Ropes & Gray Private Investment Fund Update: November 2013

Highlights

NY Fed Revises TIC Form B Reporting Requirements. The NY Fed recently amended the TIC Form B, and under the new requirements, private funds may have Form B reporting obligations with respect to certain liabilities to, and claims on, non-U.S. residents.

SEC, FINRA and CFTC Recommend Firms Review Business Continuity Plans. In light of the business disruptions and devastation caused by Hurricane Sandy, the SEC, FINRA and the CFTC are encouraging investment adviser firms to review their business continuity and disaster recovery plans and policies to ensure they address all potential impacts caused by a natural disaster or similar disruption.

Red Flags Rules Program Implementation. All SEC- and CFTC-regulated entities that determine they fall within the scope of the Red Flags Rules must adopt and implement a "Red Flags Rules Program," intended to help detect identity fraud by November 20, 2013.

SEC Updates Form PF "Frequently Asked Questions". The SEC recently released updated "Frequently Asked Questions" to Form PF which address, among other things, how a filer can obtain a private fund identification number for a new private fund and how information about liquidated funds should be reported on Form PF.

SEC Adopts Final Rule for Registration of Municipal Advisers. The SEC recently adopted a final rule to establish a permanent registration regime for municipal advisers. The compliance date for this registration regime will determine the date on which investment advisers must comply with the third-party solicitation requirements under the "pay-to-play" rules.

SEC Highlights Upcoming Exam Initiatives and Focus Areas. The SEC recently released a presentation highlighting its examinations and focus areas for the 2014 examination program in an effort to educate investment advisers about potential compliance issues.

SEC Sanctions Three Firms under Compliance Program Initiative. The SEC recently sanctioned three investment adviser firms under its "Compliance Program Initiative" for repeatedly ignoring problems with their respective compliance programs.

For a summary of all items addressed in this Update (including those highlighted above), please refer to the Table of Contents below.

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Court Decision Poses Threat to Whistle-Blower Policies. The Fifth Circuit Court of Appeals recently clarified that only employees who report potential violations to the SEC are deemed "whistle-blowers" and will be protected as such under the Dodd-Frank Act.

Previously Issued Alerts

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Regulatory Developments

NY Fed Revises TIC Form B Reporting Requirements

The U.S. Department of Treasury recently amended the requirements for the Treasury International Capital Form B ("Form B") and under the new requirements, private funds may have Form B reporting obligations. Prior to the changes, Form B was required to be filed by certain depository and banking institutions located in the U.S., bank holdings companies and financial holding companies, and securities brokers and dealers. Under the new requirements, the required filers for Form B also include "all other U.S. financial institutions that are primarily engaged in proprietary investments and/or the provision of financial services to other organizations." The Federal Reserve Bank of New York, in its revised instructions to Form B, specified that "all other financial institutions" include (among other entities) private equity funds, hedge funds, real estate investment trusts, mutual funds and pension funds (all potential filers are herein referred to as "Form B Filers").

Filing obligations would most commonly arise for private funds that (1) invest directly in non-U.S. debt instruments, (2) provide credit to non-U.S. entities, (3) directly hold non-U.S. short-term securities, or (4) maintain credit facilities with non-U.S. financial institutions.

Very generally, Form B requires certain U.S. residents to report information regarding their liabilities to, or claims on, non-U.S. residents to the extent certain Thresholds (as defined below) are met. Form B is comprised of separate reports and each report requires different information, including: (1) U.S. dollar denominated "claims" on non-U.S. residents if the U.S. resident exceeds the Threshold, (2) U.S. dollar denominated "liabilities" to non-U.S. residents if the U.S. resident exceeds the Threshold, (3) foreign currency denominated "claims" on non-U.S. residents if the U.S. resident exceeds the Threshold and (4) foreign currency denominated "liabilities" on non-U.S. residents if the U.S. resident exceeds the Threshold.[1] The "Threshold" generally means $50 million or more aggregated across all non-U.S. jurisdictions or $25 million or more in respect of any individual country.[2] Filings are typically made at the adviser level, and an adviser will consolidate and report on behalf of all U.S. entities it manages.

