UPCOMING REGULATORY INITIATIVES IMPACTING PRIVATE FUND MANAGERS

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Dechert LLP

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Upcoming Regulatory Initiatives Impacting Private Fund Managers

October 2020 / Authored by Gus Black, Katie Carter, Fiona Chandler, Richard Frase, Christopher Gardner, Philippa List, Mark Stapleton, Karen Stretch, Lindsay Trapp, Simon Wright

1. ESG

In recent years, environmental, social and governance (**ESG**) factors have become a key discussion point in the asset management industry, with many managers now incorporating ESG considerations into their investment processes. It is a topic that continues to gain global importance. In the EU, the impetus stems primarily from the EU Sustainable Finance Action plan and remains on the top of the regulatory agenda. There have been some key developments taking the form of new legislation and amendments – proposed and actual – to existing legislation.

Of most significance are the Sustainable Finance Disclosure Regulation (**SFDR**) and the Taxonomy Regulation which impact "Financial Market Participants" (**FMPs**) (which includes amongst others AIFMs, UCITS ManCos, Portfolio Managers/Advisors) in relation to "Financial Products" (which includes amongst others AIFs, UCITS and segregated investment management mandates). The SFDR impacts both firms and products and requires three types of disclosure - website disclosure, pre-contractual disclosure and periodic reporting. It will require FMPs to make significant changes to their current processes.

BREXIT - Although the legislation has passed into law, it will only start to take effect from 10 March 2021 – which is after the end of the "transition period" (scheduled to be 11.00 p.m. on 31 December 2020), and consequently will not be 'on-shored' in the UK as a piece of existing EU legislation. It remains to be seen whether the UK will diverge from the EU proposals, the UK government has stated that "*at the very least, we will match the ambition of the EU Sustainable Finance Action Plan*", but there is no detail as to what this means in practice.

In terms of other areas of law that have been or will be impacted by ESG, these include draft legislation and technical guidance proposing amendments to MiFID II (product governance/organisational requirements), amendments to the UCITS Directive and AIFMD and consultations on changes to the Non-financial Reporting Directive. Additional rules and regulations relating to sustainable development take the form of the EU Ecolabel framework for certain financial products and Green Bond Standards, together with local developments such as the AMF's recent ESG related Doctrine.

2. LIBOR

The London Interbank Offered Rate (**LIBOR**), a key interest rate benchmark that is referenced across many of the agreements that you, funds you manage or advise or entities that you have invested in, have entered into, is expected to cease to exist at the end of 2021. Whilst the UK is the home of LIBOR, this is a multi-currency, international issue as LIBOR is published in five currencies: USD, GBP, Euro, CHF and JPY. Alternative largely risk-free interest rates (the RFRs) have been identified as replacements for each of the LIBOR family of currencies: SONIA (GBP), SOFR (USD), SARON (CHF), €STR (EURO) and TONA (JPY).

Many regulators see the transition from LIBOR as a financial stability risk given the prevalence of LIBORs use in a multitude of agreements. Exposures to LIBOR can arise at every level of a business – investments, loans, hedges, fees, systems and infrastructure. With less than sixteen months to go, notwithstanding the disruption caused by the COVID-19 pandemic, achieving a smooth transition away from LIBOR benchmarks by 31 December 2021 remains a key priority for the FCA and other regulators.

There has been a notable recent increase in UK regulatory engagement in LIBOR related issues and market participants are actively being encouraged and indeed incentivised to move to alternative risk free rates. In the UK these efforts are being led by the Working Group on Sterling Risk-Free Reference Rates (**WGRFR**), the FCA and the Bank of England, and in the US by the ARRC. There has also been significant input from industry associations, in particular ISDA (as the vast majority of LIBOR exposure lies in derivatives products) and also the Loan Market Association.

In relation to regulation relating to benchmarks, on June 23 2020 the UK Government declared its intention to change the UK Benchmarks Regulation to permit changes to the methodology for determining LIBOR rates with a view to enabling LIBOR to continue to be used as a benchmark in certain limited circumstances. The FCA webpage explaining the extent of the proposals is available *here*. This was followed, on July 24 2020, by a European Commission proposal to amend the EU rules on benchmarks to empower the European Commission to designate a replacement benchmark that covers all references to widely used reference rates such as LIBOR when this is necessary to avoid a disruption of the financial markets.

Although these statements received a lot of attention and there was much speculation about what they may mean for LIBOR transition, the FCA is emphatic - it remains the central assumption that firms cannot rely on LIBOR being published after the end of 2021. The time to act is now.

