Investment Management Regulatory Update

November 24, 2015

SEC Rules and Regulations

SEC Grants No-Action Relief to BlackRock Funds for Filing Post-Effective Amendments to Their Registration Statements

On October 19, 2015, the SEC staff issued a no-action letter (the "**Letter**") granting relief to BlackRock Limited Duration Income Trust, BlackRock Debt Strategies Fund, Inc., BlackRock Floating Rate Income Strategies Fund, Inc. and BlackRock Corporate High Yield Fund, Inc. (collectively, the "**BlackRock Funds**"), each of which has filed a shelf registration statement on Form N-2 with the SEC, if the BlackRock Funds file post-effective amendments to their registration statements pursuant to Rule 486(b) under the Securities Act of 1933, as amended (the "S**ecurities Act**") under the circumstances set forth in the incoming letter (the "**Incoming Letter"**) submitted on behalf of the BlackRock Fund.

Rule 486(b) under the Securities Act ("**Rule 486(b)**") generally permits a closed-end management investment company that make periodic repurchase offers under Rule 23c-3 under the Investment Company Act (an "**Interval Fund**") to file a post-effective amendment to its registration statement that becomes effective on the date of filing, subject to certain conditions. Such post-effective amendment may only be filed to, among other things, bring the financial statements up to date or make non-material changes. According to the Letter, the adoption of Rule 486(b) in 1994 reflected the value the SEC staff

saw in allowing Interval Funds to raise capital continuously with certain automatically effective filings. The Letter also cited a no-action letter issued after the adoption of Rule 486(b) wherein the SEC staff recognized that registered closed-end management investment companies that are not Interval Funds (like the BlackRock Funds) may also benefit from additional flexibility to take advantage of positive market conditions to raise additional capital through continuous or delayed offerings of their securities.

According to the Incoming Letter, the board of directors of each BlackRock Fund concluded that the ability to raise capital through a public offering on a delayed and continuous basis would be beneficial to such BlackRock Fund and its shareholders and potential investors. However, the Incoming Letter states that the BlackRock Funds are subject to the risk of not being able to sell securities pursuant to their shelf registration statements for meaningful portions of the year because of the post-effective amendment process (which generally required the SEC's review and declaration of effectiveness) required to bring each BlackRock Fund's financial statements up to date. According to the Incoming Letter, the utilization of Rule 486(b) would benefit the BlackRock Funds and their investors by allowing the BlackRock Funds the ability to raise capital continuously, reducing the expenses incurred by the BlackRock Funds related to the SEC review process and bringing important information to investors more quickly.

In the Incoming Letter, the BlackRock Funds represented that they would comply with Rule 486(b) in making their post-effective amendments. Each BlackRock Fund further represented in the Incoming Letter that it would only sell new shares at a price no lower than the sum of such BlackRock Fund's net asset value and the per share underwriter's discount or commission. The BlackRock Funds further agreed that they would only use post-effective amendments to: (1) bring their financial statements up to date, (2) update the information required by Item 9.1.c of Form N-2 or (3) make non-material changes as appropriate. The BlackRock Funds also represented that they would file a post-effective amendment containing a prospectus pursuant to Section 8(c) of the Securities Act prior to offering common stock at price below net asset value.

Based on the foregoing facts and representations, the SEC staff agreed not to recommend that the SEC take any enforcement action under Section 5(b) or Section 6(a) of the Securities Act against any BlackRock Fund if such BlackRock Fund files a post-effective amendment to its registration statement pursuant to Rule 486(b).

- **See a copy of the Letter**
- **See a copy of the Incoming Letter**

SEC Grants No-Action Relief Relating to Bank Collective Trusts' Investment in Insurance Company Separate Accounts Relying on the Section 3(c)(11) Exemption from the Investment Company Act

On October 6, 2015, the SEC staff issued a no-action letter (the "**Letter**") clarifying the application of an exclusion from the definition of an "investment company" set forth in Section 3(c)(11) of the Investment Company Act of 1940 (the "**Investment Company Act**") to certain bank collective trusts (each, a "**BCT**") and the insurance company separate accounts ("**Separate Accounts**") in which such BCTs invest. The staff stated that it would not recommend enforcement action to the SEC under Section 7 of the Investment Company Act against such BCTs or any Separate Account in which they invest if such Separate Account continues to rely on the exclusion from the definition of "investment company" set forth in Section 3(c)(11), notwithstanding the fact that certain BCTs holding church plan assets in accordance with Section 3(c)(11) invest a portion of their assets in such Separate Account.

The Letter was issued in response to an incoming letter (the "**Incoming Letter**") submitted on behalf of the North American Division of Seventh-Day Adventists (the "**Adventists**"). According to the Incoming Letter, the Adventists maintain a plan providing defined contribution retirement income accounts (the "**Plan**"), which is maintained in accordance with Section 414(e)(3)(A) of the Internal Revenue Code of 1986 (the "**Code**") and is a "church plan" within the meaning of Section 414(e) of the Code. The

Adventists asserted that, as a "church plan," the Plan is excluded from the definition of "investment company" pursuant to Section 3(c)(14) of the Investment Company Act. According to the Incoming Letter, the Plan is planning on moving certain investments from the Plan account to a larger BCT fund (the "**Prospective BCT**") maintained by an unaffiliated bank trustee with a similar investment strategy, which invests in one or more insurance company separate accounts (the "**Separate Account**"). The Adventists further asserted that neither the Prospective BCT nor the Separate Account currently holds any other church plan assets.