Reportable "claims" include deposit balances due from banks in any maturity (including non-negotiable CDs), negotiable certificates of deposit of any maturity, broker balances, loans and loan participations of any maturity, resale agreements and similar financing agreements, short-term negotiable and non-negotiable securities (with a maturity of one year or less), money market instruments and accrued interests receivables. Long-term securities (including fund interests and securities with no contractual maturity or a maturity of over one year) are not reportable "claims."[3] Credit commitments, contingent liabilities, derivatives, spot foreign exchange contracts and precious metals are also excluded as reportable "claims."

Reportable "liabilities" include non-negotiable deposits of any maturity (including non-negotiable CDs), brokerage balances, loans of any maturity, short-term non-negotiable securities (with a maturity of one year or less), repurchase agreements and similar financing agreements and accrued interests payable. Long-term securities (including fund interests and securities with no contractual maturity or a maturity of over one year) are

[1] In the event a Form B Filer reaches the Threshold for a specific report, it is only required to file that report (i.e., it is not required to file any Form B report for which it does not reach the Threshold).
[2] Any claims or liabilities held with a U.S. bank or a U.S. custodian should be excluded from the calculations for purposes of determining whether the Threshold has been reached.
[3] Cross-border long-term securities are reported on the Treasury International Capital Form SLT.

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not reportable "liabilities." Negotiable certificates of deposit, negotiable short-term securities, contingent liabilities, derivatives, spot foreign exchange contracts and precious metals are also excluded as reportable "liabilities."

Form B includes monthly and quarterly reports. Monthly reports are due no later than fifteen (15) calendar days following the last day of the month and quarterly reports are due no later than twenty (20) calendar days following the last day of each of March, June, September and December. More information on Form B is available here and the corresponding instructions are available here.

SEC Staff Submits Report of Use of Form PF Systemic Risk Data

Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), the U.S. Securities and Exchange Commission (the "SEC") is required to create and submit reports to Congress on an annual basis highlighting how it has used the data collected in Form PF to monitor markets and protect investors. The SEC staff recently released its first annual report in which it identified several ways it has used information reported by private fund advisers on Form PF.

As a result of the rolling compliance dates for Form PF, the SEC only recently received a complete set of initial filings. In this initial annual report, the SEC released certain aggregated statistics with respect to the information it collected on Form PF, including the number of and types of filers, the amount of assets under management with respect to the various categories of filers and the value of controlled portfolio companies. In addition, the SEC reported that various divisions and offices within the SEC have been using the information reported on Form PF to analyze and identify the risk-taking activities of investment advisers to private funds. The SEC further noted that it has initially focused on various aspects of data security, collection and filing of the Form PF information and it was assessing the quality and consistency of the data provided.

The SEC's Annual Staff Report relating to the use of data collected from Form PF is available here.

SEC, FINRA and CFTC Recommend Firms Review Business Continuity Plans

The SEC, the Financial Industry Regulatory Authority ("FINRA"), and the Commodity Futures Trading Commission (the "CFTC") recently contacted several firms impacted by Hurricane Sandy to understand how their operations (including trading, customer relations, financial and regulatory obligations, and technology) were affected. Specific emphasis was given to the firms' implementation of their Business Continuity Plans and/or Disaster Recover Policies and how such plans addressed the disruptions caused by Hurricane Sandy in an effort to assist industry members in preparing for future events that have the ability to disrupt market operations.

After these discussions, the SEC, FINRA and the CFTC jointly released an Advisory Statement encouraging firms to review their Business Continuity Plans and/or Disaster Recover Policies to implement the lessons learned from Hurricane Sandy. Specifically, the statement recommends that firms address (1) widespread disruption due to natural disasters, (2) the use of alternative locations and geographic diversity, (3) vendor relationships and communications, (4) technology considerations, (5) investor and client communication plans, (6) regulatory compliance with respect to their Business Continuity Plans and/or Disaster Recover Policies and (7) adequate review and testing or such policies and procedures. In addition, the statement advises firms to consider the possibility of widespread lack of telecommunications, transportation, electricity, office space, fuel and water when reviewing their Business Continuity Plans and/or Disaster Recover Policies, to utilize backup centers and remote sites in different geographic regions and to contract with multiple telecommunication providers to prevent widespread communication disruptions.

Firms should review their Business Continuity Plans and/or Disaster Recover Policies to ensure they address the various considerations and possibilities to ensure a smooth recovery in the event their business operations are disrupted.

The full text of the advisory statement is available here.