We have a range of LIBOR resources available. Our most recent round-up on LIBOR is available *here*.

Our dedicated Dechert LIBOR site is available *here* and includes information on future update webinars and broadcasts. Of particular interest is our LIBORCast series where colleagues across Dechert offices have held discussion with key players such as ISDA, the FCA, and Fitch Ratings, to name a few.

3. Brexit

The UK formally left the EU at 11.00pm on 31 January 2020, and the UK and the EU have entered the withdrawal agreement's "transition period" designed to maintain the regulatory status quo between the UK and the EU until 11.00 p.m. on 31 December 2020. During the transition period, EU law continues to apply to and in the UK, and the UK will continue to be treated as part of the EU's single market in financial services – meaning that, until 31 December 2020, UK financial services firms will be able to access EU markets on the same terms and with the same rights and protections as before the withdrawal. This includes EU passporting rights, which will continue to apply during the transition period, meaning that UK firms accessing EU markets, and EU firms accessing UK markets, can continue to rely on passporting rights – just as they did prior to 31 January 2020. (See Dechert's OnPoint, "*Is Brexit Done? Eight Things UK Managers Need to Know About the Brexit Transition Period*" available *here.*)

The UK and EU are working to negotiate a free trade agreement (**FTA**) covering financial services (along with other areas) before 31 December 2020, but it remains to be seen whether an FTA can be agreed before the end of the transition period. If the EU and the UK are unable to reach an agreement on financial services by 11.00 p.m. on 31 December 2020 and if there is no extension to that period, then the issues facing financial services firms are effectively the same as those faced in a "no deal" Brexit.

The UK government and the FCA are proposing to implement a Temporary Permissions Regime (**TPR**) for "inbound" European Economic Area (**EEA**) firms and funds at the end of the transition period. The aim of the TPR is to allow inbound firms to continue operating in the UK within the scope of their current permissions for a limited period after the end of the transition period, while seeking full UK authorisation if necessary. It will also allow investment funds with a passport to continue temporarily marketing in the UK.

Although the window for firms and fund managers to notify the FCA that they want to use the TPR is currently closed, the FCA plans to re-open the notification window on 30 September 2020, which will allow additional notifications to be made by firms and fund managers before the end of the transition period.

Looking to the future of UK financial services regulation after the end of the transition period, HM Treasury announced in July 2020 that it intends to publish a consultation paper in autumn 2020 on the future regulatory framework for financial services, including consultations on how regulators should operate in dealing with technical standards, how policy innovation from HM Treasury and Parliament is scrutinised, and how that interacts with regulators' responsibilities.

4. European Regulatory Initiatives

4.1. AIFMD Marketing/Pre-marketing

Changes to EU law on the cross-border distribution of AIFs and UCITS will come into effect on 2 August 2021. UK AIFMs will be out of scope of the majority of these new rules, as they only apply to EU AIFMs marketing EU AIFs.

The changes introduce a definition of and conditions for pre-marketing of EU AIFs by EU AIFMs. National private placement regimes will continue to apply to marketing by non-EU AIFMs and the new pre-marketing rules will not apply to non-EU AIFMs. Conditions and de-notification requirements will also apply when marketing of an AIF / UCITS by an EU AIFM or Manco ceases in a particular EU member state.

All AIFMs will have to establish certain local facilities when marketing to retail investors. The facilities will not however need to be a physical presence in a country and may be run by a third party.

From 2 August 2021, marketing materials for AIFs and UCITS must be identifiable as such, describe the potential risks and rewards of purchasing units or shares in UCITS/AIFs in an equally prominent manner and all information included in marketing communications must be fair, clear and not misleading.

4.2. Further AIFMD developments

Liquidity stress testing: ESMA guidelines on liquidity stress testing in UCITS and AIFs will apply from 30 September 2020. The guidelines apply to fund managers, depositaries and national competent authorities and aim to increase the standard, consistency and frequency of liquidity stress testing already undertaken. The guidelines should be adapted to the nature, scale and complexity of a fund.

Leverage risk: ESMA is also working on guidelines to address leverage risk, following a consultation paper it issued in March 2020 on how the leverage-related systemic risk assessment should be conducted and when leverage limits might be imposed.

In Q3 2020 the European Commission is also expected to consult on AIFMD following its report in June assessing the application and scope of the legislation. The report set out that the European Commission is still assessing whether there is a need for any amendments to the AIFMD at this stage.

