Ropes & Gray's Private Investment Fund Update: July 2012

Highlights

- Changes to the "Qualified Client" Definition (pg 4). The SEC adopted an amended rule with respect to the definition of "qualified client" that included three transitional provisions to effectively "grandfather" newly registered investment advisers charging performance fees to non-qualified clients in certain situations.

- Updated Guidance on Form PF (pg 4). The SEC recently released guidance to help determine whether an investment adviser advises a "hedge fund" or a "private equity fund." This distinction may impact the timing of filing Form PF and the information that must be provided on Form PF.

- Revised Direct Investment Survey Filing Requirements (pg 6). The BEA recently revised the rules on Direct Investment Survey reporting. For filings due in 2013, a person is not required to make a Direct Investment Survey filing unless notified by the BEA.

- CFTC Registration May Be Applicable To Private Equity Funds (pg 6). The definition of "commodity interests" was recently amended to include "swaps," which may impact general partners and advisers of private equity funds. However, although final rules have just been adopted, we expect that most private equity firms will not need to register.

- DOJ/SEC Bring First FCPA Case Involving Private Fund Investment Adviser (pg 11). The SEC charged a former Managing Director at Morgan Stanley with violations of the FCPA, as well as aiding and abetting his employer's wholly-owned investment advisers in violation of anti-fraud provisions of the Advisers Act.

- FBAR Filing Deadline Further Extended to June 30, 2013 for Certain Persons with Signature Authority over Foreign Financial Accounts (pg 13). FinCEN recently extended the FBAR filing deadline until June 30, 2013, for certain categories of U.S persons who have signatory authority over, but no financial interest in, a foreign account.

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- FBAR Filing Deadline Further Extended to June 30, 2013 for Certain Persons with Signature Authority over Foreign Financial Accounts (pg 13). FinCEN recently extended the FBAR filing deadline until June 30, 2013, for certain categories of U.S persons who have signatory authority over, but no financial interest in, a foreign account.

- New IRS Requirements for Electronic Furnishing of Schedules K-1 (pg 13). The IRS issued new requirements that a partnership must meet to provide its partners with Schedules K-1 exclusively in electronic format.

Advisers Act Developments

Changes to the "Qualified Client" Definition

As discussed in more detail in our previous Alert, earlier this year the U.S. Securities and Exchange Commission (the "SEC") adopted a revised definition of "qualified client" by raising the thresholds qualified clients must meet in connection with the charging of performance and incentive fees/allocations by investment advisers.

The SEC subsequently adopted an amended rule that included three transitional provisions. First, registered investment advisers may continue to charge performance fees to clients (including private funds exempt under Section 3(c)(1) of the Investment Company Act of 1940 (the "Investment Company Act")) with investors that met the definition of a "qualified client" at the time of their investment in the fund, even if they do not meet the dollar amount thresholds under the amended rule. Second, the amended rule allows newly registered investment advisers to continue charging performance fees to clients pursuant to existing performance compensation arrangements if they were already charging those fees prior to registration. Finally, the amended rule allows for limited transfers of an interest in a private fund from a "qualified client" to a person that was not an investor in the fund when the existing performance compensation arrangement was entered into, and is not a "qualified client" at the time of the transfer (*e.g.*, transfers of interests in private funds by gift or bequest or pursuant to an agreement related to a legal separation or divorce). This amended rule became effective on May 22, 2012.

Prior to raising a new 3(c)(1) fund, private equity funds should revise their subscription documents to ensure that the definition of "qualified client" is updated in accordance with the SEC's order, and should analyze performance and incentive fees/allocations in accordance with the revised definition.

Updated Guidance on Form PF

As discussed in more detail in our Alert on Form PF, there are different reporting obligations that apply to an investment adviser, depending on whether the funds managed by such investment adviser are hedge funds or private equity funds. This distinction is important because whether an investment adviser advises a "hedge fund" or a "private equity fund" would impact the timing of filing Form PF, and the information required to be provided on Form PF.