The Prospective BCT, according to the Incoming Letter, currently relies on the exclusion from the definition of "investment company" set forth in Section 3(c)(11) of the Investment Company Act. With regard to BCTs, Section 3(c)(11) generally excludes from the definition of "investment company" any BCT that consists solely of the assets of certain qualified private pension plans, government plans, or church plans. Since, according to the Incoming Letter, the Plan is a "church plan," its investment in the Prospective BCT would not affect the Prospective BCT's reliance on this exclusion. However, the Separate Account in which the Prospective BCT currently invests also relies on an exclusion from the definition of "investment company" set forth in Section 3(c)(11). With regard to separate accounts, Section 3(c)(11) generally excludes any separate account whose assets are derived solely from (i) contributions under pension or profit-sharing plans which meet the requirements of Section 401 or 404(a)(2) of the Internal Revenue Code of 1986, (ii) contributions under governmental plans in connection with certain exempt interests, participations or securities and (iii) advances made by an insurance company in connection with the operation of such separate account. The staff asserted that Section 3(c)(11) explicitly permits a BCT, but not a separate account, to hold assets attributable to a church plan.

According to the staff, the first issue raised by the Adventists' proposed structure is whether the Separate Account can accept an investment from the Prospective BCT at all, since Section 3(c)(11) does not explicitly allow one entity relying on a Section 3(c)(11) exclusion (a "**3(c)(11) Entity**") to hold assets of another 3(c)(11) Entity. With respect to this issue, the Incoming Letter argued that the SEC had previously provided no-action guidance with respect to investments by one 3(c)(11) Entity in another 3(c)(11) Entity. In previous guidance, the SEC had indicated that the lower-level 3(c)(11) Entity could "look through" the top-level 3(c)(11) Entity and count the investors in the top-level entity as its own for purposes of determining the applicability of a 3(c)(11) exclusion. However, according to the staff, this guidance raises a second issue: if the Separate Account "looks through" the Prospective BCT to the Plan, and Section 3(c)(11) does not permit separate accounts holding church plan assets to be excluded from the definition of "investment company," will the Separate Account lose its excluded status under Section 3(c)(11)?

The Incoming Letter argued that in a previous no-action letter (Aetna Life Insurance Company, SEC Staff No-Action Letter (Apr. 19, 1984)), the staff had allowed church plans to invest in separate accounts without causing the separate accounts to lose their Section 3(c)(11) exclusion. In the Aetna no-action letter, the staff agreed not to recommend enforcement action if Aetna issued group annuity contracts to church-sponsored pension and retirement plans, as defined in Section 414(e) of the Code. The staff based its position on representations that the annuity contracts would be offered and sold "solely to church plans which were the functional equivalent to plans qualified under Section 401 of the Code, and which did not involve the exercise of employee discretion with respect to involvement in the contracts." The Incoming Letter argued that, consistent with the circumstances described in the Aetna no-action letter, the Plan is also functionally equivalent to plans qualified under Section 401 of the Code, and investors in the Prospective BCT have no ability to influence or direct the selection of investments by the Prospective BCT.

The Letter stated that the SEC would not recommend enforcement action based on the representations set forth in the Incoming Letter, as summarized herein. The staff stated that it was basing its position specifically on the Incoming Letter's representations that (1) the Plan satisfies the requirements of Section 403(b)(9) of the Code and is therefore functionally equivalent to plans qualified under Section 401 of the Code; (2) investors in the Prospective BCT have no ability to direct or influence the selection of

investments by the Prospective BCT, including the Prospective BCT's investment in the Separate Account; and (3) other than the Plan, investors in the Separate Account will consist solely of those investors that are eligible to invest in Section 3(c)(11) Entities in accordance with Section 3(c)(11) or as a result of SEC guidance.

- See a copy of the Letter
- See a copy of the Incoming Letter

Industry Update

Office of Compliance Inspections and Examinations Issues NEP Risk Alert on Outsourced CCOs

On November 9, 2015, the Office of Compliance Inspections and Examinations ("**OCIE**") issued a National Exam Program risk alert summarizing the results of examinations of investment advisers and investment companies (together, "**registrants**") that outsource their chief compliance officer function (the "**Alert**"). According to OCIE, the OCIE staff has noticed a burgeoning trend in the investment management industry of outsourcing compliance activities, including the role of chief compliance officers ("**CCOs**"), to third parties. The staff first summarized the applicable compliance rules—Rule 206(4)-7 under the Investment Advisers Act and Rule 38a-1 under the Investment Company Act—to which registered investment advisers and registered investment companies, respectively, are subject. The staff went on to reiterate earlier SEC guidance that an adviser's CCO should be "competent and knowledgeable regarding the Advisers Act and . . . empowered with full responsibility and authority to develop and enforce appropriate policies and procedures for the firm [and] have a position of sufficient seniority and authority within the organization to compel others to adhere to the compliance policies and procedures."