4.3. Capital Markets Union Action Plan

As part of this ongoing initiative to strengthen EU capital markets, the European Parliament and Council of the EU are due to consider a new EU directive on credit servicers and credit purchasers during 2020. The aim of the directive is to encourage the development of a secondary market for non-performing loans in the EU. The European Commission is also due to publish its action plan on the Capital Markets Union in September 2020.

4.4. CSDR

The new settlement discipline regime requirements under the Central Securities Depositories Regulation (**CSDR**) have been delayed due to the disruption caused by the COVID-19 pandemic, with ESMA now considering a 1 February 2022 deadline. The UK government announced in June that it would not be implementing the CSDR settlement discipline regime in the same form in the UK, following Brexit.

4.5. ELTIF Reform

The ACC has been active in lobbying for reform of the existing European Long-term Invest Fund (**ELTIF**) Regulation. The ACC submitted a position paper in March 2020, the aim of which was to highlight to policymakers areas where the ELTIF Regulation might be reformed, and use this to support engagement with the CMU review and other discussions relating to the policy framework for private credit in Europe.

In June the EU's High Level Forum on the Capital Markets Union (**HLF**) published its *final report* which took up the ACC's suggestions on ELTIF reform and a number of other proposals along with timelines such as:

- Revise the securitisation framework to further free up bank balance sheets and to make it easier for insurers to invest in securitisations by improving the capital treatment of securitised assets vs non-securitised assets;
- harmonise withholding tax (**WHT**) definitions, processes, forms and introduce a standardised system for WHT relief at source; and
- set up a European Single Access Point (**ESAP**) for company data, including for non-listed companies and SMEs allowing for easy access by managers and investors.

For ELTIFs, a legislative proposal is expected by the end of 2020. This timeline is that of the HLF, not that of the European Commission so it is not certain that the proposals will indeed be taken up or taken up in the timeline suggested. However, given the role of the European Commission in the discussions, it is highly unlikely that the European Commission would ignore the key recommendations entirely.

4.6. EMIR

Regulatory reporting. ESMA is due to issue a final report on new draft implementing technical standards for reporting under the European Markets and Infrastructure Regulation (EMIR), by the end of 2020. The report follows a consultation earlier this year on Technical Standards on reporting, data quality, data access and registration of trade repositories pursuant to EMIR, as amended by the EMIR Refit Regulation and the reporting responsibility changes introduced by the EMIR Refit Regulation which took effect on 18 June 2020.

Please see our OnPoint for further details of the reporting changes under the EMIR Refit and their impact, available *here*.

Initial margin. Phase 5 of the EMIR regulatory initial margin requirements will take effect on 1 September 2021. Entities in scope will have an aggregate average aggregate notional amount, so called "AANA" threshold of EUR 50bn by reference to March, April and May 2021. Phase 6 will follow on 1 September 2022 and the relevant AANA threshold for the final phase is EUR 8bn.

4.7. MiFID II "quick fix" and CRR amendment proposals

In July the European Commission published draft proposals for "quick fix" updates to MiFID II, as part of its ongoing review of the regime and a capital markets recovery package in light of the COVID-19 pandemic. The proposals include:

- changes to certain information requirements, including phasing out paper based default methods of communication, introducing an exemption from the costs and charges information for eligible counterparties and professional clients for services other than investment advice or portfolio management, and suspending best execution reports
- amending the scope of position limits in commodities markets so that they only apply to agricultural commodity derivatives and significant or critical commodity derivatives
- a new narrow hedging exemption for financial entities from the position limits regime
- 10% portfolio loss reports will no longer be mandatory for professional clients.

The European Commission also issued proposals for consultation (which closed in early September) to introduce changes to the requirements for research which is exclusively on small and mid-cap issuers or fixed income instruments.

The European Commission is targeting the end of 2020 for approval of these changes.

The European Commission also adopted a legislative proposal in June to amend the Capital Requirements Regulation to adjust the securitisation framework which may impact investment managers and their funds indirectly, with the next step being to agree the legislative text. Three amendments are proposed with the aim of making securitisation more viable for institutions:

- providing for a more risk-sensitive treatment for simple, transparent and standardised on-balance-sheet securitisation
- removing the current regulatory constraints to the securitisation of non-performing exposures
- amending the minimum credit rating requirement for providers of unfunded credit protection.

4.8. Short selling position reporting

ESMA's intervention to temporarily lower the threshold for regulatory reporting of a net short position in shares traded on an EU regulated market to 0.1% from 0.2% during the COVID-19 pandemic has been extended and will now expire on 18 December 2020. Given the ongoing disruption caused by the pandemic, similar restrictions could also be introduced in other jurisdictions over the coming months at short notice.

