulemakings.

The Lowenstein Sandler Investment Management Group alert analyzing the Division of Examinations 2024 Examination Priorities report is available here. The 2024 Examination Priorities report is available here.

### IRS Rules That Cryptocurrency Staking Rewards are Taxable

**Synopsis:** In Revenue Ruling 2023-14, issued July 31, 2023, the IRS ruled that a cash-method taxpayer that stakes cryptocurrency native to a proof-of-stake blockchain is subject to tax on additional cryptocurrency it receives as rewards when validation occurs. The ruling defines cryptocurrencies as "convertible virtual currencies" and describes the blockchain technology utilized by cryptocurrencies as well as the process by which the integrity of a blockchain is maintained via the validation of transactions. It goes on to state that "[i]n a proof-of-stake consensus mechanism, persons who hold cryptocurrency may participate in the validation process by staking their holdings if they hold the requisite number of units of a particular cryptocurrency, . . . [and that] . . . validators may be selected by the protocol for the blockchain associated with the specific cryptocurrency based on a variety of factors . . . . These validators confirm transactions and add blocks to the blockchain in accordance with the protocol. If the validator is chosen by the protocol and validation is successful, the validator will receive a reward." The IRS concludes that the value of the units received by a taxpayer for staking units and validating transactions on the blockchain is includible in the gross income of the taxpayer as of the date that the taxpayer has the ability to sell or otherwise dispose of those units.

**Status:** The IRS ruling is a reflection of the IRS's view of the law, and courts may disagree. Taxpayers should watch for further developments and guidance from the IRS and the courts on this issue.

The Lowenstein Sandler Tax alert analyzing Revenue Ruling 2023-14 is available here. The text of Revenue Ruling 2023-14 can be found here.

### Committee on Foreign Investment in the United States ("CFIUS") Update

**Synopsis:** CFIUS was very busy in 2023.

1. CFIUS added additional military base locations to the list limiting foreign investment within 99 miles of the facilities.
2. CFIUS released FAQs, which is not a normal custom for the Committee. They can be accessed here
3. The Annual Report noted that approximately ¼ of all notices now end in mitigation and more notices are being withdrawn and refiled in order to extend the negotiation mitigation timeline.

For 2024, we expect more CFIUS resources focusing on M&A and investment transaction reviews where the parties did not file with CFIUS (called "non-notified" transactions). New lawyers have been hired for this purpose. CFIUS also will publicize enforcement actions and has announced that it has already issued two new penalties with other penalties forthcoming. We expect more mitigation agreements, more monitoring, and a big focus on enforcement. In April 2024, CFIUS proposed new regulatory changes. The changes proposed include:

- Increase penalty amount from $250,000 to $5 million per violation;
- Enlarge scope for imposing penalties from "material misstatements and omissions in a declaration or notice" to non-notified transactions and actions related to mitigation agreements;
- Increase requests for mandatory information in non-notified situations and in mitigation negotiations; and
- Enhance the subpoena power of the Committee.

Finally, we expect the Treasury Department to issue a Notice of Proposed Rulemaking and issue a final rule on outbound investment. U.S. investors will need to perform due diligence on whether Chinese investment targets are subject to a prohibition or notification requirement under the Treasury's outbound investment program. As of now, we anticipate the targeted industries will be: (1) semiconductors and microelectronics, (2) quantum information technologies, and (3) artificial intelligence. For additional guidance, please follow Trade Matters, Lowenstein Sandler's Global Trade & National Security Newsletter. The latest edition can be found here.

### Export Control Update

**Synopsis:** The theme of U.S. export controls in 2024 is "export controls are the new sanctions." This suggests a new U.S. Department of Commerce's Bureau of Industry and Security (BIS) approach towards i) adding complex, tailored controls on the transfer of certain goods and

technologies; and ii) using export controls as a foreign policy tool to help implement the administration's foreign policy and national security agenda around the globe. Additional tailored controls may take the form of more controls over the activities and services of U.S. Persons and more end-use and end-user-based controls over the transfer of U.S. goods and technology. With an eye on China's civil-military fusion programs, the semiconductor industry and advanced computing, Russian export control evasion tactics; and other technology risk points, BIS is leaning toward enforcement-focused strategy.

Some examples of the export control changes seen in 2023 include:

- Expanded export controls on Russia and Belarus;
- The addition of over 100 parties to the Entity List.
- Increased international enforcement cooperation;
- Enforcement focus on technology, both hardware and technical design/development/production information;
- Increased penalties, exemplified by the $300 million penalty issued in the Seagate Technology LLC case;
- The publication of a tri-seal advisory with the Departments of Justice and the Treasury announcing BIS' intention to bring enforcement matters against foreign parties when reexport rules concerning U.S. goods and technology have been violated;
- The creation of a Disruptive Technology Strike Force at the Department of Justice (DOJ) to focus on illicit Russian, Chinese, and Iranian procurement networks;
- New policies to encourage and incentivize investment into compliance, including voluntary self-disclosure and whistleblower programs, with a message that facing an enforcement action will result in financial and reputational costs. BIS has stated that it is, "committed to implementing more aggressive and effective ways to hold companies that don't comply accountable."[1]
- Expansion of U.S. export control jurisdiction through widening the U.S. foreign direct product rule framework to capture and control more foreign-made items developed or produced from U.S. parts, technology, or know-how.

In 2024, BIS has continued its active publication of rules and focus on enforcement. It has published freight forwarder and antiboycott compliance guidance, issued control clarifications on certain integrated circuits and semiconductor manufacturing equipment, issued a proposed rule related to the restriction of information and communications technology and services to connected vehicles by entities in certain countries, and more. Further, DOJ's Disruptive Technology Strike Force has announced its first enforcement actions and BIS has shown increased cooperation with FinCEN.

Things to watch for in 2024 include controls related to the provision of cloud access to advanced computing capabilities, more restricted party list designations, enhanced focus on U.S. Persons' services and activities as well as the end-use and end-users of goods and technology, international enforcement cooperation and joint enforcement cases, a continued enforcement focus on technology exports, and the imposition of large monetary penalties.

For additional guidance, please follow Trade Matters, Lowenstein Sandler's Global Trade & National Security Newsletter. The latest edition can be found here.

**Import Trends**

**Synopsis:** In 2023 Customs and Border Protection ("CBP") and the Department of Commerce ("Commerce") significantly increased their import compliance enforcement efforts, necessitating a corresponding ramp-up in supply chain tracking, tracing, and partner diligence by importers to avoid related penalties and delays. The key areas the U.S. government has focused on are Section 301 (China tariff) liability, prohibited imports from the Xinjiang region of China under the recently-implemented Uyghur Forced Labor Prevention Act ("UFLPA"), and antidumping and countervailing ("AD/CVD") duty evasion. In 2023 the Office of Foreign Assets Control ("OFAC") also increased its involvement in the import space as it prohibited the importation of certain Russia-origin products in response to the ongoing conflict in Ukraine.

2023 saw CBP initiate numerous Risk Analysis and Survey Assessments ("RASAs") – targeted reviews of company import and supply chain diligence policies, procedures, and records that could lead to full-on comprehensive CBP audits if significant risk factors or errors are identified. Many RASAs centered on whether Section 301 duties were owed on imports with Chinese components or whether the importer properly claimed a Section 301 exclusion or shifted the country of origin away from China to lawfully avoid the additional tariffs.

CBP detained over 4,000 shipments in 2023 valued at $1.4 billion for UFLPA purposes, continuing to increase enforcement of the UFLPA's rebuttable presumption that goods with any inputs from Xinjiang whatsoever are made with forced labor and are therefore prohibited from importation into the United States. 2023 saw CBP expand UFLPA enforcement efforts to include products shipped from third countries. In fact, most products detained under the UFLPA in 2023 originated in Malaysia or Vietnam. CBP also expanded UFLPA enforcement to include new types of products, with electronics, apparel/textiles, and industrial/manufacturing materials making up the majority of UFLPA detentions. Importantly, no importers were granted an exception to the UFLPA's rebuttable presumption in 2023, meaning that shifting supply chains away from Xinjiang remains the only practical compliance option for U.S. importers.

Commerce introduced 14 new AD/CVD orders in 2023. It also conducted about 80 AD/CVD investigations that are set to conclude in 2024 and may lead to new orders. This increase follows the ongoing upward trend seen over the last several years and the continued attention on imports from China and Chinese influence in third-country markets, where Chinese producers have been rerouting their products to evade additional AD/CVD duties. Of the approximately 680 AD/CVD orders administered in 2023, more than a third relate to imports from China. In 2023 Commerce also proposed new regulations that are likely to go into effect in 2024 and will significantly enhance the U.S. government's ability to address allegations of Chinese AD/CVD transshipments.

[1] https://www.bis.doc.gov/index.php/documents/about-bis/newsroom/3488-bis-update-2024-axelrod-final/file

For additional guidance, please follow Trade Matters, Lowenstein Sandler's Global Trade & National Security Newsletter. The latest edition can be found here.

## ENFORCEMENT AND LITIGATION

### Recent SEC Enforcement Actions: Guidance for Registered Investment Advisers

**Synopsis:** Throughout September 2023, the SEC announced enforcement actions against multiple investment advisers for violating the Custody Rule and Rule 204-1(a) of the Advisers Act (the "ADV Reporting Rule") and the Marketing Rule and released an order against an adviser for failure to file Form 13F pursuant to Section 13(f)(1) of the Exchange Act.

The SEC's actions highlight several crucial lessons for investment advisers:

*Custody Rule Compliance.* Investment advisers must diligently adhere to the requirements of the Custody Rule to ensure the safety and security of client funds and securities by ensuring timely distribution of audited financials to private fund investors when relying on the Custody Rule Audited Financials Alternative.