Red Flags Rules Program Implementation

The SEC and the CFTC (together, the "Commissions") jointly issued final "Red Flags Rules" in April 2013 and by November 20, 2013, all SEC- and CFTC-regulated entities that determine they fall within the rules' scope must adopt and implement a "Red Flags Rules Program" intended to help detect identity fraud. While the Red Flags Rules issued by the SEC and the CFTC are largely similar to the Red Flags Rules adopted by the Federal Trade Commission ("FTC") under the Fair Credit Reporting Act ("FCRA") in 2007, the Commissions acknowledged that the adopting release and the final Red Flags Rules contain certain guidance, examples, and minor language changes which may lead some SEC- and CFTC-regulated entities that previously had concluded that the FTC Red Flags Rules were not applicable to them to now determine that the SEC and CFTC Red Flags Rules are, in fact, applicable to them.

SEC- and CFTC-regulated entities to which the Red Flags Rules apply are those that may be considered "financial institutions" or "creditors" under FCRA. Those financial institutions or creditors that maintain "covered accounts" need to adopt identity theft red flags programs. The SEC has stated that SEC-regulated entities likely to qualify as financial institutions or creditors and that maintain covered accounts include "most registered brokers, dealers, and investment companies, and some registered investment advisers." For instance, an investment adviser may be considered a "financial institution" subject to the Red Flags Rules if it: (a) has the ability to direct transfers or payments from accounts belonging to individuals to third parties upon the instructions of such individuals, (b) has the authority, by power of attorney or otherwise, to withdraw money from an individual investor's accounts and direct payments to third parties according to such investor's instructions, or (c) has the authority, pursuant to an arrangement with the private fund or individual, to direct such individual investor's investment proceeds to third parties. Institutions, including investment advisers, that offer margin accounts or accounts that permit wire transfers or other payments to third parties also may be subject to the Red Flags Rules.

Administratively, the Red Flags Rules require that (i) any red flags identity theft protection program be approved, if not already in place, by the board of directors, an appropriate committee thereof, or senior management of an entity if there is no board; (ii) there be high-level involvement in the oversight of the red flags program; (iii) staff be trained to implement the red flags program; and (iv) there be oversight of service provider arrangements with respect to red flags programs (i.e., compliance cannot be completely delegated to service providers). An organization's red flags program also should be appropriately tailored to the organization's size and complexity, minimally designed to (i) identify relevant patterns, practices, or specific activities that indicate possible identity theft, or red flags; (ii) detect red flags; (iii) respond appropriately to any red flags detected; and (iv) update the organization's red flags program from time to time to reflect changes in risks from identity theft.

The full text of the Red Flags Rules is available here.

SEC Updates Form PF "Frequently Asked Questions"

The SEC staff recently released an updated set of questions and answers in its "Frequently Asked Questions" relating to Form PF. Of particular note, the SEC added a new question, in which it indicated that when filing other-than-annual amendments to Form ADV for the sole purpose of generating a private fund identification number for a new private fund for Form PF, an adviser is only required to update Section 7.B.1 (with respect to the new private fund). However, it is advised that if making such other-than-annual amendment, an adviser should consult the Instructions to Form ADV to determine whether it must update any additional information.

Additionally, with respect to reporting private funds that are liquidated during a reporting period on Form PF, the SEC clarified that such liquidated funds must be included in Form PF if they were in existence during the reporting period. To clarify the current liquidated status of a fund, the SEC recommended including such information in Question 4 to Form PF (which requests a filer include any assumptions or other relevant information with respect to its filing).

Finally, the SEC provided guidance with respect to specific Form PF questions, including clarification on how cost-based calculations should be made and how borrowings should be interpreted for purposes of certain questions.

Form PF filers should review the updated "Frequently Asked Questions" to ensure they are appropriately answering and providing all information required by Form PF.

SEC Issues FAQ for Broker-Dealer Compliance Staff

The SEC staff recently issued guidance with respect to when compliance and legal personnel at broker-dealers may face supervisory liability under the Securities Exchange Act of 1934 (the "Exchange Act") in the form of "Frequently Asked Questions." Very generally, under Sections 15(b)(4) and 15(b)(6) of the Exchange Act, chief compliance officers and other legal and compliance personnel at broker-dealers may be subject to liability for failure to supervise and ensure compliance with certain legal and regulatory requirements.