4.9. SFTR

The first phase of the new reporting requirement under the Securities Financing and Transaction Regulation (**SFTR**) went live on 13 July 2020, having been postponed from April 2020 due to the COVID-19 pandemic. Key upcoming dates are:

11 October 2020: the SFTR reporting obligation under the SFTR commences for financial counterparties (FCs) including UCITS and AIFs and in-scope third country entities not caught by the first phase in July.

11 January 2021: the SFTR reporting obligation commences for non-financial counterparties.

Once the uncertainty and disruption caused by the COVID-19 pandemic eases, we expect to see further focus on regulatory reporting requirements at EU level, including under SFTR. As we originally reported in our May 2019 EMIR note, available *here* , European authorities are seeking to improve reporting standards generally, with "harmonisation" and "effectiveness and efficiency" being strong themes. This is likely to lead to further developments.

Further ongoing work being undertaken during 2020 includes the European Commission review of the effectiveness and proportionality of the SFTR, ESMA's consultation on guidelines on the calculation of positions under the SFTR, which closed in mid-September, and ESMA's report to the European Commission on fees charged to trade repositories. Please see our updates on SFTR available *here* and *here* .

5. UK Regulatory Initiatives

5.1. Financial Services Bill

The UK's departure from the EU at the end of the transition period will have significant implications for the regulation of financial institutions. The UK government intends to bring forward the Financial Services Bill 2019-21 (**FS Bill**) to establish permanent statutory frameworks for certain aspects of financial services regulation that will apply following the end of the Brexit transition period.

In June 2020, the UK government issued a policy statement providing information on proposals for the FS Bill, including information on how the UK government will tailor these prudential regimes to the specifics of the UK market. Consultation papers and other policy documents containing details of the key reforms that the UK government intends to include in the FS Bill have been published.

5.2. Proposals for an 'overseas funds regime'

Connected to the end of the transition period, HM Treasury also consulted on proposals to simplify the process for allowing investment funds set up overseas to be marketed in the UK (**OFR**). The consultation set out the UK government's proposal for a new process for allowing investment funds domiciled overseas to be sold to UK investors, to replace the existing regime.

The proposed 'overseas funds regime' will introduce two new regimes based on the principle of equivalence: one for retail investment funds and one for money market funds. Under the current proposals, HM Treasury will make a decision, based on advice from the FCA on whether to grant equivalence to a country. Once equivalence is granted, individual funds from the relevant country that wish to market in the UK will need to register with or notify the FCA. The FCA will be given powers to register funds that request access to the UK under the OFR. Funds recognised under the OFR may be subject to obligations when marketing in the UK including disclosure rules, the provision of investor facilities in the UK, regular reporting to the FCA and payment of regulatory fees.

Important to note, funds which are domiciled in non-EEA countries can also become individually recognised in the UK under the process set out in section 272 of Financial Services and Markets Act 2000. Under the current proposals, section 272 will not be repealed, but will continue to be available for individual funds that are not eligible to be recognised through the OFR because they are not covered by an equivalence determination for retail investment funds. The UK government proposes to make some minor amendments to section 272 to make it more efficient for the industry and the FCA.

The UK government is currently analysing the feedback it received.

5.3. UK government to undertake a review of the UK funds regime

In the spring 2020 Budget, the UK government announced that it will undertake a review of the UK funds regime to ensure its continued competitiveness and sustainability. The first stages are a review of the VAT treatment of fund management fees and a consultation on the tax treatment of asset holding companies in fund structures to make the UK a more attractive location for such companies.

The consultation focussed on whether there are tax changes that could help make the UK a more attractive location for companies used by alternative funds to hold assets. It closed in August 2020 and the UK government is currently analysing the feedback it received.

5.4. FCA to consult on UK prudential regime for investment firms

The IFPR is a revised prudential regime for FCA-authorised investment firms that the UK government intends to establish by summer 2021. It will be based on the Investment Firms Regulation (**IFR**) and the Investment Firms Directive (**IFD**) which establish a new prudential framework for EU investment firms, which HM Treasury and the FCA will adapt to reflect the UK investment firms sector. The IFPR will largely replace the existing prudential requirements for FCA MiFID investment firms. Its introduction will necessitate the amendment or deletion of existing legislation and regulation relating to these requirements.

In its June 2020 policy statement on prudential standards in the FS Bill, HM Treasury stated that it intends to consult publicly on the IFPR “in due course” with a view to introducing the new regime by summer 2021. The FCA intends to publish a consultation paper on the IFPR before the end of 2020.