*ADV Reporting Rule Compliance.* Advisers should promptly and accurately update their Form ADV disclosures to appropriately reflect changes in the status of private fund audited financial statements.

*Marketing Rule Robust Policies and Procedures.* Investment advisers must establish and maintain comprehensive policies and procedures that align with the modernized Marketing Rule requirements. Among other things, advisers must be able to demonstrate that hypothetical investment performance shown in advertisements is relevant in light of the financial situation and investment objectives of the intended audience.

*Marketing Rule Record-Keeping.* Advisers should be diligent in maintaining copies of their advertisements as mandated by the rule.

*Form 13F Compliance.* Advisers should ensure timely filing of Form 13F as soon as they meet the requirement of $100 million in 13F securities over which they exercise investment discretion.

The Lowenstein Sandler Investment Management Group alert analyzing these enforcement actions is available here.

### SEC Announces Enforcement Results for Fiscal Year 2023

**Synopsis:** In November 2023, the SEC issued a press release summarizing the results of its enforcement activity for fiscal year 2023. Enforcement activity resulted in a record-high amount of ordered monetary penalties and spanned an array of alleged misconduct.

In fiscal year 2023, the SEC filed 784 enforcement actions, representing a 3 percent increase over the previous fiscal year. These actions included 501 original (or "standalone") enforcement actions, 121 actions against issuers alleging they were delinquent in making required SEC filings, and 162 "follow-on" administrative proceedings seeking to bar or suspend individuals from certain functions in the securities markets based on criminal convictions, civil injunctions, or other orders.

Money ordered in the enforcement actions, comprising civil penalties, disgorgement, and prejudgment interest, totaled more than $4.9 billion. This is the second-highest amount on record in SEC history. The financial remedies comprised $3.369 billion in disgorgement and prejudgment interest and $1.580 billion in civil penalties. The SEC distributed $930 million to harmed investors in fiscal year 2023, marking the second consecutive year with more than $900 million in distributions. The SEC issued whistleblower awards totaling nearly $600 million in fiscal year 2023, the most ever awarded in one year.

Areas of focus in fiscal year 2023 included recordkeeping requirements, the Marketing Rule, failures to timely file required forms, Regulation A under the Securities Act, rewarding cooperation/whistleblowers, service provider misconduct, crypto, cybersecurity, ESG, FCPA, market abuse and public corruption.

The Lowenstein Sandler Investment Management Group alert analyzing the SEC's press release is available here. The full text of the SEC's press release is available here.

### SEC Risk Alert on Advisers' Compliance with Marketing Rule and Other Rules

**Synopsis:** On April 17, 2024, the SEC's Division of Examinations published a risk alert giving its preliminary observations of registered investment advisers' compliance with the Marketing Rule and certain other rules.

Some notable deficiencies observed include: (i) policies and procedures lacking specificity, consisting only of general descriptions/expectations related to Marketing Rule compliance; (ii) policies and procedures were incomplete and did not address applicable marketing topics or did not address applicable marketing channels utilized by the adviser; (iii) policies and procedures were either informal (i.e., unwritten) or not implemented; and (iv) copies of supporting documentation were not adequately maintained. Additionally, inaccurate reporting of Marketing Rule-related items was noted on Form ADV.

There were also deficiencies noted in advertisements, including: (i) untrue or unsubstantiated statements of material fact; (ii) omission of material facts or inclusion of information that could reasonably cause untrue or misleading inferences; (iii) lack of fair and balanced treatment of material risks or limitations; (iv) reference to investments in a manner that was not fair and balanced; and (v) inclusion/exclusion of certain performance results or presentation of certain time periods in a manner that was not fair and balanced or that provided misleading performance information in advertisements, such as utilizing outdated market data or presenting performance information without adequate context or disclosures.

**Status:** We recommend all advisers review the specific observations in the risk alert and compare them with their own practices.

The Lowenstein Sandler Investment Management Group alert analyzing the risk alert is available here.

The full text of the risk alert is available here.

**CFTC Announces Enforcement Results for Fiscal Year 2023**

**Synopsis:** On November 7, 2023, the CFTC released its annual enforcement results for its fiscal year 2023, demonstrating its continued commitment to accountability, deterrence, customer protection, and ensuring market integrity. The CFTC brought 96 enforcement actions in total, yielding more than $4.3 billion in penalties, restitution, and disgorgement.

The fiscal year 2023 enforcement results include a record-setting number of digital asset cases, actions to hold registrants to their regulatory obligations, manipulation and spoofing actions, and precedent-setting court decisions in complex litigations.

Areas of focus in fiscal year 2023 included digital assets, manipulative and deceptive conduct and spoofing, reporting, risk management and compliance violations, MNPI misappropriation, customer protection, cooperation with other organizations and whistleblower rewards.

The CFTC's press release detailing its enforcement results can be found here.

**Second Circuit Ruling Finds Syndicated Loans Are Not Securities**

**Synopsis:** On August 23, 2023, the United States Court of Appeals for the Second Circuit decided *Kirschner v. JP Morgan Chase Bank*, following an oral argument affirming the District Court's decision that the syndicated loans at issue in the case are not securities.

The Second Circuit affirmed the District Court's dismissal applying a "family resemblance" test previously adopted by the U.S. Supreme Court in Reves v. Ernst & Young. Three of four factors under this family resemblance test were found to weigh in favor of finding the syndicated loans not to be securities (no offer/sale to the public, sophisticated and experienced institutional lenders and protections afforded by securities laws found to be unnecessary).

The Second Circuit had previously solicited the SEC's views on whether the syndicated loans should be classified as securities, but the SEC eventually declined to take a position, stating that SEC staff was not in a position to file a brief on behalf of the SEC in the matter. The Second Circuit noted the SEC's decision not to file a brief in its decision.

**Status:** The Second Circuit's decision supports the view that syndicated loans are not securities (though it is ultimately a facts and circumstances test) but leaves open the possibility that the SEC's views may be given significant weight in the future.

The Lowenstein Sandler alerts discussing the case are available here and here.

**SEC Says Language in J.P. Morgan-Affiliate Release Agreements Violates Whistleblower Protections**

**Synopsis:** On January 16, 2024, the SEC announced an $18 million settlement order with J.P. Morgan Securities LLC ("JPMS") that finds that the language of release agreements JPMS entered into with clients violated Rule 21F-17(a) under the Exchange Act–a rule designed to protect potential whistleblowers. The order serves as a reminder to investment advisers and broker-dealers to ensure client and employee agreements do not contain language that could be interpreted to impede a person's ability to report matters to the SEC. Confidentiality provisions in client and employee agreements should explicitly exclude communications to governmental and/or regulatory authorities.

In the risk alert, the Division of Examinations identified the following primary compliance issues.

1. <u>Rule 21F-17(a)</u>

   The rule provides, subject to limited exceptions, that no person may take any action to impede an individual from communicating directly with SEC staff about a possible securities law violation, including enforcing or threatening to enforce, a confidentiality agreement with respect to such communications.

2. <u>JPMS' Alleged Violations</u>

   In paying out credits and/or settlements to clients, JPMS typically requested that clients receiving over $1,000 sign a release. Between 2020 and 2023, at least 362 clients signed a release with JPMS. The release included language the SEC found prohibited clients from affirmatively reporting to the SEC staff in violation of Rule 21F-17(a).

**Status:** Four points bear emphasis:

1. An investment adviser/broker-dealer need not seek to enforce a confidentiality agreement to be subject to liability under Rule 21F-17(a).
2. Generic confidentiality restrictions (without express exceptions for disclosures to governmental or regulatory authorities) are enough to subject a regulated entity to a violation of Rule 21F-17(a).
3. The exception permitting clients to regulatory inquiries was inadequate as clients were not permitted to report directly in the absence of a regulatory inquiry.
4. The inclusion of express language permitted disclosures to governmental or regulatory authorities in client and employee agreements should bring such agreements into compliance with Rule 21F-17(a).

The Lowenstein Sandler Investment Management Group alert analyzing this order is available here.

**"Shadow Trading" is Insider Trading: Jury Establishes Liability in Historic Shadow Trading Case**

**Synopsis:** On April 5, 2024, a jury found Matthew Panuwat civilly liable for insider trading in violation of federal securities laws in a first-of-its-kind "shadow trading" case (also referred to as "sympathy trading"). Following a historic trial in the U.S. District Court for the Northern District of California, the SEC stated that the case was not novel and that Panuwat's actions fell squarely within the misappropriation theory of insider trading. This case, however, is the first instance in which the SEC successfully argued that (i) a company's material nonpublic information ("MNPI") may be material to a wholly different company if both companies have a "market connection" or are "economically linked," and (ii) trading securities of one

company while in possession of MNPI of a different market-connected or economically linked company (even if the MNPI does not directly relate to the traded company's securities) can nevertheless give rise to a violation of federal securities laws.

**Status:** The SEC has made clear its intention to treat cases of shadow trading as normal course misappropriation insider trading activity. Investment adviser firms should actively consider the implications of the SEC's stance on this issue as it relates to their trading and compliance activities. Such firms may wish to consult with counsel to better assess whether their current compliance policies and procedures properly account for and mitigate the risk of shadow trading activities.

The Lowenstein Sandler Investment Management Group alert analyzing this case is available here.

### SEC Pay-to-Play Rule Rears Its Head Again in Time for Election Season

**Synopsis:** On April 15, 2024, the SEC settled with a registered investment adviser, whereby the adviser paid a $60,0000 civil money penalty in addition to being censured for violations of Rule 206(4)-5, the SEC's "pay-to-play" rule for investment advisers (the "Pay-to-Play Rule").