Form PF does not allow a firm to determine the type of fund it advises, but rather sets up various definitions. A private equity fund is essentially defined as a fund that is not a hedge fund. A hedge fund is defined as a fund that (i) pays a carry based on unrealized gains, (ii) may borrow (including guarantees) an amount in excess of one half of its NAV (including committed capital) or may have gross notional exposure in excess of twice its NAV (including committed capital) or (iii) may sell securities or other assets short or enter into similar transactions (other than for the purposes of hedging currency exposure or managing duration). If a fund satisfies any one of those three prongs, it is a hedge fund for purposes of Form PF. Prongs (ii) and (iii) of the hedge fund definition do not speak in terms of actual borrowing or shorting, but rather the ability to do so. This is notable because in many instances private equity firms do not engage in those practices, but are not prohibited from doing so by their fund agreements.

The SEC in the adopting release for Form PF clarified that "a private fund would not be a "hedge fund" for purposes of Form PF solely because its organizational documents fail to prohibit the fund from borrowing or incurring derivative exposures in excess of the specified amounts or from engaging in short selling so long as the fund in fact does not engage in these practices and a reasonable investor would understand, based on the fund's offering documents, that the fund will not engage in these practices." However, the SEC recently came out with further guidance regarding this distinction, as follows:

Q3.1: ***I advise a private fund that would be categorized as a private equity fund, except for the fact that the fund documents allow the fund to either employ large amounts of leverage or sell assets short. The fund does not in fact, nor does it intend to, incur leverage or short any assets. May I treat this private fund as a private equity fund instead of as a hedge fund for reporting purposes?***

A3.1: No. In adopting the Form, the Commission considered, but did not accept, commenters' arguments that the leverage and shorting characteristics in the definition of "hedge fund" should focus on actual or contemplated use, rather than potential use. See Investment Advisers Release 3308, text accompanying footnote 78. (Posted June 8, 2012)

While the SEC's pronouncements may be susceptible to multiple readings, we believe the most logical reading of the adopting release together with the guidance in the recent "Frequently Asked Questions" is that (i) if private equity fund documents are silent on leverage and shorting, and the fund's offering documents would not otherwise lead a reasonable investor to believe that the fund could engage in leverage or short sales, the fund is a "private equity fund" for purposes of Form PF, but (ii) if private equity fund documents explicitly allow leverage and/or shorting, even if there is no intention to engage in such activities, then regardless of reasonable investor expectations the fund may be categorized by the SEC as a "hedge fund" for purposes of Form PF.

This distinction is important for several reasons:

1. An adviser with at least $5 billion in regulatory assets under management attributable to "hedge funds" as of March 31, 2012 must file its first Form PF within 60 days following June 30, 2012. Advisers to only private equity funds do not have to file the first Form PF until 2013, regardless of assets under management.

2. Large hedge fund advisers (those with $1.5 billion in regulatory assets under management attributable to hedge funds) must file Form PF quarterly. All private equity advisers (large or otherwise) must file annually.

3. The information to be provided on Form PF differs greatly depending on whether a fund is a hedge fund or private equity fund.

In light of these consequences, we would recommend reviewing your fund documents to determine whether they allow leverage or derivatives in excess of the thresholds above or permit shorting. If the fund documents specifically allow such practices, you should consider whether you wish to amend the LPA to eliminate such authority.

Furthermore, as highlighted in our previous Alert (discussing regulatory developments relating to fund documents), please note that Form PF includes several reporting requirements that may require funds to collect information they had not previously collected in their subscription documents, including information about the types of investors invested in the fund and affiliations among investors. This information must be collected at the launch of a new fund, as well as upon any transfers of fund interest to ensure accurate information on the investors invested in the fund. **Prior to raising a new fund or consenting to the transfer of interest in its fund, private equity funds should revise their subscription and transfer documents to ensure all required information about beneficial ownership will be obtained by the funds.**

Pay-To-Play Solicitor Ban Compliance Date Extended

The Advisers Act political contribution rules prohibit an investment adviser from providing (or agreeing to provide), directly or indirectly, payment to any third-party for a solicitation of business from any government entity on behalf of such adviser, unless such third-party solicitor is (i) an SEC-registered investment adviser, (ii) a registered broker or dealer or (iii) a municipal adviser (the "Solicitor Ban"). The SEC extended the compliance date for the Solicitor Ban from June 13, 2012 until nine months after the compliance date of a final rule adopted by the SEC by which municipal adviser firms must register under the Securities Exchange Act of 1934 (the "Exchange Act"). This extension was granted to ensure an orderly transition for investment advisers and third-party solicitors as well as to provide additional time for them to adjust compliance policies and procedures after the transition. The SEC will announce the new compliance date once such a final rule is adopted.