The FCA published a discussion paper (**DP 20/2**) in June and will use the results of the feedback to inform its development of the new UK prudential regime for investment firms. Comments on DP 20/2 should be submitted by 25 September 2020.

5.5. FCA is continuing to assess the impact of remedies from its asset management market study (AMMS) and is specifically examining consumer disclosures

On 7 April 2020, the FCA published its 2020/21 business plan, which sets out its business priorities for the year ahead. The FCA’s immediate focus was to address the challenges presented by the COVID-19 pandemic.

In the field of Investment Management, the FCA stated that it would continue to assess the impact of remedies from its 2017 Asset Management Market Study (**AMMS**). The AMMS was a competition-based market study carried out by the FCA to understand how UK asset managers compete to deliver value to retail and institutional investors. Following the study, the FCA proposed a package of remedies in its final report to make competition work better in the UK asset management market. The proposals aimed to:

- help provide protection for investors who are not well placed to find better value for money;
- drive competitive pressure on managers; and
- help improve the effectiveness of intermediaries.

For 2020/21 the FCA is due to review industry progress in relation to investment platforms and the provision of information about costs and charges following the market study.

5.6. PRIIPS

The EU PRIIPs Regulation has applied across the EU since 1 January, 2018.

The PRIIPS Regulation sets the requirements for a standardised disclosure document, known as the Key Information Document (**KID**) that must be provided to retail investors when they purchase particular packaged investment products, known as PRIIPs.

The PRIIPs Regulation, like other EU legislation that is directly applicable, will form part of UK law at the end of the transition period, and will be amended so that it operates effectively after Brexit.

In June 2020, the UK government announced plans to introduce legislation to improve the functioning of the PRIIPs regime in the UK and it followed this up in July 2020 with a policy statement (available *here*) that contained information on three proposed amendments to the UK framework:

- Clarification of the scope of the UK PRIIPs Regulation - there is currently significant uncertainty in industry as to the precise scope of PRIIPs. The proposed amendment would delegate to the FCA to clarify the scope of the UK PRIIPs Regulation through its rules, enabling the FCA to address existing, and potentially future, ambiguities relating to certain types of investment product. The definition of a PRIIP would remain unchanged.
- Replacement of "performance scenario" with "appropriate information on performance" in UK PRIIPs Regulation. The current methodology for calculating these scenarios has been criticised for producing misleading performance scenarios across a wide range of products. The proposed amendment would enable the FCA to amend the UK PRIIPs KID Delegated Regulation to clarify what information on performance should be provided in the KID.
- Further extension of the current UCITS exemption. UCITS funds are exempted from the requirements of the PRIIPs Regulation until 31 December 2021. Until that date, instead of a KID, UCITS funds must produce a Key Investor Information Document (**KIID**) per the requirements of the UCITS Directive. The proposed amendment would delegate a power to HM Treasury to further extend the exemption for UCITS for up to five years.

In terms of timing, there is nothing concrete, merely a statement that HM Treasury intends to legislate for these amendments when parliamentary time allows.

The UK government also announced that, in the longer term, it intends to conduct a more wholesale review of the disclosure regime for UK retail investors. The wider review will explore, for example, how to harmonise the PRIIPs regime with requirements in MiFID II.

5.7. HM Treasury proposals to amend the financial promotions approval regime

In July, HM Treasury announced a consultation on limiting the scope of firms that can approve the financial promotions of unauthorised persons. The term "financial promotion" describes the communication of an invitation or inducement to engage in investment activity. Section 21 of the Financial Services and Markets Act 2000 (or FSMA) provides that a firm must not, in the course of business, communicate a financial promotion unless the firm is FCA-authorised or the content of the communication is approved by an authorised firm (subject to certain exemptions).

The problem that HM Treasury is seeking to address relates to the role of an authorised firm approving a financial promotion that an unauthorised firm wishes to communicate.

The Consultation proposes the creation of new gateway by which a firm would first need to obtain specific consent from the FCA before it was able to approve the financial promotions of unauthorised persons.

HM Treasury has proposed two options for the 'gateway':

1. Option 1 - all authorised firms are subject to a requirement that they may not approve promotions of unauthorised persons, and firms must apply to the FCA to remove or vary the requirement; or

2. Option 2 - approving financial promotions of unauthorised persons is a regulated activity for which a specific permission is needed.

The UK government's preference is Option 1 as it would represent a less significant change to the current regulatory framework and treatment of financial promotions.