**Status:** The settlement serves as a potent reminder of the existence of the Pay-to-Play Rule and underscores the necessity for investment advisers to implement robust controls regarding their campaign contributions and those of their covered associates, including, but not limited to, additional training, prohibitions on and/or preclearance procedures for campaign contributions, reporting, monitoring of publicly available information to ensure compliance, and/or periodic audits. All of these procedures should be tailored to an investment adviser's specific risks, investors, and business model. In that vein, this settlement may be indicative of the SEC's increased focus on enforcement of the Pay-to-Play Rule (especially during election season), and investment advisers should be aware that even minor infractions can lead to monetary penalties and corresponding reputational risk.

The Lowenstein Sandler Investment Management Group alert analyzing this settlement is available here.

### *Meta v. Bright Data* Ruling Has Important Implications for Webscraping Activities by Investment Advisers

**Synopsis:** On January 23, 2024, Judge Edward M. Chen of the United States District Court for the Northern District of California ruled in *META PLATFORMS, INC. v. BRIGHT DATA LTD.*, granting Bright Data's motion for summary judgment. While Meta's contractual terms did not extend to logged-out webscraping activities in this case, advisers should remain vigilant in looking for potentially broader contractual terms prohibiting webscraping in such circumstances in the future.

Meta had alleged, among other claims, a breach of contract by Bright Data due to its webscraping activities and resale of information obtained from publicly available portions of Meta's businesses Facebook and Instagram. Bright Data had previously created corporate accounts at both Facebook and Instagram, for purposes such as corporate marketing, and in creating those accounts had agreed to each of Facebook's and Instagram's terms of use.

Judge Chen engaged in a careful analysis of the relevant contractual language and found that the contractual language was not clear on the relevant points. Accordingly, Bright Data was found not to have breached the Facebook and Instagram terms through either (a) its webscraping (while logged out) and resale activities while it was an active account holder/user of Facebook and Instagram or (b) its webscraping and resale activities after the termination of its Facebook and Instagram accounts.

**Status:** In light of *Meta v. Bright Data*, investment advisers should continue to exercise care in their use of webscraped data. Webscraping from websites where the adviser or its agents maintain an account requires particular diligence to determine if the applicable terms of use may restrict webscraping even when logged out (particularly where the website owner may have updated its terms in light of the court's decision in *Meta v. Bright Data*). Similarly, investment advisers should ensure that their diligence of third-party providers of webscraping services or webscraped data addresses any accounts that the provider may maintain with the applicable websites being webscraped.

The Lowenstein Sandler Investment Management Group alert analyzing *Meta v. Bright Data* is available here. Lowenstein Sandler's survey results concerning the use of alternative data and AI in the investment management industry are available here.

### SEC Settlements Highlight Governing Document Amendment Considerations for Private Funds

**Synopsis:** In a February 28, 2023, settlement (In the Matter of Foresight Wealth Management, LLC, and Adam E. Nugent), the SEC settled with a fund manager who, among other things, failed to disclose material facts and conflicts of interest when proposing governing document amendments to investors in their funds. In this situation, the settlement notes the manager, who was separately a co-creator of a holding company with the purpose of operating in California's marijuana industry, engaged in fraudulent offerings that resulted in the enrichment of outside investors who had not made capital contributions to the fund in question.

In an October 17, 2014, settlement (In the Matter of Clean Energy Capital, LLC, and Scott A. Brittenham), the SEC describes a scenario where certain private funds had insufficient cash to pay expenses but were not permitted under their governing documents to borrow money or issue promissory notes (which would have been used to cover expenses). The settlement explains that the manager unilaterally amended the governing documents to permit borrowing and then made loans to the funds, without disclosing to the investors (a) information about the loans, (b) that fund assets would be pledged as collateral, or (c) the existence of the amendments themselves.

**Status:** These settlements serve as a cautionary tale and highlight the importance of full transparency when proposing governing document amendments. Managers must clearly describe and disclose any conflicts of interest related to such amendments. Further, managers must be aware that even if an amendment provision permits unilateral amendment, the manager still may be unable to do so when any such conflict is present. Managers often

believe that the only steps they need to take in making an amendment to a governing document is by following the relevant amendment provision. However, managers must take into consideration any potential conflicts of interest outside the scope of their governing documents and ensure they make full and accurate disclosures when proposing any amendments.

The Lowenstein Sandler Investment Management Group alert analyzing these settlements is available here.

### SEC Settlements Highlight Continued Scrutiny of Off-Channel Communications

**Synopsis:** On August 14, 2024 and April 3, 2024, the SEC announced further settlements regarding "off-channel communications." Settlements of this type have become increasingly common in recent years, have resulted in large-scale fines across the industry, and continue to be a focus of the SEC.

The SEC's investigations have uncovered pervasive and longstanding use of unapproved communication methods, known as off-channel communications, along with a failure to implement procedures to monitor employees in these areas.

During the relevant periods, personnel sent and received off-channel communications that were records required to be maintained under relevant securities laws but failed to ensure these records were retained, depriving the SEC of these communications in its investigations. In some cases, auto-delete functions had been enabled. The failures involved personnel at multiple levels of authority, including supervisors and senior managers. The firms were each charged with recordkeeping violations and with failing to reasonably supervise their personnel with a view to preventing and detecting those violations.

**Status:** Advisers should carefully examine their policies and procedures regarding recordkeeping and off-channel communications (and the employee training associated therewith) to help ensure they are both compliant with relevant laws and properly tailored to the adviser's business. Advisers should continuously train their employees on the current recordkeeping requirements and acceptable means of communication for business purposes and consider adding the topic to existing year-end training sessions. In addition, advisers may also consider having their chief compliance officers circulate memoranda outlining acceptable means of communication as memorialized in applicable compliance policies and procedures.

The Lowenstein Sandler Investment Management Group alert analyzing the April 3, 2024 settlement and related SEC guidance is available here.

### Tax Court Rules Offshore Hedge Fund Engaged in U.S. Trade or Business – *YA Global Investments LP v. Commissioner*

**Synopsis:** On November 15, 2023, the Tax Court released its opinion in *YA Global Investments LP v. Commissioner,* 161 T.C. No. 11 (2023). YA Global Investments, LP ("YA Global") was a Cayman Islands limited partnership that was the flagship fund of Yorkville Advisors, LLC ("Yorkville"), a U.S.-based fund sponsor. YA Global had no employees and took the position that it was not engaged in a U.S. trade or business during the tax years at issue. YA Global was party to a management agreement with Yorkville pursuant to which Yorkville was designated as YA Global's agent with authority to buy, sell, and otherwise transact in securities for YA Global's account. The management agreement initially gave Yorkville unrestricted authority, subject only to YA Global's ability to periodically notify Yorkville of revised investment restrictions and was only subsequently amended to reflect that Yorkville's actions were subject to YA Global's policies and control. Yorkville's compensation consisted of a 2% management fee for gross assets and a 20% incentive fee based on YA Global's profits.

YA Global's primary activity was providing funding to portfolio companies using convertible debentures, "standby equity distribution agreements" or "SEDAs," promissory notes, warrants, and other securities. Yorkville, on behalf of YA Global, engaged in direct negotiation with borrowers over loan terms and negotiations of SEDAs with portfolio companies. Under the SEDAs, YA Global had the right, for a period of time, to buy stock in and from the portfolio companies at a discount to the trading price of such stock. The portfolio companies also paid fees to YA Global and Yorkville under the SEDAs. The opinion indicates that YA Global held itself out as being willing and able to provide capital to portfolio companies and that its reputation (bolstered by its sponsorship of industry conferences and its own marketing materials) led companies in search of funding to reach out directly to Yorkville. During the tax years at issue, YA Global was Yorkville's only (or only significant) client.

The Tax Court found (i) that Yorkville was considered YA Global's agent, and (ii) that YA Global's activities, including those conducted by Yorkville on its behalf, were not merely investing in or trading securities, but instead constituted a U.S. trade or business. As a consequence, YA Global did not qualify for the securities trading safe harbor and had income that was effectively connected with such U.S. trade or business.

**Status:** Few cases have addressed what activities of a taxpayer can constitute a U.S. trade or business where the taxpayer "only" transacts in securities. The facts of the YA Global case are substantially outside of the norm for most investment funds, especially as it relates to the types of fees received and the extent of the activities of Yorkville conducted within the United States which were attributed to YA Global. Nevertheless, this case is instructive in identifying conduct to avoid in structuring investment funds. Fund managers should continue to limit the receipt of fees by investment funds (including via fee offsets or other mechanisms of reimbursement) and should carefully review their investment management agreements and economic arrangements with tax counsel.

### Tax Court Holds Limited Partners Are Not Automatically Exempt from Self-Employment Tax under "Limited Partner Exception" – *Soroban Capital Partners, LP v. Commissioner*

**Synopsis:** On November 28, 2023, the Tax Court released its opinion in *Soroban Capital Partners, LP v. Commissioner*, 161 T.C. No. 12 (2023). Soroban, a Delaware limited partnership, is a hedge fund manager located in New York City. During 2016 and 2017, Soroban had four partners: three individual limited partners, each of whom was a limited partner, and Soroban Capital Partners GP LLC, a Delaware limited liability company, as its general partner.

The general partner was owned indirectly by the three individual limited partners.

During the years at issue, Soroban made guaranteed payments for services to each of the three individual limited partners and allocated the remaining ordinary business income among all of its partners. Soroban reported the guaranteed payments, as well as the general partner's share of ordinary business income, but not the limited partners' shares of ordinary business income, as subject to self-employment ("SECA") tax. The IRS challenged Soroban's position that the limited partners' shares of ordinary business income were not subject to SECA tax and made adjustments to Soroban's net earnings from self-employment. Soroban filed a petition in Tax Court challenging the adjustments and then filed a motion for summary judgment requesting that the Court find as a matter of law that a "limited partner exception" in Section 1402(a)(13) of the Internal Revenue Code of 1986, as amended (the "Code"), that excludes from net earnings from self-employment "the distributive share of any item of income or loss of a limited partner, as such," precluded the limited partners' shares of ordinary business income of Soroban from being subject to SECA tax.