The Alert discussed the factors the staff considers in evaluating the effectiveness of registrants' compliance programs, including their outsourced CCOs, including whether: (i) the compliance environment addressed and supported the goals of the applicable federal securities laws, (ii) the compliance program was reasonably designed to prevent, detect and address violations of the applicable federal securities laws, (iii) the compliance program bolstered open communication between service providers and those with compliance oversight responsibilities, (iv) the compliance program was proactive, (v) the CCO was authoritative enough to influence adherence with the registrant's compliance policies and procedures and was given sufficient resources to perform his or her responsibilities and (vi) compliance was an integral part of the registrant's culture.

In addition, the Alert included the following key observations from the examinations conducted:

- **Communications**. The staff observed that outsourced CCOs who had more frequent and more personal interactions with registrant employees seemed to have a deeper understanding of the registrants' business, operations and risks and, as a result, there were fewer inconsistencies between the written compliance policies and procedures and the registrants' actual business practices.
- **Resources**. The staff also noted more significant compliance-related issues at registrants with an outsourced CCO who served as the CCO for various unaffiliated firms and who did not seem to have enough resources to perform compliance duties.
- **Empowerment.** The staff observed that the ability of an outsourced CCO to independently acquire records to conduct the annual review (as opposed to relying on the registrant to choose the records for the CCO's review) affected the accuracy of the annual reports as compared to the actual practices of the registrant.

- **Meaningful Risk Assessments**. The staff emphasized that CCOs need to understand and be able to clearly articulate the registrant's business and compliance risks. The Alert noted that while the use of standardized checklists to obtain relevant information regarding the registrants may be a helpful guide, such checklists could be too generic and therefore not fully capture the applicable business models, practices, strategies and compliance risks and could also lead to inconsistent or incorrect responses from the registrants that the CCO might not be knowledgeable enough to follow up on.
- **Compliance Policies and Procedures**. The staff observed instances where registrants did not appear to have adopted, implemented and/or adhered to policies and procedures that were reasonably designed (or that were relevant to the registrant). Specifically, the staff observed instances of compliance policies and procedures not being followed (e.g., reviews required for the payment of cash for solicitation activities and personal securities transactions that were not taking place). The staff further observed compliance policies and procedures (including the compliance manual itself) that were not tailored to the registrants' businesses or practices. The staff noted the examples of compliance manuals that did not identify critical areas and included policies inapplicable to the advisers' businesses and operations (e.g., describing management fees as being collected quarterly in advance when in practice clients were billed monthly in arrears and referencing departed employees as responsible for certain compliance duties).
- **Annual Review**. The staff observed a lack of documentation evidencing the testing by outsourced CCOs for compliance with existing policies and procedures. Further, the staff noted that certain outsourced CCOs visited registrants' offices infrequently and conducted only limited reviews of documents or compliance training while at the registrants' offices.

The Alert concluded by emphasizing the compliance weaknesses observed by the staff in examining registrants that outsource their CCOs. It urged registrants to assess whether their compliance programs have any weaknesses, especially with respect to identifying all applicable business and compliance risks and ensuring the firm's compliance program is appropriately tailored to cover all relevant business activities.

- **See a copy of the Summary**

SEC Chair Mary Jo White Discusses Regulation of Private Fund Advisers

On October 16, 2015, SEC Chair Mary Jo White discussed the regulation of private fund advisers five years after the passage of the Dodd–Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**") at the Managed Funds Association Outlook 2015 Conference in New York. White focused on (i) what the SEC has learned from the data it has collected as a result of the registration and reporting requirements set forth in the Dodd Frank Act, (ii) risks and challenges for private funds and their advisers that can affect the asset management industry more broadly and (iii) firm-specific risks that advisers should consider.

According to White, the Dodd-Frank Act's new registration and reporting requirements have enabled the SEC to better understand the risks posed by private funds and their advisers. White explained that Form ADV has provided the SEC with census information about registered advisers and the private funds they manage, including their organization, operations and investment profiles, as well as their affiliates and service providers. White also noted that Form PF has provided a rich repository of information about private funds to the SEC and to the Financial Stability Oversight Council ("**FSOC**"), which has enabled the SEC to better monitor industry trends. White further commented that the SEC has used the new data to examine private funds' use of derivatives and leverage, their exposure to particular foreign markets and their employment of high-frequency trading.

White went on to discuss the areas of risk that could impact the broader financial services industry. First, she discussed the risks arising from services provided to investors and the activities of market

participants. White cited the SEC's recently proposed rules for liquidity management programs and mutual fund swing pricing, as well as its expanded proposed reporting requirements for registered advisers and funds, as indicia of the SEC's important shift in focus to activities that could pose broader market risks. She further noted that FSOC, with the aid of the SEC, requested public comment on the services and activities of a broad cross section of asset managers, which she thought was a constructive shift in focus from firm-specific to broader industry risks.