The 'gateway' proposal would not affect the way authorised firms communicate their own financial promotions, approve their own promotions for communication by unauthorised persons, or approve the promotions of unauthorised persons within the same corporate group.

The consultation closes on 25 October 2020.

The Consultation was covered in the "AIMA Regulatory Deep Dive Programme – UK", presented by Dechert. For more information, please click *here*.

5.8. HM Treasury proposes expansion of financial promotion regime to include cryptoassets

HM Treasury launched a second *consultation* in July setting out proposals to expand the perimeter of the financial promotion regime to bring the promotion of certain types of unregulated cryptoassets within its scope. This consultation and the consultation on the approval of financial promotions of unauthorised firms (see 5.7 above) should be read together.

The UK government is of the view that many types of unregulated cryptoassets (that is, exchange tokens and utility tokens) expose consumers to "unacceptable levels of risk" as well as raising issues of market integrity and giving rise to financial crime risks.

To address these concerns, the UK government proposes to make changes to bring certain activities in relation to cryptoassets within the financial promotion regime. Not all cryptoassets would be caught in the proposed expansion of the financial promotion regime as the UK government considers that applying the financial promotion regime to too wide a range of cryptoasset activity could stifle innovation without a proportionate benefit to consumer protection.

The deadline for responses to the consultation is 25 October 2020.

6. US Regulatory Initiatives

6.1. SEC Risk Alert in relation to Private Fund Advisers and Exam Focus

The Staff of the Securities and Exchange Commission's (**SEC**) Office of Compliance Inspections and Examinations (**OCIE** or **staff**) issued a National Exam Program Risk Alert on 23 June 2020 (**Risk Alert**). The Risk Alert focuses on advisers that manage private equity funds or hedge funds (**private funds**), and highlights deficiencies observed by the Staff that "may have caused investors in private funds ... to pay more in fees and expenses than they should have or resulted in investors not being informed of relevant conflicts of interest concerning the ... adviser and the fund." Despite the SEC's focus under Chairman Clayton on retail investors, the Risk Alert exemplifies OCIE's continued efforts to regulate advisers to private funds, and is intended to assist private fund advisers in improving their compliance programs, as well as investors in their diligence of such advisers.

The Risk Alert identifies three "general areas of deficiencies": conflicts of interest; fees and expenses; and policies and procedures related to material nonpublic information (**MNPI**). These categories are not new to private fund managers as they are largely in line with those categories on which OCIE focused during its initial Presence Exam Initiative in October 2012 to assess the private fund industry. Since that time, high-profile speeches by senior SEC Staff have re-emphasized many of those same areas, in particular conflicts of interest, fees, expenses, valuation and co-investment allocation. More recently, in OCIE's 2020 examination priorities, the Staff stated that examinations will "assess compliance risks, including controls to prevent the misuse of material, non-public information and conflicts of interest, such as undisclosed or inadequately disclosed fees and expenses, and the use of ... affiliates to provide services to clients." These examination priorities also discuss side-by-side management of mutual funds and private funds.

For further information on the Risk Alert please see our *OnPoint*.

6.2. Amendments to Definitions of Accredited Investor and Qualified Institutional Buyer

In late August 2020, the SEC adopted its final rules in relation to an expanded definition of Accredited Investor and conforming changes to the definition of Qualified Institutional Buyers.

New Categories of Accredited Investor

Those persons that hold certain professional certifications that demonstrate a background and understanding of securities and investing are now capable of being Accredited Investors. An SEC order issued in conjunction with the final rules confirmed that those holding Series 7, 65 or 82 licenses will qualify, provided they are currently in good standing. These categories can be amended by the SEC in separate orders, making the addition of new categories simpler than rule amendments.

"Knowledgeable Employees" of private funds are now able to qualify as accredited investors for investment in the relevant fund. The definition of "Knowledgeable Employee" is the same as Rule 3c-5(a)(4) of the Investment Company Act of 1940 (**1940 Act**). This addition eliminates the requirement that knowledgeable employees that received the relevant exemption under the 1940 Act independently meet the accredited investor definition in order to invest in a 3(c)(1) or 3(c)(7) fund.