Other Regulatory Developments

Revised Direct Investment Survey Filing Requirements

The Bureau of Economic Analysis (the "BEA") recently revised the rules on Direct Investment Survey reporting for both Outward Direct Investment Surveys (detailing information on direct investments made by U.S. entities in non-U.S. entities) and Inward Direct Investment Surveys (detailing information on direct investments made by non-U.S. entities in U.S entities). With respect to Direct Investment Surveys due in 2013 (*i.e.* with respect to Annual Surveys for the 2012 calendar year and with respect to Quarterly Surveys for the first quarter of 2013, and thereafter), only persons notified by the BEA will be required to file Direct Investment Survey(s) with the BEA (*i.e.*, any person that does not receive a notice from the BEA will not be required to make such a filing).

CFTC Registration May Be Applicable To Private Equity Funds

If a private fund trades in one or more commodity interests, the operator of the fund (typically, the general partner of such fund) and the adviser to the fund are required to register with the U.S. Commodity Futures Trading Commission (the "CFTC") as a commodity pool operator and a commodity trading adviser, respectively (absent an exemption to registration). Previously, commodity interests generally included only futures and options on futures and commodities. However, the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") added "swaps" to the list of commodity interests. Swaps will include most over-the-counter derivatives, including currency derivatives.

As a result, general partners and advisers to private equity funds may need to register with the CFTC absent an exemption. It is worth noting, however, that we would expect most private equity firms will be able to rely on certain *de minimus* exemptions in Rule 4.13(a)(3). In short, under the Rule 4.13(a)(3) exemption, a private fund is exempt from registration if it either keeps (1) the initial margin, premiums and required minimum security deposit required to establish commodity interest positions below 5% of the fund's liquidation value or (2) the net notional value of its commodity interest position from exceeding 100% of the fund's liquidation value. Under the amended rule, general partners and advisers of private equity funds claiming relief under the Rule 4.13(a)(3) exemption must confirm their claim of exemption on an annual basis. **The final definition of "swaps" was adopted by the CFTC on July 10, 2012. However, the U.S. Treasury may make a final determination governing whether foreign exchange swaps and forwards are "swaps" for this purpose. Once the proposed decision has been finalized by the U.S. Treasury, we will provide more detailed guidance on "next steps."**

SEC and CFTC Jointly Propose Rules to Help Prevent and Detect Identity Theft

In February 2012, the SEC and the CFTC (together, the "Commissions") jointly issued proposed rules and guidelines intended to help protect investors from identity theft by ensuring that investment advisers registered or required to register under the Advisers Act, broker-dealers, mutual funds, and other entities regulated by the Commissions create programs to detect and respond appropriately to red flags. The proposed rules implement new provisions enacted by Title X of Dodd-Frank, which amends the Fair Credit Reporting Act ("FCRA") and transfers authority over certain parts of the FCRA from the Federal Trade Commission ("FTC") to the Commissions for entities they regulate. The proposed rules and guidelines are substantially similar to rules and guidelines adopted in 2007 by the FTC and other federal financial regulatory agencies that were previously required to adopt such rules (the "2007 Rules").

The proposed rules would require that (i) each entity regulated by the Commissions that falls within the scope of the rules to develop and implement a written identity theft program that includes reasonable policies and procedures to identify, prevent and mitigate identity theft in connection with certain existing accounts or the opening of new accounts and (ii) the identity theft program be subject to periodic review and updates. The Commissions also proposed guidelines to assist entities in formulating and maintaining a program that would satisfy the requirements of the proposed rules.

Comments were due to the Commissions by May 7, 2012. The Commissions propose to make the rules and guidelines effective 30 days after publication of the final rules in the Federal Register. The complete SEC/CFTC release can be found here.