White then addressed the operational risks facing the industry arising from inadequate or failed systems and processes of service providers to private fund advisers and private funds. First, she discussed the risks posed by the transition of client accounts from one adviser to another. She recommended that advisers and funds have a transition plan in place to manage the potential difficulties in liquidating certain asset classes, as well as to address transfer restrictions and confidentiality provisions in client contracts. Second, White discussed cybersecurity, recommending close attention to the staff guidance earlier in the year. Please see the **May 20, 2015 Investment Management Regulatory Update** for a discussion of this guidance. She noted that Regulation S-P requires registered investment advisers to adopt written policies and procedures reasonably designed to secure customer information and protect against anticipated threats to and unauthorized use of such information, and further explained that cybersecurity failures pose a risk to the entire financial industry because the illicitly gained information from an intrusion into a single firm can put assets and information at other firms at risk. White, therefore, urged all market participants to implement robust cybersecurity plans.

Third, White discussed market stress as a threat facing the asset management industry broadly. According to White, the SEC is currently considering how to implement the Dodd-Frank Act's requirements for annual stress testing by large registered advisers and funds. Please see the **December 16, 2014 Investment Management Regulatory Update** for a discussion of a previous speech White made that covered this topic. She acknowledged the potential issues with transferring bank and broker-dealer stress testing to the diverse asset manager market that is not accustomed to such testing. She confirmed that the SEC is using Form PF data to develop the stress testing plans. White further noted that asset managers should be aware of the effect that other sectors' risk management efforts could have on them, such as the impact of the Volcker Rule from the banking regime and the effects of clearing agencies' attempts to manage their risks through margin requirements, collateral policies and position portability. She predicted that such cross-sector effects are likely to continue as regulators continue their work.

White continued her speech by discussing the firm-specific risks that the SEC has identified through its examinations of private fund advisers. She began with a discussion of the fiduciary duty advisers owe to their clients, under which, according to White, advisers must act in the best interest of clients and either seek to avoid or disclose conflicts of interest. White explained that the SEC identified several areas of concern related to fiduciary duty through its presence exam initiative. The first area centered on marketing, where examiners raised concerns about back-tested performance figures, portable performance data and inadequate disclosures about benchmark comparisons. White also discussed the problems examiners found with the disclosure of conflicts of interest. She highlighted those conflicts related to the allocation of profitable trades and investment opportunities to proprietary funds over client accounts. White also cited conflicts involving fees and expenses. In some cases, the SEC staff was concerned about advisers charging a fund they advise for the salaries of their employees or rehiring their employees as consultants to be paid by the funds instead of by the adviser. White further notes that the SEC examiners continue to find instances of advisers failing to disclose the practice of receiving accelerated monitoring fees. For more information on a recent enforcement action relating to the lack of disclosure of accelerated monitoring fees, please see the article **SEC Charges Three Blackstone Advisers with Disclosure Failures** below. White also expressed the concern examiners have regarding the hiring of related parties by private fund real estate advisers without adequate disclosure. She also encouraged the audience to review the recent conflicts-related enforcement actions against private fund advisers, which involved the misallocation of expenses to funds, the non-disclosure of the

fees and discounts from service providers and the failure to disclose loans received from clients. Please see the **September 24, 2015 Investment Management Regulatory Update** for a discussion of the enforcement action against an adviser relating to the failure to disclose a loan made to a senior executive.

White closed by emphasizing the importance of private fund advisers' ability to work together with regulators, with investors and with other market participants to address industry-wide and firm-specific risks.

- **See a copy of the Speech**

SEC Chief of Staff Andrew J. Donohue Addresses NRS Conference on the Role of Compliance Professionals

On October 14, 2015, Andrew J. Donohue, Chief of Staff of the SEC, addressed the NRS 30th Annual Fall Investment Adviser and Broker-Dealer Compliance Conference to discuss the role of compliance professionals and how the SEC works to promote its compliance efforts within the financial industry.

Donohue began his speech by discussing ways in which the SEC works to promote compliance among investment advisers and broker-dealers. Donohue focused first on the SEC's Office of Compliance Inspections and Examinations ("**OCIE**"), which, in conjunction with the Division of Trading and Markets and the Division of Investment Management, among others at the SEC, directly engages with the senior management of firms in the financial industry. Such meetings, according to Donohue, promote relationships between the SEC staff and firms outside the context of an examination or enforcement action and also provide an opportunity for compliance professionals to discuss their concerns and challenges with respect to their role in the industry. Next, Donohue discussed the SEC staff's efforts to inform compliance professionals of particular risks and potential compliance pitfalls through its publications and other outreach efforts. Donohue noted the Guidance Updates published by the Division of Investment Management and OCIE's Risk Alerts and annual examination priorities as examples of how the SEC staff communicates to compliance professionals its thinking and those areas the staff is particularly focused on. Further, Donohue highlighted OCIE's regular outreach events and the various speeches delivered by the SEC staff at financial industry events as ways the SEC promotes a dialogue with compliance professionals.