Expansion to Permit Certain Persons/Entities

The definition of Accredited Investor also has been expanded to include:

a) The pooling of income from "Spousal Equivalents" (cohabiting persons occupying a relationship generally equivalent to that of a spouse) for the purposes of the net worth tests;

b) Investment advisers that are registered under Section 203 of the Investment Advisers Act of 1940 (**Advisers Act**), investment advisers registered under state laws in the U.S. and investment advisers that utilize the exemptions under Sections 203(m) and 203(l) of the Advisers Act (**private fund adviser** and **venture capital fund adviser**, respectively);

c) Rural Business Investment Companies (**RBICs**);

d) Limited liability companies (**LLCs**) with total assets that exceed $5 million;

e) Certain family offices and family clients (those meeting the definition in the Advisers Act (i) with more than $5 million in assets under management; (ii) that are not formed for the purpose of investing in the offered securities; and (iii) whose prospective investments are directed by individuals who have knowledge and experience in financial and business matters); and

f) Certain entities, such as Native American tribes and governmental bodies, that meet an "investments" test rather than "assets" test. Such entities must have $5 million in investments owned.

Qualified Institutional Buyers

The amendments include certain conforming changes to Rule 144A (which provides a safe harbor for certain resales of restricted securities to qualified institutional buyers (**QIBs**) from the registration requirements of the Securities Act), to ensure that there are not inconsistencies between the entity types available for Accredited Investors and QIB status. In addition, a new category has been added to permit certain institutional accredited investors (see (f) above) to automatically qualify as QIBs provided they meet the $100 million in owned and invested securities test in Rule 144A.

For further information, please see our client alert on the rule proposals *here*.

6.3. Application of Statutory Disqualification Prohibitions to CPOs Exempt under CFTC Regulation 4.13

The Commodity Futures Trading Commission (**CFTC**) on 4 June 2020 unanimously approved an important final amendment to Regulation 4.13 under the Commodity Exchange Act (**CEA**). This amendment adds a new requirement that any person filing with the National Futures Association (**NFA**) a notice of exemption from registration as a CPO under Regulation 4.13(a)(1), (2), (3) or (5), or annually affirming such an exemption, must make a specified representation. The representation will provide that neither the person, nor any of the person's principals, has in its background a statutory disqualification that would require disclosure under Section 8a(2) of the CEA if such person sought registration (unless such disqualification arises from a matter disclosed in connection with a previous application for registration, where such registration was granted). The CFTC definition of a "principal" is as set forth in CFTC Regulation 3.1(a).

More information in relation to this and other updates from the CFTC is available in our *OnPoint.*

6.4. Proposed amendments to the SEC Advertising and Solicitation Rules

The SEC has proposed amendments to Rule 206(4)-1 – Advertisements by Investment Advisers (**Current Advertising Rule**) and Rule 206(4)-3 – Cash Payments for Client Solicitations (**Current Solicitation Rule**) under the Advisers Act, as well as technical amendments to Rule 204-2 (**Current Recordkeeping Rule**) and Form ADV, Part 1A (separately, **Proposed Advertising Rule** and **Proposed Solicitation Rule**, and collectively, **Proposal**). The Proposal was published in the Federal Register on 10 December 2019 with a comment period ending 10 February 2020; there has not been any further indication of timing in relation to the finalization of the updates.

The Proposed Advertising Rule, if adopted, would dramatically revise and modernize the regulatory framework for investment adviser and private fund marketing materials. It would replace the current set of rigid prohibitions (particularly those relating to testimonials and past specific recommendations) with a more flexible, principles-based approach, and would codify and rationalize the current patchwork of guidance provided through SEC enforcement actions and Staff no-action letters (particularly as these apply to performance presentation). Among other things, the Proposed Advertising Rule seeks to:

a) Bring the regulatory scheme into the 21st century and adapt it from primarily paper-based premises to a more technology-neutral basis that recognizes the realities of the Internet, social media and mobile applications;

b) Eliminate unnecessary or outdated requirements;

c) Distinguish in many key instances between retail and institutional investors with the intention of more appropriately calibrating the Current Advertising Rule's requirements to the differing needs of such investors; and

d) Rely more expressly on compliance policies and procedures, as well as additional reviews by advisers, than under the Current Advertising Rule.

While the changes in the Proposed Solicitation Rule are less fundamental, they also reflect a significant modernization of the Current Solicitation Rule with a more streamlined structure.

These changes, while mainly of concern to SEC-registered investment advisers, will also be relevant to managers that are not registered with the SEC, as the Advertising Rules are generally considered largely applicable via the "Anti-Fraud" provisions under Rules 206(4)-8 of the Advisers Act. For further information in relation to the proposed changes please see our *OnPoint*.