In the Frequently Asked Questions, the SEC stated that as an initial matter, a broker-dealer's compliance and legal personnel (including the chief compliance officer) were not presumed to be "supervisors" solely resulting from their status as a member of the legal or compliance team. Instead, the SEC clarified that whether compliance or legal personnel are "supervisors" is a facts and circumstances determination that considers whether such personnel have supervisory authority over business units or employees outside of the compliance and legal departments. The SEC also set forth factors and criteria to assist broker-dealers in determining whether compliance or legal personnel may be deemed to have supervisory authority.

The SEC also emphasized in several responses that compliance and legal personnel may be involved in the implementation of a compliance program, monitoring systems and other programs to identify instances of noncompliance, and may participate in the management of the firm without being considered supervisors, so long as such person's duties and responsibilities are clearly defined and the facts and circumstances are such that such person does not have the requisite degree of responsibility, ability or authority to affect the conduct of

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business units or employees. In the event a person is considered a "supervisor," he or she must reasonably supervise compliance and regulatory programs with the intent of preventing violations of federal securities laws and other related rules and regulations.

Based on the SEC guidance, broker-dealers should consider reviewing the duties and responsibilities of compliance and legal personnel to determine whether they would be considered "supervisors" under the Exchange Act and clarify such persons' roles within the firm to ensure only those appropriate persons are deemed to be "supervisors."

SEC Adopts Final Rule for Registration of Municipal Advisors

When the SEC adopted final rules regarding the ban on third-party solicitation under the "pay-to-play" rules, the compliance date for such rules was nine months after the compliance date of a final rule adopted by the SEC by which municipal advisers must register under the Exchange Act. On September 20, 2013, the SEC adopted such a Final Rule to establish a permanent registration regime for municipal advisors. This Final Rule was required to implement the provisions of the Dodd-Frank Act, which amended Section 15B of the Exchange Act. The Dodd-Frank Act generally prohibits municipal advisors from soliciting or providing certain advice to municipal entities without first registering with the SEC. The SEC had previously published a proposed rule to establish a permanent municipal advisors' registration regime on December 20, 2010, which was discussed in a previous Alert.

The SEC previously noted that once such a Final Rule was adopted, it would issue the new compliance date for the ban on third-party solicitation via a notice in the Federal Register. **We will keep you apprised of any new developments with respect to compliance with the ban on third-party solicitation rules, including any compliance date released by the SEC.**

Examination and Enforcement Actions Developments

SEC Highlights Upcoming Exam Initiatives and Focus Areas

The SEC is in the process of conducting "Compliance Outreach Programs" in regional seminars for investment advisers, investment company senior officers and chief compliance officers. The Compliance Outreach Program was created to promote open communications regarding various investment adviser, fund and broker-dealer compliance issues and to discuss topics including the SEC's examination process, priorities, risk surveillance, examination selection process, Form PF and other recent industry and regulatory developments. These seminars provide the SEC staff with an opportunity to identify common issues in examinations or investigations and give insight as to how compliance professionals have addressed these various matters.

In connection with these Compliance Outreach Programs, the SEC recently posted a PowerPoint presentation highlighting its exam initiatives and focus areas for the 2014 Investment Adviser/ Investment Company examination program. In this presentation, the SEC noted that upcoming focus areas include fraud detection, general risk management and other ongoing risks, such as safety of assets, conflicts of interest related to marketing/performance, compensation arrangements, conflicts of interest related to the allocation of investment opportunities and fund governance. The SEC noted that it will also be focusing on new and emerging issues, including dual registered investment advisers and broker-dealers, "alternative" investment companies, and payments for distribution in guise. Finally, in upcoming examinations, the SEC will also give

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more attention to various policy topics, specifically compliance with the "pay-to-play" rules and compliance with exemptive orders.

More information about the Compliance Outreach Program is available here. To view the PowerPoint presentation, please click here.

SEC Sanctions Three Firms under Compliance Program Initiative

The SEC recently sanctioned three investment adviser firms under its "Compliance Program Initiative" for repeatedly ignoring problems with their respective compliance programs. Under the Investment Advisers Act of 1940, as amended (the "Advisers Act"), firms are required to adopt and implement policies and procedures that are reasonably designed to prevent violations of applicable securities laws. The policies and procedures must be reviewed at least annually for effectiveness and a chief compliance officer must be responsible for their administration. The Compliance Program Initiative was designed by the SEC to address repeated instances of compliance failures that, in its view, could lead to larger compliance problems in the future. Specifically, under the Compliance Program Initiative, the SEC targets firms that have been previously notified of compliance problems, but have not effectively addressed those warnings.