Donohue then discussed OCIE's strategy for optimizing its examination resources and recommended that compliance professionals consider adopting similar strategies within their own firm's compliance departments. First, Donohue noted how the implementation of a risk-based strategy across the examination program, through the efforts of OCIE's Risk Assessment and Surveillance Group, has helped OCIE identify the greatest risks to investors and markets. Next, Donohue explained how OCIE has incorporated technology to help enhance its work. As an example, Donohue noted that many OCIE exam teams use the "National Exam Analytics Tool," which accesses and tests a registrant's trading data to identify compliance issues. In addition, Donohue noted how the OCIE's Risk Analysis Examination Group uses technology when examining clearing firms and large broker-dealers to help detect improper behavior, such as unsuitable recommendations, misrepresentations, inadequate supervision, churning and reverse churning. Donohue also discussed the SEC's effort to optimize its resources by enhancing its existing expertise. Donohue highlighted how the SEC developed the Technology Controls Program to strengthen OCIE's knowledge in the areas of information technology and cybersecurity in the financial industry. Further, Donohue noted the SEC's efforts to recruit specialized staff in areas such as derivatives, prime brokerage and quantitative analytics, among others, to bolster OCIE's capabilities and efficiencies in examinations.

Next, Donohue addressed a concern among chief compliance officers ("**CCOs**") regarding their potential personal liability in light of their elevated role in financial firms. First, Donohue reviewed a few enforcement actions the SEC brought against CCOs this year in connection with causing their firms' violations of Section 206(4)-7 of the Investment Advisers Act of 1940, as amended (the "**Advisers Act**"),

which generally requires a registered investment adviser to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules promulgated thereunder. In *In the Matter of BlackRock Advisors, LLC and Bartholomew A. Battista*, according to Donohue, the CCO knew and approved of various outside activities of his firm's employees, but failed to adopt any written policies and procedures to assess and monitor such outside activities. In *In the Matter of SFX Financial Advisory Management Enterprises, Inc. and Eugene S. Mason,* Donohue asserted that the CCO's failure to implement a provision of his firm's policies and procedures related to the review of cash flows in client accounts enabled a firm employee to misappropriate client funds. For a detailed discussion of the BlackRock and SFX Financial enforcement actions, please see the **July 14, 2015 Davis Polk Investment Management Regulatory Update**. According to Donohue, the SEC is not targeting compliance professionals, and he referred back to a May 2014 speech delivered by Andrew Ceresney, Director of the SEC's Division of Enforcement, to highlight the three typical scenarios in which the Enforcement staff is likely to recommend an enforcement action against a CCO: when a CCO has (i) affirmatively participated in the misconduct; (ii) helped mislead regulators; or (iii) had clear responsibility to implement compliance programs and/or policies and wholly failed to do so. According to Donohue, CCOs should feel comfortable, in light of the above factors, to carry out their responsibilities without the fear of personal liability.

Donohue closed by recommending that compliance professionals consider their roles in terms of the following categories and noted that they must develop detailed knowledge and understanding within each category to be effective within their firms:

- Laws, Regulations and Other Requirements
- Organization and Operations of the Firm
- Conflicts of Interest
- Clients of the Firm
- Compliance and Other Systems
- Policies and Procedures
- Markets and Business Practices
- Culture of the Firm

Finally, Donohue noted that it is important for compliance professionals to also recognize what they do not know and to encourage an environment of open communication among colleagues in order to identify potential risks.

- **See a copy of the Speech**

SEC Releases Private Funds Statistics Report

On October 16, 2015, the SEC staff published a report (the "**Report**") summarizing recent private fund industry statistics and trends, which were gathered through aggregating data reported by private fund advisers on Form ADV and Form PF. The Report reflects data reported from the first calendar quarter of 2013 through the fourth calendar quarter of 2014.

The Report includes statistics about gross and net assets, beneficial ownership, derivatives, distribution of borrowings, as well as specific reported information on large hedge fund advisers, liquidity funds, hedge funds and private equity funds. The Report also includes an analysis of hedge fund gross notional exposure to net asset value and a comparison of average hedge fund investor and hedge fund portfolio liquidity.

- **See a copy of the Press Release**

- See a copy of the Report

CFTC Responds to FAQs Regarding Form CPO-PQR

On November 5, 2015, the Division of Swap Dealer and Intermediary Oversight (the "**Division**") of the Commodities Futures Trading Commission (the "**CFTC**") issued responses (the "**Responses**") to 53 frequently asked questions regarding Form CPO-PQR. Form CPO-PQR is generally required to be completed and filed by any commodity pool operator ("**CPO**") that operated at least one pool (a "**Pool**") for which such CPO was required to be registered with the CFTC as a CPO during the relevant reporting period.

The Responses provided guidance on a number of Form CPO-PQR topics including, among other things:

Operation by Two or More CPOs. The Responses clarified that if a Pool is operated by two or more CPOs (each, a **"Co-CPO**") during a reporting period, each CPO is required to file a Form CPO-PQR. However, only the Co-CPO with the highest total assets under management, aggregated across all Pools operated by the Co-CPOs, is required to fully complete Form CPO-PQR for the Pool and the other Co-CPO(s) only need to complete Part 1 of Schedule A of Form CPO-PQR in respect of the relevant Pool. In addition, if one of the Co-CPOs is a registered investment adviser, the other Co-CPO(s) must file the relevant sections of the Form CPO-PQR, consistent with the above description, such that the largest CPO that is not a registered investment adviser would be required to fully file Form CPO-PQR even if a Form PF was filed for that Pool by the CPO that is a registered investment adviser.