SEC To Miss First JOBS Act Deadline

The SEC will miss its first rulemaking deadline under the Jumpstart Our Business Startups Act (the "JOBS Act"), under which the SEC was required to lift the general solicitation and advertising ban for certain private offerings (*i.e.*, offerings made under Regulation D to accredited investors). The JOBS Act gave the SEC until July 4, 2012 to issue rules to lift the ban. The SEC has given notice that it intends to consider a draft of these rules at a meeting held on August 22, 2012. We understand the SEC may consider adopting interim final temporary rules (rather than proposed rules) on that date.

SEC and CFTC Adopt Criteria to Identify "Systemically Important" Non-Bank Financial Firms

On April 3, 2012, the Financial Stability Oversight Council (the "FSOC") announced a final rule establishing criteria for identifying non-bank financial firms as "systemically important." Firms that are identified as non-bank systemically important financial institutions ("non-bank SIFIs") are considered threats to U.S. financial stability and will be regulated like banks. The FSOC will apply a three-part process for determining whether private equity firms, hedge funds, insurance firms, and other financial firms are non-bank SIFIs. The text of the adopting release is available here.

In Stage 1 the FSOC will evaluate companies that meet the threshold of having $50 billion or more in consolidated assets and (i) $30 billion or more in gross notional credit default swaps outstanding for which the nonbank financial company is the reference entity, (ii) $3.5 billion or more of derivative liabilities, (iii) $20 billion in total outstanding debt, (iv) 15 to 1 leverage ratio, as measured by total consolidated assets (excluding separate accounts) to total equity, or (v) 10 percent ratio of short-term debt (with maturity less than 12 months) to total consolidated assets. In applying the Stage 1 thresholds set forth above, the FSOC "may consider the aggregate risks posed by separate funds that are managed by the same adviser, particularly if the funds' investments are identical or highly similar." Further, the FSOC" will appropriately reflect the distinct nature of assets under management compared to the asset manager's own assets." Fewer than 50 entities are expected to meet the first-stage thresholds.

If a firm meets the Stage 1 thresholds, in Stage 2, the FSOC will use public information (*e.g.* from regulatory agencies), along with information voluntarily submitted by the company, to evaluate its risk profile and characteristics. The FSOC will analyze a firm based on six metrics: (i) size, (ii) interconnectedness, (iii) substitutability, (iv) leverage, (v) liquidity risk and maturity mismatch, and (vi) existing regulatory scrutiny. This review will consist of both quantitative and qualitative analysis.

In Stage 3, the FSOC will continue its Stage 2 analysis and using information directly from the firm. Each firm reviewed during this Stages 3 will receive notice of such review and be given an opportunity to submit materials within a specified time. The firm will also be given notice when the record is deemed complete. If after all three parts of the review, the FSOC votes to render a decision to designate the firm as a non-bank SIFI, a firm can challenge the designation by requesting a hearing before the FSOC and, if necessary, by suing in federal court.

After Stage 3, the FSOC will vote on designating a firm as a non-bank SIFI or not. Designation as a non-bank SIFI requires affirmative votes by at least two-thirds of the FSOC, including the Chairperson. The FSOC will consult with the relevant regulatory agency prior to rendering a decision and shall issue written notice to the firm explaining the basis of the proposed determination at least one business day before publicly announcing a final determination.

Firms designated as non-bank SIFIs will be subject to the Board of Governors and prudent standards established by the Board of Governors under the Dodd-Frank Act. The Board of Governor's proposed prudential standards for non-bank SIFIs include: (i) risk-based capital requirements and leverage limits, (ii) liquidity requirements, (iii) single-counterparty credit limits, (iv) risk management, (v) stress tests, (vi) the debt-to-equity ceiling and (vii) early remediation.

House Bill Would Transfer Investment Adviser Oversight to SROs

On April 25, Representatives Bachus (R-Ala.) and McCarthy (D-N.Y.) introduced a bill that would shift responsibility for investment adviser oversight from the SEC to one or more Self-Regulatory Organizations ("SROs"), which would be called National Investment Adviser Associations ("NIAAs"). The Financial Industry Regulation Authority ("FINRA"), which supports the bill, appears to be the only SRO currently capable of serving such a role. The Bill follows in the wake of an SEC study released in 2011 that reviewed the need for enhanced examination and enforcement resources for investment advisers and proposed the SRO model as an option for Congress to consider.