The Tax Court analyzed principles of statutory construction to ascertain Congress's intent under Section 1402(a)(13) and stated that if Congress had intended for limited partners to be per se excluded from SECA tax, Congress could have used the term "limited partner" and not "limited partners, *as such*," reasoning that Congress instead intended for the exception to apply only to passive investors. The Tax Court held that a "functional analysis test" of a limited partner's roles and responsibilities must be applied to determine whether the limited partner is a "limited partner, as such," eligible for the limited partner exception, or a limited partner "in name only."

**Status:** The *Soroban* opinion addressed only the legal question on summary judgment of whether a partner in a limited partnership is per se excluded from SECA tax. Therefore, the Tax Court has not yet addressed whether the limited partners in *Soroban* satisfy its proposed "functional analysis test." Currently, there are two other pending Tax Court cases relating to fund managers which raise the same arguments as *Soroban*, as the IRS continues its audit campaign targeting fund managers with an eye to assessing self-employment taxes. *See, e.g.*, *Denham Capital Management LP*, No. 9973-23 (T.C. 6/22/23) (petition filed); *Point72 Asset Management LP*, No. 12752-23 (T.C. 8/11/23) (petition filed). Given its precedential nature, the ultimate *Soroban* decision is expected to have significant implications for state-law limited partners who perform services for their partnerships.

**Economic Sanctions Enforcement Trends**

**Synopsis:** The U.S. Office of Foreign Assets Control ("OFAC") continued its increased enforcement efforts, resulting in 17 settlements for a total of a record $1.5 billion in penalty assessments. Sanctions targeting Russia grew more complex, including authorizing sanctions against non-U.S. financial institutions determined to be facilitating transactions or providing services to Russia's military-industrial base; and the designation of hundreds of individuals and entities, including those operating in Russian energy, financial and mining industries.

OFAC also significantly relaxed sanctions on Venezuela in October 2023, authorizing U.S. person transactions related to the Venezuela oil and gas sector. The U.S. government conditioned this authorization on the Maduro regime's continued political negotiations with the Venezuelan opposition. This authorization was short-lived, however. Because Maduro failed to meet the U.S. government's condition, OFAC reimposed the sanctions in April 2024, greatly narrowing the scope of authorized oil and gas-related activities in Venezuela.

OFAC also continued its focus on the virtual currency. 2023 sanctions violation settlements with virtual currency companies included: Binance ($968,618,825); CoinList Markets ($1,207,830); Poloniex ($7,591,630); and UpHold HQ ($72,230). These settlements involved both intentional violations in the case of Binance ("management acted willfully . . . encouraged its users to circumvent company controls and misled third parties"), and failure to exercise due caution in the implementation of their existing compliance controls in the case of CoinList, Poloniex, and Uphold HQ. OFAC also designated several entities and individuals involved in the cryptocurrency industry for violating or evading sanctions and money laundering. OFAC has repeatedly warned that the virtual currency industry must commit to compliance and allocate appropriate resources to address a company's sanctions risk. We expect OFAC to continue to investigate and enforce sanctions regulations against companies in this industry.

**Status:** Common themes that emerged from the 2023 settlements highlight OFAC's expectation that companies establish and commit to compliance programs appropriate to a company's risk profile. This includes integrating all information available to a company into compliance programs. Conducting sufficient due diligence in mergers & acquisitions, particularly acquisitions of non-U.S. entities or entities operating in high-risk regions or activities.

For additional guidance, please follow Trade Matters, Lowenstein Sandler's Global Trade & National Security Newsletter. The latest edition can be found here.

**Increased Cyber and Privacy Class Actions**

**Synopsis:** 2023 saw an increase in cyber and privacy class action lawsuits where some of these lawsuits are relying on laws that predate the internet. There has also been an increase in class actions filed under New Jersey's Daniel law which allows judges, law enforcement personnel and other officials to request that state and local government ran websites as well as sites ran by individuals and businesses stop disclosing their home addresses and unpublished telephone numbers.

**Status:** The suits relying on laws, some that pre-date the internet, are using state wiretapping and federal video statutes that were passed in the 1980s and they are targeting organizations that maintain websites and sell consumer data to aggregators and share it with third-party analytic companies. For example, we have seen in 2023 and 2024 cases alleging a "wiretap" for the use of "cookies" when a person is behind a covered entity login on a website relating to medical treatment, or cases ultimately dismissed on jurisdictional grounds regarding behavioral software to determine how a consumer interacts with a website.

Another area where we are seeing an increase in class actions involves the use of biometrics. Some states have passed laws governing the use of biometrics such as facial recognition and using this information without the proper consent of the consumer. We are also seeing a significant uptick in data breach class actions given the statutory damages in the California general privacy legislation passed a few years ago. Litigation continues to be active in this area and we expect more in 2024 and 2025.

**Cyber Threat Landscape: (1) Data Ransom Without The "Ware", (2) Much Faster Actors And (3) Continued Supply Chain Woes**

**Synopsis:** We are seeing an evolution in the cyber threat landscape when it comes to ransomware and the methods the attackers are using. Previously, attackers would use ransomware to regularly encrypt the data before demanding a ransom. Enterprise-level encryption is becoming more difficult with more ubiquitous deployment of endpoint detection and response software, among other controls. Recently attackers are quickly entering enterprises in a stealthy matter, exfiltrating the information and then exiting without being detected, sometimes executing ransomware and sometimes not. In 2023 and 2024, we also learned that the IT and vendor supply chain remains a target for attackers.

**Status:** The new methods of attack include partial encryption, theft, business partner intimidation, and data destruction as well as more traditional ransomware and distributed denial of service attacks are potential waves of attack within a multi-faceted extortion scheme. If an attacker learns that one route is unsuccessful, there could always be another wave of attack. To save time and avoid detection threat actors are turning to stealing/exfiltrating sensitive and important information from organizations and demanding a ransom in return for not releasing the information to competitors and the public. If organizations refuse, they are going to other inside individuals whose information they have obtained from the organization and demanding the ransom from them to avoid release of their personal or sensitive information. We are also seeing threat actors use partial encryption and data corruption techniques in an effort to extort organizations and individuals by demanding a ransom to either get their data back or avoid continued data corruption within the network. This is particularly true for supply chain organizations. Attackers have realized they can leverage information from the supply chain and access multiple companies simultaneously. An example is the MOVEit breach that resulted in over 600 additional breaches with current cost estimates over $12 billion. See *The Wall Street Journal*, and *The New York Times*. In addition, we have seen an increased interest in attacks on critical vendor relationships such as call centers, business process outsourcing entities and common infrastructure equipment including VDRs, e-rooms, SFTPs and VPNs and VoIP platforms. See *The Washington Post*.

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## COMPLIANCE CHECKLISTS

### PRIVATE INVESTMENT FUNDS AND THEIR ADVISERS

- ☐ **Conduct periodic review of compliance policies.**
- ☐ **Provide/collect new issues certifications regarding whether funds/investors are "restricted persons."**
- ☐ **Conduct periodic review and update of offering documents.**
- ☐ **Consult counsel regarding annual Form D amendments and blue-sky and local securities matters in connection with offers or sales.**
- ☐ **Starting September 30, 2024, "Qualified Institutional Investors" (less than 10% beneficial ownership) and "Exempt Investors" must make initial Schedule 13G filings within 45 days of quarter-end (e.g., by November 14 for filings due in respect of the third quarter of 2024).**
- ☐ **Starting September 30, 2024, all Schedule 13G filers must file to reflect material amendments within 45 days of quarter-end (e.g., by November 14 for filings due in respect of the third quarter of 2024).**
- ☐ **File Form 5 within 45 days of the end of the issuer's fiscal year-end (e.g., for issuers with a December 31st fiscal year-end, by February 14, 2024, for filings due in 2024 and February 14, 2025, for filings due in 2025).**
- ☐ **File Schedule 13H year-end amendments within 45 days of calendar year-end (e.g., February 14, 2024, for filings due in 2024 and February 14, 2025, for filings due in 2025).**
- ☐ **Amend Schedule 13H quarterly as applicable.**
- ☐ **File Form 13F within 45 days of quarter-end (e.g., by February 14, May 15, August 14, and November 14 for filings due in 2024).**
- ☐ **File Form PF quarterly updates and annual updates.**
- ☐ **Form 13F Filers Must File Form NP-X by August 31, 2024.**
- ☐ **Conduct periodic review of Section 13 and Section 16 filings.**
- ☐ **Conduct periodic review of BEA and TIC forms.**
- ☐ **Monitor compliance with 25 percent ERISA limitation with respect to benefit plan investors.**
- ☐ **Prepare annual VCOC Certification (if required) for benefit plan investors.**
- ☐ **Prepare Form 5500 Schedule C fee disclosures for ERISA plan investors.**
- ☐ **Prepare year-end audits and distribute financial statements as appropriate.**
- ☐ **Collect annual holdings reports and annual certifications from access persons and other personnel.**
- ☐ **Renew "bad actor" questionnaires and conduct placement agent verifications.**
- ☐ **Conduct annual training of personnel.**
- ☐ **Update conflict assessments and risk assessments.**
- ☐ **Conduct periodic anti-money laundering verifications (e.g., OFAC verifications).**
- ☐ **Reevaluate state privacy obligations.**
- ☐ **Distribute privacy notices, if required.**

***Discussion:***

**Compliance Policies.** The compliance and operating requirements pertaining to registered investment advisers and unregistered advisers (including exempt reporting advisers) have continued to merge, and more and more unregistered managers are adopting best practices and upgrading their compliance policies to meet the demands of regulators and/or investors. Whether your firm is currently federally registered or will be required to register in the future, you should review your compliance policies periodically to verify that they are adequate and appropriately tailored to your business risks and that your firm is adhering to them.