Form PF. The Responses clarified that a CPO that is registered as an investment adviser with the SEC and files a Form PF with the SEC is permitted to file that Form PF with the CFTC in lieu of a Form CPO-PQR as long as such CPO also files Schedule A of Form CPO-PQR with the CFTC. In addition, the Responses noted that such a CPO is not excluded from filing NFA Form PQR with the National Futures Association ("**NFA**").

Exempt Pools. The Responses also clarified that a CPO that operates Pools for which it is exempt from registration under CFTC Regulation 4.13(a)(3) is not required to include such Pools in the Form CPO-PQR, but is required to include such Pools on NFA Form PQR. In addition, Pools for which the CPO was not required to be registered more generally should not be included in determining the amount reported on Box 0155 of Schedule A to Form CPO-PQR as the "Highest Total Aggregated Pool Assets Under Management."

Multiple Participant Classes with Differing Investment Strategies. The Responses clarified that if multiple classes of a Pool are each engaged in differing trading strategies and a participant in the Pool cannot participate in each of the classes, then the CPO must report on the performance and risks for each investment strategy of the participant classes. However, if all of the participants invest in the various investment strategies, the Responses stated that the CPO is permitted to report on the performance of the Pool as a whole.

Parallel Managed Accounts. The Response clarified that a CPO should include all managed accounts or other pools of assets that the CPO operates and that pursue substantially the same investment objectives and strategy and invest side-by-side in substantially the same assets as the identified Pool ("**Parallel Managed Accounts**") in determining whether it meets a reporting threshold. Unlike Form PF, according to the Responses, Form CPO-PQR is not limited to "dependent" Parallel Managed Accounts and no references to Parallel Managed Accounts should be read with such limitation. Additionally, the Responses stated that CPOs should aggregate Parallel Managed Accounts with the Pool that has the largest assets under management to which the Parallel Managed Accounts relate. If a CPO is reporting on a Pool as part of a "Master-Feeder Arrangement" (as defined in Form CPO-PQR), then it should report on such Pool in accordance with Instruction #4's fund-of-funds requirements.

Parallel Pool Structures. The Response also clarified that Pools that are part of any structure in which one or more Pools pursues substantially the same investment objective and strategy and invests side-by-side in

substantially the same assets (a "**Parallel Pool Structure**") must be reported separately, and a CPO should aggregate Parallel Pool Structures only to determine whether such CPO meets the reporting thresholds. The definition of a Parallel Pool, according to the Responses, should be read consistently with the definition of "Parallel Pool Structure."

- **See a copy of the Responses**

ILPA Proposes Fee Reporting Template for Public Comment

On October 22, 2015, the Institutional Limited Partners Association ("**ILPA**") proposed a template for the reporting of private equity firms' fees and expenses (the "**Fee Reporting Template**"). The proposed Fee Reporting Template includes disclosure on a number of items, including fees, expenses and incentive compensation paid to private equity managers and their affiliates. According to ILPA, the Fee Reporting Template is intended to promote "increased uniformity in the fee disclosures being provided to [private equity investors]" by (1) reducing the burden of compliance on managers by standardizing the template for reporting and (2) providing investors with an improved set of information to help streamline analysis and internal decision making.

The proposed Fee Reporting Template includes itemized disclosure of Advisory Fees, Broken Deal Fees, Transaction & Deal Fees, Directors Fees, Monitoring Fees, Organizational Costs, Placement Fees and Capital Markets Fees, along with the percentage offsets to the management fee paid by the investor. It also includes reporting on partnership expenses and management fees gross and net of offsets, waivers and rebates.

The proposed Fee Reporting Template also includes disclosure of detailed, periodic balances of all incentive compensation paid to the manager and its related parties, including the change in accrued incentive compensation that would be paid to the manager upon realization of all remaining investments in a fund at their current carrying value. It also includes information on manager compensation received from other sources, such as portfolio companies and affiliated entities. All disclosures in the proposed Fee Reporting Template are made at the level of the individual investor and reported for the current quarterly period, the trailing 12 months and since inception.

The proposed Fee Reporting Template also includes a supplemental fund-of-funds template, which includes additional disclosure such as all monies paid in respect of the fund of fund's underlying fund commitments. In addition, the proposed Fee Reporting Template includes a definitions annex, and ILPA has acknowledged that the definitions provided could differ from certain fund limited partnership agreements. ILPA suggested that if this were the case, managers should use "best efforts" to adapt the template to conform to their agreements. ILPA also acknowledged that there has been concern from managers about the extent to which information reported on the proposed Fee Reporting Template would be subject to state freedom of information statutes. ILPA indicated that its guidance will evolve as feedback from the industry is received.