6.5. Proposed amendment to Rule 13f-1 and Form 13F

In July 2020, the SEC proposed amendments to Rule 13f-1 of the Securities Exchange Act of 1934 and the corresponding Form 13F which would dramatically raise the reporting threshold for institutional investment managers, from $100 million to $3.5 billion, to reflect the change in size and structure of the U.S. equities market since 1975, when Rule13f-1 was adopted. Rule 13f-1 and the corresponding Form 13F relate to required reporting by institutional investment managers of positions meeting the reporting thresholds of specified publicly traded equity securities. The proposed amendments would also amend Form 13F to increase the information provided by institutional investment managers by eliminating the omission threshold for individual securities, and requiring managers to provide additional identifying information. There are also additional proposed amendments to modernize the structure of data reporting and to take account of confidential treatment requests per recent U.S. Supreme Court jurisprudence.

The comment period for the proposal recently passed and it is notable that the New York Stock Exchange issued a commentary submission against the proposal on the basis that it would decrease transparency in the markets.

6.6. SEC Registration of UK Managers

Following the implementation of the European Union's (**EU**) General Data Protection Regulation (**GDPR**), non-US firms have been unable to register with the SEC as investment advisers pursuant to the Advisers Act because of concerns held by the SEC's Staff regarding the impact of GDPR on the cross-border transfer of data.

Specifically, the Staff's fears were based on the fact that provisions of GDPR seemed to prevent the Staff from obtaining prompt, direct access to the books and records of EU firms.

A number of industry groups have been involved in lobbying the SEC on behalf of their members to resolve this issue and find ways to address the SEC's concerns. The industry groups have actively encouraged a direct dialogue between the SEC and UK Information Commissioner's Office (**ICO**), which has met with success.

The ICO has provided comfort (believed to be in the form of a letter) to the SEC that UK firms can, according to the ICO's interpretation of GDPR, share any necessary data with the SEC without breaching the provisions of GDPR.

Although there has been no formal announcement, nor have copies of what the ICO may have sent to the SEC been made public, Peter Driscoll, Director of OCIE, stated at an industry event that took place on 15 September 2020 that the SEC is likely to begin registering UK firms as investment advisers very shortly.

The SEC's position only covers UK firms at this time, but we understand that other jurisdictions hope to obtain relief in the future.

6.7. Adoption of Amendments to Volcker Rule

The Office of the Comptroller of the Currency (**OCC**) , the Board of Governors of the Federal Reserve System (**Board**), the Federal Deposit Insurance Corporation (**FDIC**), the SEC and the CFTC (together, **Agencies**) on 25 June 2020 adopted a final rule (**Final Rule**) amending certain provisions of the regulations implementing the so-called "Volcker Rule." The Final Rule's amendments, which relate to the provisions of the regulations implementing the Volcker Rule (**Volcker Rule Regulations**) dealing with "covered funds," are substantially the same as those the Agencies proposed for comment earlier in 2020, although the Agencies made certain changes to the proposal in response to comments. The Final Rule will take effect on 1 October 2020.

With the Final Rule, the Agencies seek to: limit certain unintended consequences of the Volcker Rule Regulations; reduce their extraterritorial impact; and generally streamline the provisions relating to covered funds – while maintaining, and in some cases improving, consistency with the requirements and purpose of the Volcker Rule. The Final Rule includes a number of amendments which are covered in more detail our *OnPoint*, including:

a) New exclusions from the covered fund definition for credit funds, venture capital funds, family wealth management vehicles, and customer facilitation vehicles;

b) Revisions to existing exclusions from the covered fund definition for foreign public (retail) funds, loan securitizations, and public welfare and small business funds;

c) Modification of the definition of "ownership interest" under the Volcker Rule Regulations to clarify that: (i) an ownership interest in a covered fund does not include bona fide senior loans or senior debt instruments, and (ii) certain types of creditor rights do not give rise to an ownership interest;

d) Codification of an existing policy statement by the OCC, the Board, and the FDIC to address situations where a foreign fund that is not a covered fund could be deemed to be a banking entity;

e) Clarification that in certain circumstances, a banking entity is not required to treat investments by the banking entity or its directors or employees alongside a covered fund as investments by the banking entity in the covered fund itself; and

f) Modifications to the so called "Super 23A" provisions of the Volcker Rule to allow a banking entity to make certain short-term extensions of credit to covered funds advised or sponsored by their banking entity or its affiliates and engage in riskless principal transactions with such funds.

For further information, please do not hesitate to get in touch with a member of Dechert's financial services team or your usual Dechert contact.

Dechert's financial services advisory capability spans 16 jurisdictions including Ireland, Luxembourg, Germany, France and Belgium as well as throughout the United States, Middle East and Asia. Please visit dechert.com for further detail.

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