**New Issues Certifications.** If you purchase "new issues" (i.e., equity securities issued in an initial public offering),

your broker (or, if you are a fund of funds that invests indirectly in new issues, the underlying funds) will require that you certify each year as to whether the fund is a "restricted person" within the meaning of FINRA rules 5130 and 5131. To make the certification, you must determine the status of investors in your fund as either restricted persons or unrestricted persons.

**Offering Documents.** Offering documents should be reviewed from time to time to verify that they (i) contain a current, complete, and accurate description of the fund's strategy, management, and soft-dollar and brokerage practices; (ii) comply with current laws and regulations; and (iii) reflect current disclosure best practices.

**Form D Amendments and Blue Sky and Local Securities Matters.** You should continue to inform counsel of all offers or sales of fund interests. Ongoing offerings may necessitate an amendment to a private fund's Form D (typically required on an annual basis on or before the first anniversary of the most recent notice previously filed). Additionally, offers to U.S. persons may trigger filing obligations in a given investor's state of residence, while offers to foreign persons may require filings in the country of an investor's residence.

**Beneficial Ownership Reporting Requirements.** Amendments with respect to Schedule 13D and Schedule 13G became effective February 5, 2024 (the compliance date for the revised Schedule 13G filing deadlines is September 30, 2024, and compliance with the structured data requirements is not mandatory until December 18, 2024). All Schedule 13D filers now have to file an initial Schedule 13D within five (5) business days after either acquiring beneficial ownership of more than 5% of a class of covered securities or losing eligibility to file on Schedule 13G. An amended Schedule 13D to disclose material changes is now due within two (2) business days of the applicable change. Starting September 30, 2024, "Qualified Institutional Investors" and "Exempt Investors" will have to file an initial Schedule 13G no later than 45 calendar days after the calendar quarter (e.g., by November 14 for filings due in respect of the third quarter of 2024) in which they beneficially own more than 5% of a class of covered securities (or within five (5) business days after month-end for Qualified Institutional Investors exceeding 10% beneficial ownership). Starting September 30, 2024, "Passive Investors" now have to file an initial Schedule 13G no later than 5 business days after exceeding 5% beneficial ownership. Starting September 30, 2024, all Schedule 13G filers must file a Schedule 13G amendment to disclose material changes no later than 45 calendar days after each calendar quarter e.g., by November 14 for filings due in respect of the third quarter of 2024). In addition, starting September 30, 2024 (a) Qualified Institutional Investors must file a Schedule 13G amendment within five business days after month-end if exceeding 10% beneficial ownership or in the event of a 5% increase or decrease in beneficial ownership and (b) Passive Investors must file a Schedule 13G amendment within two (2) business days if exceeding 10% beneficial ownership or in the event of a 5% increase or decrease in beneficial ownership. Form 5 must be filed within 45 days of the end of the issuer's fiscal year-end (e.g., for issuers with a December 31st fiscal year-end, by February 14, 2024, for filings due in 2024 and February 14, 2025, for filings due in 2025). All relevant Section 13 and Section 16 filings should be reviewed periodically to ensure they are current and complete.

**BEA and TIC Forms.** Firms should periodically review the Bureau of Economic Analysis ("BEA") and Treasury International Capital ("TIC") forms and filing requirements applicable to such firm.

**BEA**

BEA forms include a benchmark form, an annual form, a quarterly report, and a transaction form. Benchmark forms are required if the criteria described in such forms are met, even if the reporter is not contacted by the BEA. A response to the reporting requirements of the BE-13 (survey of new foreign direct investments in the U.S.) is also required whether or not a reporter is contacted by the BEA. Note that the BEA has also issued special reporting instructions for private funds, such that reporting on some BEA forms is only due if the private funds themselves have 10 percent voting ownership of operating companies (as opposed to, for example, only reporting a U.S. entity holding the general partner interests of a foreign limited partnership that serves as a private fund).

- **Form BE-10: The Benchmark Form.** A BE-10 report is required of any U.S. reporter that had a foreign affiliate – that is, that had direct or indirect ownership or control of at least 10 percent of the voting stock of an incorporated foreign business enterprise or an equivalent interest in an unincorporated foreign business enterprise. The last benchmark form was filed in 2020 for the fiscal year ending in 2019. The next benchmark form will be due in May 2025 for the fiscal year ending in 2024.
- **Form BE-12: The Benchmark Form.** The benchmark form BE-12 is a comprehensive survey of the value of foreign direct investments in the U.S. The BE-12 is filed every five years; the last BE-12 covered the fiscal year ending in 2017. The next benchmark form is expected to be due in 2028, for the fiscal year ending in 2027. The previous BEA form is available here. All entities subject to the reporting requirements must file, even if they are not contacted by BEA.
- **Form BE-180: The Benchmark Survey.** The benchmark survey is filed every five years. A U.S. person (including an individual or an entity) is required to make a BE-180 filing if the U.S. person (1) is a "financial services provider" and (2) had either combined sales to or combined purchases from foreign persons of "financial services" that exceeded $3 million during the relevant fiscal year. The last benchmark survey was due September 30, 2020, for the 2019 fiscal year. The next benchmark form will be due on September 30, 2025, for the fiscal year ending in 2024.
- **Form BE-13: Survey of New Foreign Direct Investments in the U.S.** The purpose of the survey of new foreign direct investment in the United States is to capture new investment transactions when a foreign direct investment relationship is created or when an existing U.S. affiliate of a foreign parent establishes a new U.S. legal entity, expands its U.S. operations, or acquires a U.S. business enterprise. The initial report must be filed no later than 45 days after the date of the investment transaction. A U.S. entity is required to report if (1) it is acquired or established by a foreign person or entity resulting in the creation of a foreign direct investment relationship or (2) it is an existing U.S. affiliate of a foreign parent and establishes a new U.S. legal entity, expands its U.S. operations, or acquires a U.S. business enterprise. Foreign direct investment is defined as the ownership or

control, directly or indirectly, by one foreign person of 10 percent or more of the voting securities of an incorporated U.S. business enterprise or an equivalent interest of an unincorporated U.S. business enterprise, including a branch.

**TIC**

- **Form S: Report of Purchases and Sales of Long-Term Securities by Foreign Residents.** Form S was a monthly report filed by all U.S.-resident entities that purchase from or sell long-term securities directly to foreign residents to provide data on foreigners' purchases and sales of all long-term securities, including equities and shares of mutual funds. Form S was discontinued as of January 31, 2023, but institutions that previously filed the form are required to keep records for three years to respond to any potential inquiries regarding historical submissions.
- **Form SLT: Report of Aggregate Holdings of Long-Term Securities by U.S. and Foreign Residents.** Form SLT is a monthly report filed by all U.S. persons who are U.S.-resident custodians (including U.S.-resident central securities depositories), U.S.-resident issuers, or U.S.-resident end-investors whose consolidated total of all reportable long-term U.S. foreign securities is a fair value equal to or more than $1 billion on the last business day of the reporting month. Form SLT must be filed no later than the 23rd calendar day of the month following the report as-of date. If the $1 billion threshold is met in any month, reporting is required for the remainder of the calendar year.
- **Form SHC: Report of U.S. Ownership of Foreign Securities, Including Selected Money Market Instruments.** Form SHC is a benchmark survey filed approximately every five years. Reporters must provide detailed security-by-security information on their holdings of foreign securities. The reporting requirement applies to significant U.S.-resident custodians of foreign securities and U.S.-resident investors holding securities without using U.S.-resident custodians. The most recent survey was due March 4, 2022 (data as of December 31, 2021) and the next survey is expected to be due in 2027.
- **Form SHL: Report of Foreign Residents' Holdings of U.S. Securities, Including Selected Money Market Instruments.** Form SHL is a benchmark survey filed approximately every five years; the report is used to gather information on foreign residents' holdings of U.S. securities, including money market instruments, to provide aggregate information to the public on foreign portfolio investments, and to meet international reporting commitments. Reports were due August 30, 2024 with respect to the current full survey as of June 28, 2024. The survey is available here. All U.S.-resident entities must report detailed information on Schedule 2 of the survey, unless the total fair (market) value of the reportable U.S. securities owned by foreign residents is less than $200 million as of the close of business on June 28, 2024. All U.S.-resident entities that have been contacted by the Federal Reserve Bank of New York must report Schedule 1, regardless of the size of their consolidated holdings.

**Form 13H.** Section 13(h) of the Exchange Act established a reporting system and filing requirements for "large traders," i.e., persons effecting transactions in certain securities in amounts equal to 2 million shares or $20 million (determined by the fair market value of the shares) in one calendar day, or 20 million shares or $200 million in one calendar month. Persons meeting these thresholds must file Form 13H no later than 10 days after the identifying activity level is reached. Amended filings must be effected promptly after the end of a calendar quarter during which any of the information contained in Form 13H becomes outdated or inaccurate. Large traders may file amended filings more often than quarterly but are not required to do so. Annual amendments (regardless of the number of amended filings previously effected) are due within 45 days of the end of each calendar year (e.g., by February 14, 2024, for filings due in 2024 and February 14, 2025, for filings due in 2025). Persons may now satisfy both the amended fourth-quarter filing and the annual update to Form 13H, as long as such filing is made within the period permitted for the fourth-quarter amendment (i.e., promptly after the fourth quarter's end).