The proposed bill, H.R. 4624 (the "Bill"), would amend the Investment Advisers Act of 1940 (the "Advisers Act") by (1) adding a new Section 203B, which would require investment advisers to register with an NIAA and (2) adding a new Section 203C, which would provide the SEC with supervisory authority over NIAAs. An investment adviser would be exempt from registration under the proposed requirements if such investment adviser has 90% or more of its total assets under management attributable to, individually or in the aggregate, qualified purchasers or private funds.

While there is no action to take at this time, we will alert you to further developments, as the Bill could have a significant impact on costs and future oversight of investment advisers registered with the SEC.

Examination and Enforcement Action Developments

SEC Official Outlines Three-Part Approach to Examining Newly Registered Investment Advisers and Key Conflicts of Interests for Private Equity Funds

Speaking at the Private Fund Compliance Forum 2012 in New York on May 2, Carlo di Florio, Director of the Office of Compliance Inspections and Examination ("OCIE"), outlined the SEC's strategy for examining the many newly registered private fund advisers. Director di Florio's remarks, which have been echoed recently by other SEC officials, articulate a three-part approach. Click here for the full text of Director di Florio's speech.

The first phase will consist of an industry outreach and educational efforts to share the SEC's expectations with respect to the highest-risk areas for private fund advisers. The second phase will be coordinated, targeted examinations of "a significant percentage" of the new registrants. Director di Florio suggested this second phase will occur "late summer or early fall." The third phase will share the results of these exams more broadly, through a series of "after-action" reports or a "National Examination Risk Alert" that will describe the common risks identified along with other collective findings.

In choosing investment advisers for exams, OCIE looks to a number of risk factors to identify exam candidates. For private fund advisers, these factors include material changes in business activities or investment strategies; changes in the responsibilities, outside activities, or employment of key personnel; the disciplinary history of the firm and its personnel; assets being held by affiliate firms; and anomalies in fees, performance, or disclosure compared to peers or prior periods (which might consist of apparent smoothing of returns, perceived overstatement of assets, or consistent claims of high rates of return). Once a firm is selected for an exam, OCIE will focus on risk areas it identifies in an analysis that is more specific to the investment adviser and its funds.

For newly registered investment advisers concerned about exams, Director di Florio recommended that the "best way to avoid attracting [the SEC's] attention would be to be very proactive and thoughtful about identifying conflicts . . . and remediating those conflicts with strong policies, procedures and other risk controls, as well as making sure that [the] firm has a strong ethical culture from top to bottom." Director di Florio recognized that some conflicts are inherent in the private equity business model and stated that these need to be managed instead of eliminated.

Director di Florio noted that potential conflicts exist in each stage of the lifecycle of a private equity fund: the Fund-Raising Stage, the Investment Stage, the Management Stage and the Exit Stage. Potential conflicts that may arise in the Fund-Raising Stage include (i) conflicts surrounding the use of third-party consultants (*i.e.* placement agents), (ii) conflicts between the private fund manager and the fund or its investors and (iii) conflicts over how the fund is marketed, specifically with respect to the representations about returns on previous investments. Conflicts may also arise in the Investment Stage with respect to (i) opportunities for insider trading, (ii) allocation of investment opportunities and (iii) allocation of fees. Conflicts that may arise in the Management Stage are similar to those in the Investment Stage, and may also include misleading reporting to current or prospective investors in a fund. Finally, conflicts that may arise in the Exit Stage include (i) delayed divestment of fund assets to accrue additional management fees, (ii) conflicts surrounding liquidity events and (iii) conflicts with respect to the valuation of portfolio assets.

Private fund advisers should review their compliance programs in light of the upcoming exams and remarks regarding conflicts of interests for private equity firms.

Senior SEC Officials Discuss Asset Management Examination and Enforcement Initiatives and Priorities for 2012

In several recent public appearances, senior members of the SEC staff have commented on their current examination and enforcement priorities for the asset management industry in 2012. Although each speaker qualified his comments as an expression of solely his own opinion, several common themes emerged from these remarks:

- Registration and Inspection**:** OCIE and the Division of Enforcement ("DOE") are beginning the process of examining private equity firms, and the Asset Management Unit of the SEC has added a staff member with industry experience in private equity.