The SEC sanctioned the three firms for failure to correct ongoing compliance obligations including: failure to complete annual compliance reviews, inclusion of misleading statements on material materials (i.e., misstating the firm's assets under management on its websites, misleading disclosures about historical performance, compensation and conflicts of interest), over- and under-billing clients and failure to include compliance deficiencies to clients on certain due diligence questionnaires.

The firms charged agreed to settlements which include (among other things) payment of monetary penalties, hiring new compliance officers and compliance consultants to assist them with their compliance programs, undergoing compliance training and reimbursement payments to over-billed clients.

SEC Institutes Proceedings against Ex-Oppenheimer Manager for Fund Valuation

The SEC has instituted an order instituting administrative proceedings and cease-and-desist proceedings against Brian Williamson, a former Oppenheimer & Co. Inc. manager, for misleading investors by providing them with false information regarding the financial performance and valuation of a fund of funds managed by Williamson—Oppenheimer Global Resource Private Equity Fund I, L.P. ("OGR"). Among his other roles at OGR, Williamson had primary responsibility for the content of OGR's pitch books and quarterly reports. In its proceedings, the SEC primarily claims that Williamson, at various times during 2009 - 2010:

1. made, approved and revised fund marketing materials to mislead investors about the internal rate of return on investments by neglecting to take into account various fees and expenses paid to managers and OGR's sponsor entity; and
2. revalued the OGR's largest single holding at his own increased valuation and made or approved statements implying that the valuation (and increased rates as a result of the valuation) were based off of the portfolio manager's estimated valuations rather than Williamson's own revised valuation.

The SEC order cites numerous instances where Williamson knew or recklessly disregarded that information regarding the performance and valuation of OGR's investments was false and misleading. The SEC claims that as a result of Williamson's conduct, he willfully violated Section 17(a) of the Securities Act of 1933, as amended, Section 10(b) of the Exchange Act (and Rule 10b-5 thereunder) and Section 206(4) of the Advisers Act (and Rule 206(4)-8 thereunder). Earlier this year Oppenheimer agreed to pay approximately $2.8 million to resolve its role in the case, but Williamson is now fighting the charges.

Court Decision Poses Threat to Whistle-Blower Policies

A recent decision by the Fifth Circuit Court of Appeals ruled that whistle-blowing employees are protected from retaliation under the Dodd-Frank Act if they report potential violations to the SEC, but not if they report those potential violations only to their employer. In *Asadi v. G.E. Energy*, Asadi, a former employee of G.E. Energy in Amman, Jordan, was terminated after informing his supervisor and a company ombudsperson of a suspected violation of the Foreign Corrupt Practices Act. The Fifth Circuit concluded that Asadi was not a whistle-blower as defined by the Dodd-Frank Act and was thus not protected by the provisions thereunder.

While the SEC's definition of a "whistle-blower" is fairly broad and expansive, the Fifth Circuit noted that because Congress directly addressed the definition of a "whistle-blower" in the Dodd Frank Act, it was required to reject the SEC's expansive definition for purposes of determining whistle-blower protection. The Fifth Circuit's decision further clarified that under Dodd-Frank, "there is only one category of whistle-blowers: individuals who provide information relating to a securities law violation to the SEC." The Fifth Circuit's decision further clarified that employees who only report potential violations internally may be covered by the Sarbanes-Oxley Act of 2002; however, the court noted that the Dodd-Frank Act whistle-blower protection provides for greater monetary damages.

This ruling may undermine programs that many companies have developed to encourage would-be whistle-blowers to report such violations on an internal basis, instead of going to the SEC.

As a result, companies should take a closer look at the policies and provisions they currently have in place to provide comfort to employees that they will be protected from retaliation. Companies may want to ensure that they make clear (through actions and words) that they place a high priority on internal whistle-blowers and that they endeavor to take all whistle-blower complaints seriously.

Previously Issued Alerts

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

General Solicitation and Other Changes to Regulation D: The Impact on Private Funds
July 15, 2013

First Circuit Holds that Private Equity Fund May Be Liable for Portfolio Company's Multiemployer Plan Withdrawal Liability
July 26, 2013

SEC Releases Guidance with Respect to Privately Offered Securities and the Custody Rule
August 5, 2013

Update on SEC Staff Position on Private Fund Broker-Dealer Issues
October 4, 2013

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