**Form 13F.** Section 13(f) of the Exchange Act requires "institutional investment managers" with investment discretion over $100 million or more of certain equity securities to file quarterly reports on Form 13F. Form 13F must be filed within 45 days of the end of each calendar quarter (e.g., by February 14, May 15, August 14, and November 14 for filings due in 2024). An initial Form 13F must be filed at the end of the first year in which an institutional investment manager exceeds the $100 million threshold.

**Form PF.** Many smaller private advisers and large private equity advisers will be required to file an annual update to Form PF by April 29, 2024 (120 days after the end of their fiscal year). Quarterly updates to Form PF are required of large hedge fund advisers within 60 days after the end of their fiscal quarter (e.g., for advisers with a December 31, 2023, fiscal year-end, by February 29, May 30, August 29, and November 29 for filings due in 2024) and large liquidity fund advisers within 15 days after the end of their fiscal quarter (e.g., for advisers with a December 31, 2023, fiscal year-end, by January 15, April 15, July 15, and October 15 for filings due in 2024). Quarterly updates are required of private equity advisers within 60 days after the end of their fiscal quarter (e.g., for advisers with a December 31, 2023 fiscal year-end, by February 29, May 30, August 29, and November 29 for filings due in 2024) with respect to the completion of any adviser-led secondary transaction, removal of a general partner by investors or termination of a fund's investment period. Further, large hedge fund advisers must report certain events (including extraordinary investment losses, margin and default events, and large withdrawal and redemption requests) as soon as practicable, but no later than 72 hours, after they occur.

**Form NP-X.** Institutional investment managers that file on Form 13F must make public filings on Form N-PX to report their "say-on-pay" proxy voting. Reports must be filed no later than August 31 of each year and must cover the most recent one-year period running from July 1 to June 30.

**Monitor Compliance With 25 Percent ERISA Limitation on Benefit Plan Investors.** If the aggregate amount invested in a fund by "benefit plan investors" (e.g., employee benefit plans, individual retirement accounts, and Keogh plans and entities – the underlying assets of which include "plan assets" – but excluding governmental plans, foreign plans, and certain church plans) equals 25 percent or more of the total value of any class of equity interests in the fund (excluding investments by the fund's managers

who are not benefit plan investors), the fund will generally be deemed to hold plan assets subject to various ERISA requirements and prohibitions, unless the venture capital operating company ("VCOC") exception (described below) or another regulatory exception applies. Accordingly, many funds (particularly those that do not qualify as VCOCs, such as hedge funds) limit equity participation by benefit plan investors to less than 25 percent. If you sponsor such a fund, you should continuously monitor (i.e., upon subscriptions, capital calls, redemptions, and transfers) the level of investments by benefit plan investors to ensure the 25 percent threshold is not exceeded.

**Annual VCOC Certification.** Prior to investing in a venture fund or a private equity fund, ERISA plan investors often require the fund to provide an annual VCOC certification stating that the fund qualifies as a VCOC. A venture fund or a private equity fund that qualifies as a VCOC will not be deemed to hold plan assets subject to ERISA even if equity participation by benefit plan investors exceeds the 25 percent threshold (described above). In general, a fund will qualify as a VCOC if (i) at any time during the fund's annual valuation period at least 50 percent of the fund's assets (other than short-term investments pending long-term commitment or distribution to investors), valued at cost, are invested in venture capital investments in operating companies for which the fund has management rights, and (ii) the fund, in the ordinary course of its business, actually exercises substantial management rights with respect to one or more of the operating companies in which it invests on an annual basis.

**Form 5500 Schedule C Fee Disclosures.** Funds that have ERISA plan investors (including funds that do not allow equity participation by benefit plan investors to exceed the 25 percent threshold (described above) and thus are not subject to ERISA), excluding VCOCs and other entities treated as operating companies, are required to provide plan administrators of their ERISA plan investors with certain fee-related information that is necessary for the completion of Schedule C to the plan's annual report on Form 5500 in advance of the filing deadline for the annual report.

**Year-End Audit.** All necessary year-end audits must be completed so that funds can distribute financials to investors on a timely basis as required by relevant governing documents and, in certain instances, as required to comply with the Custody Rule under the Advisers Act and/or CFTC requirements.

**Annual Holdings Reports and Annual Certifications.** The beginning of the calendar year is a good time for investment advisers to have all "access persons" provide their annual holdings reports regarding securities ownership required pursuant to Rule 204A-1 of the Advisers Act. It is also a good time to have all personnel provide their annual certifications of compliance with firm policies and conflict-of-interest questionnaires.

**"Bad Actor" Questionnaires and Placement Agent Verifications.** The beginning of the calendar year is a good time to have certain personnel and service providers (e.g., directors of offshore private funds) recertify their status with respect to the SEC's "bad actor" rules in order to rely on the private placement exemption under Rule 506. This bad actor certification is often combined with the annual certification of compliance with firm policies discussed above. It is also a good time to have placement agents recertify their status with respect to such rules and certain other disciplinary matters.

**Conduct Annual Training of Personnel.** As a best practice under the Advisers Act, investment advisers should hold annual training sessions with existing employees to remind them of their obligations under the firm's compliance manual and code of ethics.

**Update Conflict Assessments and Risk Assessments.** As a best practice under the Advisers Act, investment advisers should annually reevaluate their "conflict assessment" and "risk assessment" (i.e., evaluation of how the firm's activities, arrangements, affiliations, client base, service providers, conflicts of interest, and other business factors may cause violations of the Advisers Act or the appearance of impropriety) to determine that new, evolving, or resurgent risks are adequately addressed.

**Periodic Anti-Money Laundering Verifications.** Private investment funds and their advisers have ongoing anti-money laundering compliance obligations that necessitate periodic verifications, the frequency of which depends on such funds' and advisers' operations. The beginning of the calendar year is a good time to assess such obligations and to conduct renewed verifications, such as comparing investor bases with the U.S. Treasury Department's OFAC lists.

**Privacy Notices.** In accordance with applicable federal law, investment advisers and investment funds must have a privacy policy in place. In addition to being provided at the time of initial subscription, privacy notices must generally be distributed at least annually, and more frequently if there are any changes to the policy/notice. An exception provides that annual notice is not required where an adviser or fund (i) only shares nonpublic personal information ("NPPI") with nonaffiliated third parties in a manner that does not require an opt-out right be provided and (ii) has not changed its policies and practices with regard to disclosing NPPI since its most recent distribution of its privacy notice. Advisers and funds should periodically determine whether they can rely on this exception and review their privacy notices. We believe that the best time for the annual distribution of the notice if required, is with a fund's annual financial statements and/or tax reports. Additionally, state privacy laws and regulations such as the California Consumer Privacy Act may subject investment advisers and investment funds to additional and/or more stringent privacy requirements.

**REGISTERED INVESTMENT ADVISERS AND EXEMPT REPORTING ADVISERS (WHERE INDICATED)**

- ☐ **Prepare annual updating amendments to Form ADV (for registered investment advisers and certain "Exempt Reporting Advisers").**
- ☐ **Review new issue status of clients and investors.**
- ☐ **Deliver Form ADV Part 2A (or portions thereof) to clients and fund investors (for registered investment advisers).**
- ☐ **Review Form ADV Part 3 (Form CRS) updates and delivery requirements.**
- ☐ **Comply with state annual filing requirements.**
- ☐ **Review investment adviser representative state law compliance.**
- ☐ **Conduct periodic review of compliance policies and code of ethics.**
- ☐ **Comply with custody rule annual surprise examination.**
- ☐ **File Form 13F within 45 days of quarter-end (e.g., by February 14, May 15, August 14 and November 14 for filings due in 2024).**

- ☐ **File Form NP-X by August 31, 2024.**
- ☐ **Distribute privacy notices, if required.**
- ☐ **Prepare Form 5500 Schedule C fee disclosures for ERISA plan accounts.**
- ☐ **Comply with ERISA Section 408(b)(2) fee disclosure requirements for Covered Plans.**
- ☐ **Conduct periodic vendor due diligence updates, including with respect to proxy advisory firms**

***Discussion:***

**Annual Updating Amendments to Form ADV.** An investment adviser that (i) is registered with the SEC or (ii) is considered an "exempt reporting adviser" (i.e., an investment adviser relying on the private fund adviser exemption or the venture capital adviser exemption), in each case as of December 31, 2023 (and with a December 31, 2023, fiscal year-end), must have filed an annual updating amendment of items on the form by March 30, 2024.

**Review New Issue Status of Clients/Investors.** Investment advisers should review the new issue status of clients and investors on an annual basis.

**Deliver Form ADV Part 2.** An investment adviser that is registered with the SEC and whose Form ADV Part 2A has materially changed since such adviser's last annual amendment must deliver either an amended Part 2A (which must include a summary of such material changes) or a summary of such material changes (which must include an offer to provide a copy of the amended Part 2A). Although such delivery requirements expressly apply only to "clients" (as defined in federal securities laws), we recommend that advisers to private funds deliver such items to their fund investors. Such items must be delivered within 120 days of the end of the adviser's fiscal year (e.g., by April 29, 2024, for advisers with a December 31, 2023, fiscal year-end).

**Review Form ADV Part 3 (Form CRS) Update and Delivery Requirements.** An investment adviser that is registered with the SEC must amend its Form ADV Part 3 within 30 days whenever any information therein becomes materially inaccurate by filing an additional other-than-annual amendment or by including such amended information as part of an annual updating amendment. An investment adviser firm must deliver the most recent Form ADV Part 3 to each new retail investor before or at the time of entering into an investment advisory contract and to each existing retail investor before or at time when (i) a new account is opened that is different than the retail investor's existing account, (ii) the investment adviser firm recommends that the retail investor roll over assets from a retirement account into a new or existing account or investment, or (iii) the investment adviser firm recommends new investment advisory service.