- Compliance Concerns: OCIE is concerned that asset management firms are not committing sufficient resources to compliance and the SEC is consistently asking firms to identify the level of resources they devote to compliance and how they have determined the adequacy of those resources. Under this initiative, failure to satisfy the requirements of Rule 206(4)-7 under the Advisers Act and Rule 38a-1 under the Investment Company Act may constitute a violation in and of itself. Pursuant to an informal "two strikes, you're out" approach, the failure to correct compliance deficiencies after a negative SEC comment could result in higher fines and "time-out" penalties.

- Focus on Aberrational Performance: The SEC staff has been increasing its focus on investigating funds with outlying performance. Three recent enforcement cases were built using new technologically-savvy techniques for identifying outlier performance.

- Expense Disclosure: OCIE staff is concerned that firms often fail to disclose all expenses charged to clients, and that "house" expenses and personal expenses are sometimes improperly allocated to clients.

- Portfolio Management Disclosure: In addressing failures to comply with investment guidelines or investment strategies, DOE staff is not receptive to arguments that the deviations are immaterial or ultimately benefited investment performance for clients. One speaker suggested that DOE staff may scrutinize disclosures made outside of a product's offering documents, such as a portfolio manager's oral representations. The Asset Management Unit may pursue misstatements of the qualifications of portfolio managers in Form ADV as well.

Increasingly Global Reach of the SEC

The SEC announced on March 23 that it had entered into supervisory cooperation arrangements with the Cayman Islands Monetary Authority ("CIMA") and the European Securities and Markets Authority ("ESMA"). The two memoranda of understanding ("MOUs") are part of a long-term strategy to improve the SEC's oversight of regulatory entities that operate across national borders. The new MOUs are intended to improve the SEC's ability to share information about regulated entities such as investment advisers and investment fund managers. A copy of the MOU with CIMA is available here, and a copy of the MOU with ESMA is available here.

In contrast to enforcement cooperation agreements, supervisory cooperation arrangements, like the MOUs signed with CIMA and ESMA, generally establish mechanisms for continuous and ongoing consultation, cooperation, and exchange of supervisory information related to the oversight of globally active firms and markets. The SEC entered into its first supervisory cooperation arrangement in 2006 with the United Kingdom's Financial Services Authority. Following the recent financial crisis, the SEC has expanded its focus on supervisory cooperation arrangements in an effort to better identify emerging risks to U.S. capital markets and the international financial system.

These arrangements facilitate the ability of regulators to cooperate with the SEC, helping to increase the level of information flow that enables regulators to monitor effectively the entities within their jurisdiction and to identify potential and actual risks to both local markets and the global financial system. **The recently signed MOUs, which signal the potential for increased cooperation between the SEC and foreign securities regulators, may increase the number of international securities fraud cases brought by the SEC.**

DOJ/SEC Bring First FCPA Case Involving Private Fund Investment Adviser

On April 25, the SEC charged a former Managing Director in Morgan Stanley's Chinese real estate investment and fund advisory group with violations of the Foreign Corrupt Practices Act (the "FCPA"), under Sections 30A(g) and 13(b)(5) of the Exchange Act. He was also charged with aiding and abetting his employer's wholly owned investment advisers in violation of the anti-fraud provisions of the Advisers Act, namely Sections 206(1) and 206(2). On the same day, the executive pleaded guilty to the Department of Justice's ("DOJ's") criminal charge of conspiring to evade internal accounting controls required by the FCPA. This case represents the first FCPA-related charges involving a private fund investment adviser.

The SEC and DOJ allege that Garth R. Peterson, an American citizen living in Singapore, exploited his personal friendship and secret business relationship with a Chinese government official (the former Chairman of a state-owned property management company for a district in Shanghai) to steer business opportunities to the investment funds managed by his employer, as well as to "secretly acquire" millions of dollars worth of real estate investments for himself. Mr. Peterson, whose principal responsibility had been to evaluate, negotiate, acquire, manage and sell real estate investments on behalf of Morgan Stanley's advisers and funds, was terminated in 2008 for his misconduct. Robert Khuzami, Director of the DOE, summed up the case with the following statement: "Peterson crossed the line not once, but twice. He secretly bribed a government official to illegally win business for his employer and enriched himself in violation of his fiduciary duty to Morgan Stanley's clients."