ILPA had previously issued reporting guidelines in 2011 indicating that it did not expect managers' reports to be in the exact format of the 2011 template. However, according to the FAQs accompanying the proposed Fee Reporting Template, ILPA now expects all managers, including managers of fund-of-funds, to provide the information in the Fee Reporting Template to their investors.

ILPA has asked for comments on the Fee Reporting Template by December 11, 2015. ILPA plans to publish final guidance, along with recommendations on fee reporting and compliance disclosure best practices, on January 29, 2016.

- **See a copy of the Fee Reporting Template**

Litigation

SEC Charges UBS Advisory Firms for Failing to Disclose Change in Investment Strategy

On October 16, 2015, the SEC issued an order (the "**Order**") instituting and settling administrative and cease-and-desist proceedings against UBS Willow Management L.L.C. ("**UBS Willow Management**") and UBS Fund Advisor L.L.C. ("**UBS Fund Advisor**" and, collectively with UBS Willow Management, the "**Respondents**") for failing to disclose a material change in the investment strategy of UBS Willow Fund L.L.C. (the "**Fund**"), a closed-end fund advised by the Respondents.

According to the Order, UBS Willow Management offered the Fund to investors from 2000 to 2012 and marketed it as a product that invested in distressed debt, a strategy based on the view that debt would increase in value. In 2008, according to the SEC, the Fund started purchasing credit default swaps, a strategy based on the view that debt would decrease in value. The SEC alleged that UBS Willow Management failed to adequately disclose the change in investment strategy and the related risks to the Fund's board of directors. In addition, according to the Order, UBS Willow Management continued to distribute the Fund's original offering memorandum and marketing brochure to prospective investors, without making any updates to reflect the new strategy. Moreover, according to the SEC, UBS Willow Management did not adequately disclose the change in investment strategy in the Fund's registration statement, annual shareholder report or Forms N-CSR. The SEC stated that UBS Fund Advisor had contractual control and supervisory authority over UBS Willow Management at all times.

The SEC alleged that UBS Willow Management's misrepresentations to potential investors in the offering memorandum and marketing brochure constituted willful violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act of 1933 (the "**Securities Act**"), which prohibit making untrue statements of material fact or material omissions in the offer or sale of securities and engaging in a course of business which operates as a fraud or deceit in the offer or sale of securities. According to the SEC, by failing to inform the Fund's board of directors of the change in investment strategy, UBS Willow Management violated Section 206(2) of the Investment Advisers Act of 1940 (the "**Advisers Act**"), which prohibits an investment adviser from engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client. In addition, the SEC stated that as a result of its misrepresentations to investors, UBS Willow Management willfully violated Section 206(4) of the Advisers Act and Rules 206(4)-8(a)(1) and 206(4)-8(a)(2) thereunder, which prohibit an adviser to a pooled investment vehicle from making any false or misleading statement of material fact to any investor or prospective investor and engaging in any act, practice or course of business that is fraudulent, deceptive or manipulative with respect to any investor or prospective investor in the pooled investment vehicle. Furthermore, according to the SEC, UBS Willow Management caused the Fund to violate Section 34(b) of the Investment Company Act of 1940 (the "**Investment Company Act**"), which generally prohibits an investment adviser from making fraudulent material statements or omissions in a registered investment company's registration statement, and to violate Rule 8b-16 thereunder, which generally requires that a material change in a registered investment company's investment objectives be disclosed in either an amended registration statement or in the annual shareholder report. Finally, the SEC stated that UBS Fund Advisor failed to supervise UBS Willow Management or prevent its violations of federal securities laws.

The Respondents agreed to settle the charges without admitting or denying the SEC's findings. The SEC censured the Respondents and ordered them to pay a $3,000,000 civil money penalty. Further, the SEC ordered the Respondents to pay disgorgement of $8,223,110 and $1,373,436.74 of prejudgment interest.

- **See a copy of the Press Release**
- **See a copy of the Order**

SEC Charges Affiliated Broker-Dealer and Investment Adviser with Failing to Prevent Misuse of Material Nonpublic Information

On October 8, 2015, the SEC issued an order (the "**Order**") instituting and settling administrative and cease-and-desist proceedings against Wolverine Trading, LLC ("**WT**"), an Illinois broker-dealer, and Wolverine Asset Management, LLC ("**WAM**"), an Illinois registered investment adviser and an affiliate of WT, for repeatedly sharing with each other material, nonpublic information and thereby failing to enforce policies and procedures reasonably designed to prevent the misuse of material, nonpublic information. According to the Order, these actions constituted willful violations of Section 15(g) of the Securities Exchange Act of 1934, as amended (the "**Exchange Act**"), on the part of WT, and Section 204(A) of the U.S. Investment Advisers Act of 1940, as amended (the "**Advisers Act**"), on the part of WAM. According to the SEC, these violations also revealed WT's and WAM's failure to maintain adequate written policies and procedures, as their firms' policies included numerous vague provisions regarding, and did not offer sufficient guidance, monitoring or surveillance with respect to, potential information sharing.