**State Filing Requirements.** Applicable state laws may require a federally registered investment adviser to make notice filings and to pay fees in the state if he or she has clients or a place of business therein. Laws vary significantly from state to state. There also may be certain licensing or qualification requirements for representatives of investment advisers. Please contact counsel with any state-specific questions.

**Compliance Policies and Code of Ethics.** Federally registered investment advisers must adopt and maintain comprehensive compliance policies and a code of ethics and also must appoint a chief compliance officer. If you have not already done so, please contact counsel immediately for assistance in creating and/or documenting compliance procedures appropriately tailored to your business. In addition, compliance policies and procedures must be reviewed by the adviser at least annually. The compliance policies and procedures review should focus on an evaluation of the effectiveness of the policies and procedures in light of current risks and the need for revisions as a result of (i) any compliance issues that arose during the prior year, (ii) any changes in the business activities of the investment adviser, and/or (iii) any regulatory changes. We recommend that this review be conducted relatively early in the year or staggered throughout the year so that it does not interfere with other time-sensitive activities when quarter-end or year-end matters are pressing. Policies that are materially changed as a result of such review should be redistributed to all appropriate personnel. In addition, Item 11 of Form ADV Part 2A must contain a current description of the code of ethics and a statement that the investment adviser will provide the code of ethics to any current or prospective client upon request. Exempt reporting advisers are also advised to have written compliance policies since they are subject to certain regulations.

**Custody Rule Annual Surprise Examination.** With certain limited exceptions, where the adviser (or its related person) possesses or may possess client funds and securities, the adviser is required to undergo an annual surprise examination by an independent public accountant.

**Form 5500 Schedule C Fee Disclosures.** Advisers managing ERISA plan accounts are required to disclose certain fee-related information necessary for plan administrators to complete Schedule C to the plan's annual report on Form 5500 in advance of the date such annual report is required to be filed.

**Compliance With ERISA Section 408(b)(2) Fee Disclosure Requirements.** Advisers providing services directly to an ERISA-covered defined contribution or defined benefit plan as either a fiduciary or a registered investment adviser (as well as fiduciary services to a first-tier ERISA "plan asset" fund in which a covered plan has a direct investment, brokerage, and recordkeeping services to certain participant-directed plans to which investment alternatives are made available, and certain other services) are generally required to make detailed fee disclosures to a plan fiduciary in advance of the date the underlying contract or arrangement is entered into, extended, or renewed. Additionally, changes to such required fee disclosures must be disclosed as soon as practicable, but in no event more than 60 days from the date on which the adviser becomes informed of such change. Advisers providing such services should monitor ongoing compliance with the ERISA Section 408(b)(2) disclosure requirements.

**Vendor Due Diligence Updates.** As part of an effective third-party risk management program, advisers are encouraged to implement an effective due diligence process with respect to service providers utilized by the adviser, consisting of both an initial due diligence assessment and periodic reviews thereafter. Such periodic reviews may include tailored certifications from the vendor in light of the services provided by each such vendor; a review of the vendor's regulatory history, public filings, registrations, and licenses (as applicable); a review of the vendor's financial statements; and (as necessary) conference calls and on-site visits. Advisers should document the due diligence process and results.

## COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

- ☐ **Registered commodity pool operators ("CPOs") and commodity trading advisors ("CTAs") must conduct annual regulatory compliance reviews and complete certain regulatory requirements, which include preparation of annual questionnaires and annual registration updates (applies to registered CPOs and CTAs).**
- ☐ **National Futures Association ("NFA") Member CPOs must prepare and file certain portions of NFA Form PQR within 60 days of year-end (e.g., by February 29, 2024, for filings due in 2024, and March 1, 2025, for filings due in 2025).**
- ☐ **Prepare and file certain portions of Form CTA-PR within 45 days after the end of the calendar quarter for CTAs who are NFA Members (e.g., February 14, May 15, August 14, and November 14 for filings due in 2024), and 45 days after the end of the calendar year for other CTAs (e.g., February 14, 2024, for filings due in 2024 and February 14, 2025, for filings due in 2025).**
- ☐ **Annual affirmation of CPO registration exemption under sections 4.5, 4.13(a)(1)-(3), or 4.13(a)(5) or exemption from CTA registration under Section 4.14(a)(8) by March 1.**
- ☐ **Review CPO delegations in connection with annual pool financial statement filings.**
- ☐ **Annual NFA Bylaw 1101 diligence.**

***Discussion:***

**Annual Compliance Reviews/Regulatory Requirements.** Registered CPOs and CTAs must conduct annual compliance reviews. These reviews and requirements include (i) the preparation and filing with the NFA of Annual Questionnaires and Annual Registration Updates within 30 days of the anniversary date of their registration; (ii) completion of the NFA's Self-Examination Checklist; (iii) sending privacy policies to every current customer, client, and pool participant; (iv) testing disaster recovery plans and making necessary updates; (v) providing ethics training to staff, and inspecting the operations of branch offices; (vi) for registered CPOs, preparation of Pool Quarterly Reports within 45 days after the end of the year (and within 45 days after the end of each quarter); and (vii) for registered CTAs that are NFA members, the filing of Form CTA-PR, required within 45 days after the end of the year (and within 45 days after the end of each quarter). Finally, unless the applicable fund(s) qualify for an exemption, registered CPOs and CTAs must update their disclosure documents periodically, as they may not use any document dated more than 12 months prior to the date of its intended use. Disclosure documents that are materially inaccurate or incomplete must be promptly corrected, and the correction must be promptly distributed to pool participants. The NFA's Notice to Members regarding these regulatory compliance matters is available here.

**Prepare and File Portions of NFA Form PQR.** NFA Member CPOs must file NFA Form PQR within 60 days of year-end (e.g., by February 29, 2024, for filings due in 2024 and March 1, 2025, for filings due in 2025).

**Prepare and File Portions of Form CTA-PR.** CTAs are required to have completed Form CTA-PR within 45 days after the end of the calendar quarter for CTAs who are NFA Members (e.g., February 14, May 15, August 14, and November 14 for filings due in 2024), and 45 days after the end of the calendar year for other CTAs (e.g., February 14 for filings due in 2024 and February 14, 2025 for filings due in 2025).

**Annual Affirmation of CPO or CTA Exemption.** Each person who has filed a notice of exemption from CPO registration under sections 4.5, 4.13(a)(1)-(3), or 4.13(a)(5) or exemption from CTA registration under Section 4.14(a)(8) must have affirmed such notice of exemption within 60 days of calendar year-end (e.g., February 29, 2024, for affirmations due in 2024 and March 1, 2025, for filings due in 2025) through the NFA's exemption system.

**Review of CPO Delegations.** All CPO delegation agreements entered into by registered CPOs must comply with specific criteria set forth by the CFTC and must be retained as part of the relevant CPO's records. As part of their annual pool financial statement filings through the NFA website, CPOs should ensure that all necessary CPO delegations are in place and appropriately documented.

**NFA Bylaw 1101 Diligence.** NFA Bylaw 1101 prohibits NFA members from conducting futures-related business with nonmembers who are required to be registered with the CFTC but have not done so. Members should compare their list of exempt CPO/CTAs with which the member transacts (including investors in pools) to the information NFA makes available. Members can review exemption information either by using the NFA's BASIC system or by accessing a spreadsheet (found in the member's Annual Questionnaire) that includes a list of all persons or entities that have exemptions on file with NFA that must be affirmed on an annual basis. Members transacting with a person that previously claimed an exemption from CPO/CTA registration and has not filed a notice affirming the exemption, not filed a notice of exemption for another available exemption, or not properly registered and become an NFA member by December 31 of each year should promptly contact such person to confirm whether the person will file a notice affirming the exemption. If the person does not intend to file a notice affirming the exemption or the person does not, in fact, file an affirmation within 60 days of year-end (e.g., by February 29, 2024,for affirmations due in 2024 and March 1, 2025, for filings due in 2025), then the member must promptly obtain a written representation as to why the person is not required to register or file a notice of exemption and evaluate whether the representation appears adequate. If the member determines that this written representation is inadequate and the person is required to be registered, then the member must cease transacting with the person.

## RECENT PUBLICATIONS AND COMMENTARY

*Below are links to recent articles and publications featuring or authored by members of the Investment Management Group.*

## CLIENT ALERTS AND NEWSLETTERS

- **"The Real (Estate) Deal: FinCEN's New Reporting Requirements for Property Transfers"**
  *Anti-Money Laundering Client Alert*
  Robert A. Johnston Jr., Paula A. Ladd, Ryan E. Fennell, Samantha Sigelakis-Minski
  August 30, 2024

- **"Investment Advisers Prepare: The BSA is Here"**
  *Anti-Money Laundering Client Alert*
  Robert A. Johnston Jr., Scott H. Moss, Paula A.