The SEC and Mr. Peterson have agreed to settle this matter, subject to court approval, with a permanent bar from the securities industry, a payment of more than $250,000 in disgorgement, and the relinquishment of approximately $3.4 million in property that Mr. Peterson acquired through his misconduct. With respect to the DOJ charges, Mr. Peterson will appear for criminal sentencing on July 17, where he will face up to five years in prison and up to a $250,000 fine.

Despite bribes paid with Morgan Stanley funds, Morgan Stanley faces no charges stemming from Mr. Peterson's conduct. Instead, the SEC has characterized Mr. Peterson as a "rogue employee" whose deceptions circumvented his employer's aggressive, carefully thought-out internal controls. Morgan Stanley not only had a record of the anti-corruption trainings it had held for Asia-based employees (54 in a six-year period) but it was also able to specify how many trainings Mr. Peterson personally had attended and how many FCPA-compliance reminders he had received. Moreover, along with frequent training and reminders, Morgan Stanley regularly updated its internal policies, required annual certifications from its employees, monitored transactions, and randomly audited employees. Morgan Stanley's persistent and extensive controls appear to have played a role in both the SEC and DOJ's decisions not to charge the company, as did the fact that the company self-reported the issues and terminated Mr. Peterson.

The Morgan Stanley case reemphasizes to investment firms the importance of establishing adequate and effective FCPA and anti-corruption internal controls in order to protect both the entity and individual personnel from such enforcement.

FSA Fines Former JC Flowers UK CEO

On January 31, 2012, the Financial Services Authority ("FSA") announced that it had fined Ravi Shankar Sinha, the former CEO of JC Flowers & CO UK Limited ("JCF"), £2.867 million (consisting of a £1.367 million disgorgement sum and £1.5 million penalty) for fraudulently invoicing a portfolio company over an eight-month period in 2009. The FSA Final Notice is available here.

The FSA alleged that JCF acted as an investment adviser to certain private equity funds (the "JCF Funds"). Mr. Sinha invested his own capital in companies in which the JCF Funds invested, and borrowed nearly €9 million for investment purposes. Starting in 2007, Mr. Sinha's own financial position deteriorated and in order to address his financial obligations, between February and October 2009, Mr. Sinha fraudulently obtained £1.367 million for himself from a company in which JCF Funds had invested ("Company A") without the knowledge or involvement of anyone else within JCF. He did this by issuing invoices to Company A for fees, payable to himself, and secured payment of the invoices by deliberately misleading the CEO of Company A and concealing from JCF the fact that he had received the payments. JCF discovered Mr. Sinha's conduct in October 2009, notified the FSA, and suspended and later dismissed Mr. Sinha. The FSA has rejected Mr. Sinha's assertion that, because he had lost his entitlement to "carry" when his JCF employment was terminated, a sum which would have exceeded the £1.367 million, he obtained no net financial benefit for his misconduct and therefore this "carry" sum should offset any proposed disgorgement sum.

Mr. Sinha is the first executive in the private equity industry to be fined by the FSA and comes within one week of the FSA fining hedge fund manager David Einhorn and his U.S.-based hedge fund. Together these actions demonstrate the FSA's focus on the alternative investment fund management industry and highlight the importance to private equity firms of having adequate compliance systems and controls in place. A robust code of ethics should be in effect, and employment arrangements should ideally contain terms of service which refer to such compliance rules and codes. **Firms should consider reviewing internal guidelines that regulate how portfolio companies are invoiced, ensuring it is made clear (i) how such invoices are authorised and issued to portfolio companies; and (ii) how these invoices should be properly filed and collated internally.**

SEC Credits Former Executive's Cooperation by Declining to Take Enforcement Action

For the first time since the publication of its plan to incentivize individual cooperation in investigations, the SEC publicly recognized the assistance of a former executive that led to settled enforcement actions against the executive's employer—AXA Rosenberg Group LLC, an investment adviser—and the company's co-founder. On March 19, 2012, the SEC announced that it had credited the cooperation of the former executive by declining to take enforcement action against him for his role in the cover-up of a material computer coding error.