According to the SEC, WT and WAM repeatedly violated their firms' policies and procedures by sharing trade position information and strategies in connection with TVIX, an exchanged-traded note issued by Credit Suisse AG ("**CS**"). According to the Order, on February 21, 2015, CS announced a temporary suspension of new issuances of TVIX, which over the course of a month resulted in TVIX's market price trading at a significant premium as compared to its indicative value. The SEC asserted that, during the suspension period, WT shared with WAM information about its trading positions, activities and strategies with respect to TVIX, and WAM shared information with WT regarding its plan to enter into a swap and request the creation of TVIX notes. This information sharing, according to the Order, took the form of email correspondence, conference calls and in-person meetings between representatives of WT and WAM, thereby revealing the firms' failure to enforce its policies and procedures with respect to information barriers.

Under Section 15(g) of the Exchange Act, a broker-deal is required to establish, maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of such broker's or dealer's business, to prevent the misuse of material, nonpublic information by such broker or dealer or any person associated with such broker or dealer. Further, under Section 204A of the Advisers Act, a registered investment adviser must establish, maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of such investment adviser's business, to prevent the misuse of material, nonpublic information by such investment adviser or any person associated with such investment adviser. The SEC found that both WT and WAM willfully violated Section 15(g) of the Exchange Act and Section 204A of the Advisers Act, respectively, through their failure to enforce effective policies and procedures to prevent their sharing of material, nonpublic information.

WT and WAM agreed to settle the charges without admitting or denying the SEC's findings. The SEC censured WT and WAM, and both firms were ordered to pay a $375,000 civil money penalty. Further, the SEC ordered WAM to pay disgorgement of $364,145.80 and $39,158.47 of prejudgment interest.

- **See a copy of the Press Release**
- **See a copy of the SEC Order**

SEC Charges Three Blackstone Advisers with Disclosure Failures

On October 7, 2015, the SEC issued an order (the "**Order**") instituting and settling administrative and cease-and-desist proceedings against Blackstone Management Partners L.L.C., Blackstone Management Partners III L.L.C. and Blackstone Management Partners IV L.L.C. (together, "**Blackstone**") for disclosure-related violations under Sections 206(2) and 206(4) of the Investment Advisers Act of 1940, as amended (the "**Advisers Act**") and Rules 206(4)-7 and 206(4)-8 thereunder. The SEC charged

Blackstone in connection with its failure to fully disclose its receipt of accelerated monitoring fees and discounts it received on legal fees.

According to the Order, Blackstone generally entered into monitoring agreements with the portfolio companies held by the funds it advised, pursuant to which Blackstone provided consulting and advisory services to the portfolio companies in exchange for an annual fee. Blackstone received these fees in addition to the management fee it received that was paid by the limited partners of the funds it advised (although, in some cases, the monitoring fees partially offset the management fees). According to the SEC, the monitoring arrangements allowed for the fees to be accelerated upon the occurrence of certain triggering events, such as the sale or initial public offering of the company. When such events occurred, payment of fees for the remaining term of the agreement would become due and payable as "termination payments." The SEC asserted that although Blackstone disclosed the monitoring arrangements in various documents provided to investors before their commitment to the relevant fund, it did not disclose its practice of accelerating the monitoring fees until after it had already received such fees. The SEC found that the practice of accelerating payments while the Blackstone-advised funds held an ownership stake in the portfolio company effectively reduced the amounts distributable to limited partners because it diminished the portfolio company's assets when such portfolio company was sold or taken public. The SEC stated that Blackstone did not disclose this practice to the funds, the limited partner advisory committees of the funds or the limited partners of the funds until the limited partners had already committed capital and Blackstone had received the accelerated fees.

In addition, the SEC found that Blackstone negotiated a unitary legal services agreement with an outside law firm whereby the discount on legal feels received by Blackstone was much greater than that received by funds it advised. The fee arrangement, negotiated in late 2007, remained in place until early 2011 when an internal audit caused Blackstone to end the arrangement. It was replaced by a task-based fee structure with equal discounts for Blackstone and the funds it advised. According to the SEC, Blackstone did not disclose to limited partners the different discounts that had previously been in place until August 2012.

Investment advisers are prohibited under Section 206(2) of the Advisers Act from engaging in any transaction, practice or course of business which operates as a fraud or deceit upon any client or prospective client. Section 206(4) under the Adviser Act and Rule 206(4)-8 thereunder generally prohibit investment advisers from making any untrue statement of material fact or omitting a material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading to any investor or prospective investor. The SEC alleged that Blackstone violated Sections 206(2) and 206(4) of the Investment Advisers Act and Rule 206(4)-8 thereunder by failing to inform investors about the full extent of its receipt of accelerated monitoring fees and the benefits of the discounts it received that the funds it advised did not. In addition, the SEC found that this conduct violated Section 204(4) of the Advisers Act and Rule 206(4)-7 thereunder, which require investment advisers to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act.

Blackstone agreed to settle the charges without admitting or denying the SEC's findings. The SEC censured Blackstone and ordered it to pay a civil money penalty of $10 million, to disgorge $26.5 million of unlawful gains and to pay $2.6 million in prejudgment interest.

- **See a copy of the Press Release**
- **See a copy of the SEC Order**

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