Ladd, Ryan E. Fennell, Samantha Sigelakis-Minski
August 30, 2024

- **"United States Department of Justice Obtains First Insider Trading Conviction Based Exclusively on the Use of a Trading Plan and Signals More to Come"**
  *Investment Management Client Alert*
  C. Patrick Thomas, Scott H. Moss
  July 22, 2024

- **"Supreme Court: SEC Cannot Force Defendants in Civil-Penalty, Antifraud Enforcement Actions To Litigate Before the Commission Instead of Federal Court"**
  *Investment Management Client Alert*
  C. Patrick Thomas, Scott H. Moss
  July 18, 2024

- **"Not Business as Usual: California's Extensive New Disclosure Bill"**
  *Anti-Money Laundering Client Alert*
  Robert A. Johnston Jr., Melissa L. Wiley, Ryan E. Fennell, Samantha Sigelakis-Minski
  May 24, 2024

- **"SEC Settlement Reflects Continued Scrutiny Regarding Conflicts and Preferential Treatment"**
  *Investment Management Client Alert*
  Jeremy Cantor, Jimmy Kang, Scott H. Moss
  May 21, 2024

- **"SEC and FinCEN Propose Customer Identification Obligations for Investment Advisers"**
  *Anti-Money Laundering Client Alert*
  Scott H. Moss, Robert A. Johnston Jr., Samantha Sigelakis-Minski, Angenny M. Rosario
  May 20, 2024

- **"SEC Finds Advisers' Compliance with Marketing Rule Still Lacking Despite Examination and Enforcement Focus"**
  *Investment Management Client Alert*
  Scott H. Moss, Jimmy Kang
  May 1, 2024

- **"SEC Pay-to-Play Rule Rears Its Head Again in Time for Election Season"**
  *Investment Management Client Alert*
  Jimmy Kang, Jeremy Cantor, Scott H. Moss
  April 23, 2024

- **"'Shadow Trading' is Insider Trading: Jury Establishes Liability in Historic Shadow Trading Case"**
  *Investment Management Client Alert*
  Scott H. Moss, Jonathan A. Danziger, Jimmy Kang, John B. Meyer, Jeremy Cantor
  April 19, 2024

- **"SEC Settlement Highlights Continued Scrutiny of Off-Channel Communications"**
  *Investment Management Client Alert*
  Scott H. Moss, Jeremy Cantor, Erich J. Kaletka
  April 10, 2024

- **"SEC Settlements Highlight Governing Document Amendment Considerations for Private Funds"**
  *Investment Management Client Alert*
  Scott H. Moss, Jeremy Cantor, Erich J. Kaletka
  April 3, 2024

- **"Antitrust Agencies' Health Care RFI Signals Increased Scrutiny of PE Deals"**
  *Antitrust/Competition Client Alert*
  Zarema A. Jaramillo, Jonathan A. Danziger, Jack Sidorov, Sydney J. Kaplan
  March 11, 2024

- **"FINRA's intrusive crypto sweeps are misguided"**
  *Blockworks*
  William Brannan, Ethan L. Silver
  March 4, 2024

- **"Don't pop the champagne; the CTA isn't dead ... yet."**
  *Anti-Money Laundering Client Alert*
  Robert A. Johnston Jr., Melissa L. Wiley, Paula A. Ladd, Samantha Sigelakis-Minski
  March 4, 2024

- **"Data Protection Demands Complicate CTA Compliance"**
  *Corporate Compliance Insights*
  Robert A. Johnston Jr., Mary J. Hildebrand CIPP/US/E, Judith G. Rubin CIPP/US/E, CIPT
  February 28, 2024

- **"SEC and CFTC Adopt Another Round of Amendments to Form PF for Private Fund Advisers"**
  *Investment Management Client Alert*
  Scott H. Moss, Kevin S. Zadourian, Michael J. Scales
  February 26, 2024

- **"U.S. Treasury Issues Notice of Anti-Money Laundering Regulations for Residential Real Estate Transfers"**
  *Anti-Money Laundering Client Alert*
  Robert A. Johnston Jr., Paula A. Ladd, Samantha Sigelakis-Minski, Farah Z. Hussain
  February 16, 2024

- **"SEC Proposes to Modify Section 3(c)(1) Investment Company Act Exemption for Certain Private Funds"**
  *Investment Management Client Alert*
  Scott H. Moss, Jeremy Cantor
  February 16, 2024

- **"Investment Advisers Beware: The BSA is Coming (Maybe)"**
  *Anti-Money Laundering Client Alert*
  Robert A. Johnston Jr., Paula A. Ladd, Ryan E. Fennell, Samantha Sigelakis-Minski, Farah Z. Hussain
  February 15, 2024

- **"*Meta v. Bright Data* Ruling Has Important Implications for Webscraping Activities by Investment Advisers"**
  *Investment Management Client Alert*
  Scott H. Moss, Boris Liberman, George Danenhauer, Michael J. Scales
  February 15, 2024

- **"SEC Expands Definitions of 'Dealer' and 'Government Securities Dealer' to Adapt to Modern Market Practices"**
  *Investment Management Client Alert*
  Scott H. Moss, Boris Liberman, Alex D. Stone
  February 14, 2024

- **"SEC Says Language in J.P. Morgan-Affiliate Release Agreements Violates Whistleblower Protections"**
  *Investment Management Client Alert*
  C. Patrick Thomas, Scott H. Moss, Matthew M. Oliver, Ethan L. Silver
  January 29, 2024

- **"U.S. Treasury Renews Push to Make Investment Advisers Subject to the BSA"**
  *Anti-Money Laundering Client Alert*
  Robert A. Johnston Jr., Paula A. Ladd, Jimmy Kang, Samantha Sigelakis-Minski, Nathan Shultz
  January 16, 2024

- **"SEC Settlement Reflects Continued Scrutiny Regarding MNPI, Advertisements and Investor Communications"**
  *Investment Management Client Alert*
  Scott H. Moss, Jeremy Cantor
  January 11, 2024

- **"Alternative Data is Now Mainstream; AI Could Be Next: The 2023 Lowenstein Sandler Alternative Data Report"**
  *Lowenstein Sandler LLP*
  Scott H. Moss, Boris Liberman, George Danenhauer
  January 11, 2024

- **"Governor Signs New York LLC Transparency Act into Law"**
  *Anti-Money Laundering Client Alert*
  Robert A. Johnston Jr., Melissa L. Wiley, Paula A. Ladd, Samantha Sigelakis-Minski, Sara Lazarevic, Stephanie Stephenson
  January 3, 2024

- **"The SEC's Private Fund Adviser Rules Explained — Part 4: The Quarterly Statement Rule"**
  *Investment Management Client Alert*
  Scott H. Moss, Michael J. Scales
  December 7, 2023

- **"About Time: FinCEN Extends Deadline for New Companies Reporting Beneficial Ownership Information"**
  *Anti-Money Laundering Client Alert*
  Robert A. Johnston Jr., Melissa L. Wiley, Paula A. Ladd, Samantha Sigelakis-Minski, Steven R. Grayes
  December 1, 2023

- **"SEC's 2024 Examination Priorities for Investment Advisers"**
  *Investment Management Client Alert*
  Scott H. Moss, Akash Balaggan
  November 13, 2023

- **"The SEC's Private Fund Adviser Rules Explained — Part 3: Deciphering a Private Fund Manager's Fiduciary Duty"**
  *Investment Management Client Alert*
  Scott H. Moss, David L. Goret, Louise Gong, Zachary D. Furnald
  October 26, 2023

- **"SEC's 2024 Examination Priorities for Broker-Dealers"**
  *Investment Management Client Alert*
  Ethan L. Silver, William Brannan, Leo B. Choi, Macauley Venora
  October 25, 2023

- **"The SEC's Private Fund Adviser Rules Explained — Part 2: The Preferential Treatment Rule"**
  *Investment Management Client Alert*
  Scott H. Moss, David L. Goret, Jeremy Cantor, Zachary D. Furnald, Michael J. Scales
  October 24, 2023

- **"Slew of Recent SEC Enforcement Actions: Guidance for Registered Investment Advisers"**
  *Lowenstein Sandler LLP*
  Scott H. Moss, David L. Goret, Kevin S. Zadourian, Alex E. Lipton
  October 18, 2023

- **"The SEC's Private Fund Adviser Rules Explained — Part 1: The Restricted Activities Rule"**
  *Investment Management Client Alert*
  Scott H. Moss, David L. Goret, Michael J. Scales
  September 25, 2023

- **"The Critical Importance of an Effective Investment Policy Statement"**
  *Lowenstein Sandler LLP*
  Bryan I. Reyhani, Tolulope "Tolu" Adetayo
  September 7, 2023

- **"SEC Enacts Wide-Sweeping Private Funds Rules"**
  *Investment Management Client Alert*
  Scott H. Moss, David L. Goret, Jeremy Cantor, Zachary D. Furnald
  August 29, 2023

- **"Keys To Robust AML Programs at Private Funds"**
  *Law360*
  Scott H. Moss, Jimmy Kang, Samantha Sigelakis-Minski, Robert A. Johnston Jr., Paula A. Ladd
  August 18, 2023

- **"Are syndicated loans actually securities? The SEC 'is not in a position' to say."**
  *Investment Management Client Alert*
  Scott H. Moss, Jennifer Fiorica Delgado
  July 19, 2023

- **"SEC Adopts Rules to Combat Fraud and Undue Influence in the Security-Based Swap Market"**
  *Investment Management Client Alert*
  Boris Liberman, Scott H. Moss, Michael J. Scales
  June 22, 2023

- **"SEC Issues Additional Guidance on Investment Adviser Examinations and Compliance with the Marketing Rule"**
  *Investment Management Client Alert*
  Scott H. Moss, Yvette Yun
  June 21, 2023

- **"Gensler Warns of Increased SEC Requirements for Money Market and Open-End Funds"**
  *Investment Management and White Collar Defense Client Alert*
  Robert A. Johnston Jr., Rachel Maimin, Kathleen A. McGee, Scott H. Moss
  May 31, 2023

- **"SEC Adopts Amendments to Form PF for Registered Investment Advisers to Private Funds"**
  *Investment Management Client Alert*
  Scott H. Moss, Michael J. Scales
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- **"SEC Provides Guidance to Newly Registered Investment Advisers"**
  *Investment Management Client Alert*
  Scott H. Moss
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