In its announcement, the SEC revealed that the former executive's cooperation was instrumental in enabling the agency to conduct its investigation. The SEC evaluated the executive's assistance under the four factors laid out in the agency's Policy Statement Concerning Cooperation by Individuals in its Investigations and Related Enforcement Actions: (1) assistance provided by the individual; (2) importance of the underlying matter; (3) interest in holding the individual accountable; and (4) the individual's profile. All four factors weighed in favor of leniency toward the cooperating individual, presenting a model of cooperation with a government investigation. **Private fund advisers should be aware that the SEC is actively using the increased cooperation incentives to enhance the likelihood of individuals aiding investigations of their employers.**

Tax-Related Developments

FBAR Filing Deadline Further Extended to June 30, 2013 for Certain Persons with Signature Authority over Foreign Financial Accounts

In February, the Financial Crimes Enforcement Network ("FinCEN") issued Notice 2012-1, extending the filing deadline for U.S. Treasury Form TD F 90-22.1, "Report of Foreign Bank and Financial Accounts" ("FBAR") until June 30, 2013 for certain categories of U.S. persons that have signing authority over, but no financial interest in, a foreign account. Generally, each U.S. person who has a financial interest in, or signature authority over, one or more foreign financial accounts during a calendar year is required, absent an extension, to report those accounts to the Internal Revenue Service by filing an FBAR no later than June 30 of the succeeding calendar year. A person has a "financial interest" in a foreign financial account if such person is (a) the owner of record or legal titleholder of such account or (b) the direct or indirect owner of 50% or more of the entity that is the owner of record or legal titleholder.

However, as noted in our previous Alert, the filing deadline for all other U.S. persons with FBAR filing obligations (including U.S. funds with financial interests in their own foreign accounts) that do not meet the applicable criteria to receive an extension and the FBAR filing obligation for such persons remained unchanged and must be filed by June 30 for the previous calendar year, unless such person meets the criteria to receive an exemption from filing.

Individuals at registered private fund advisers with signing authority over (but no financial interest in) foreign accounts will have until June 30, 2013 to file a 2011 FBAR, as well as FBARs for prior years with previously extended deadlines.

New IRS Requirements for Electronic Furnishing of Schedules K-1

The IRS has issued new requirements that a partnership must meet in order to provide its partners with Schedules K-1 exclusively in an electronic format (*e.g.*, in a pdf attached to an email or downloadable through a web portal). Notably, pursuant to these requirements, a partner must first provide affirmative consent to receive its Schedules K-1 exclusively in an electronic format. In addition, the IRS now requires that a partnership provide its partners with a set of specific disclosures prior to, or in the statement requesting, the partners' consent. The consent must also demonstrate that the partners are able to access the Schedules K-1 in the electronic format in which the partnership will deliver the schedules. The IRS has described specific methods that a partnership may use to obtain a partner's consent. A partnership must obtain consents individually from each partner and, consequently, absent consents from all partners, may provide Schedules K-1 exclusively in electronic format to some but not all partners. Please note that a Schedule K-1, whether provided electronically or on paper, must also meet all other IRS requirements applicable to the content and delivery of such statements.

Partnerships that deliver Schedules K-1 exclusively in an electronic format and fail to comply with the new requirements may be deemed to have failed to provide their partners with Schedules K-1 and could be subject to penalties.

Partnerships that previously received consents from partners to provide Schedules K-1 exclusively by electronic means should review such consents to determine whether the prior consents conform to these new requirements or whether new consents are needed. In addition, partnerships may wish to incorporate new consent procedures into their subscription process.

Previously Issued Alerts

Below please find more detailed Alerts Ropes & Gray has issued over the past months:

Regulatory and Case Law Developments Relating to Private Equity Fund Documents
February 14, 2012

Significant Developments for the Implementation of FATCA: The IRS and Treasury Department Release Proposed Regulations
March 1, 2012

Congress Passes JOBS Act
March 29, 2012

Direct Investment Survey Reporting Requirements: What Private Equity Funds and Investors Need to Know
April 25, 2012