



K&L GATES



2018 SAN FRANCISCO INVESTMENT MANAGEMENT
CONFERENCE

Industry Updates / Hot Topics

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AGENDA

- SEC Fiduciary Rule – “Regulation Best Interest”
- California Privacy Laws
- Amendments to the SEC Advertising Rule and Cash Solicitation Rule
- GIPS 2020 Update
- Impact of Recent CFIUS Actions





REGULATION BEST INTEREST

REGULATION BEST INTEREST

- Dodd-Frank Section 913 directs SEC to study the implications of different standards for broker-dealers and investment advisers and adopt a uniform fiduciary standard
 - Section 913(f) authorizes rulemaking to address “regulatory standards of care ... for providing personalized investment advice” to retail customers
 - This does not impose a fiduciary obligation on broker-dealers
- In April 2018, SEC proposed a new rule establishing a standard of conduct for **broker-dealers and associated natural persons** when making recommendations **to a retail customer**
- The proposed standard of conduct: Act **in the best interest of the retail customer at the time a recommendation is made** without placing the financial or other interest of the broker-dealer or associated natural person making the recommendation ahead of the interest of the retail customer



REGULATION BEST INTEREST (CONT.)

- The proposed rule provides that a broker-dealer will be deemed to have acted in the best interest of its customer if:
 - It **discloses in writing** prior to a recommendation the material terms of the relationship between the broker and the customer, as well as fees and charges and material conflicts related to the recommendation
 - It **exercises reasonable diligence, care, skill and prudence** to evaluate the recommendation and conclude that it is in the best interest of the customer
 - It establishes, maintains and enforces **policies and procedures reasonably designed to** (i) identify and disclose or eliminate material conflicts of interest associated with the recommendation and (ii) identify, disclose and mitigate (or eliminate) material conflicts of interest related to the financial incentives of the broker-dealer and its associated persons



The background features a dark blue and black color palette with glowing digital elements. On the left, there's a grid of light blue dots forming a map-like shape. To the right, a bar chart with orange bars is visible. The bottom half of the image is a solid dark blue band containing the title text. Below the band, there are vertical lines with colored circles (orange, purple, white) and a grid of blue dots, suggesting a data visualization or network structure.

CALIFORNIA PRIVACY LAWS

THE CALIFORNIA CONSUMER PRIVACY ACT OF 2018 (“CCPA”)

- CCPA effective on January 1, 2020
- CCPA provides consumers with the right to:
 - Know what personal information is collected, whether the personal information is sold or disclosed for a business purpose, and to whom
 - Access personal information that a covered business has about them
 - Delete their personal information
 - Opt out of the sale of their personal information or, for minors under 16, opt in
 - Equal service and price, which means that consumers who exercise rights under CCPA must receive the same goods or services as those who do not (although certain financial incentives are permitted)



CCPA AND THE GENERAL DATA PROTECTION REGULATION (“GDPR”)

- CCPA and GDPR both view the privacy of personal information as a fundamental right
- Both laws broadly define what is “personal” but CCPA’s definition includes a reasonableness qualifier
- Like GDPR, CCPA provides individuals rights to control how their personal information is used and disclosed
- Both CCPA and GDPR recognize the need for businesses to conduct due diligence on third parties that assist them with personal information processing and to have the arrangements memorialized in a contract
- CCPA and GDPR both have potentially large regulatory fines





ADVERTISING RULE AND CASH SOLICITATION RULE

HISTORY OF THE ADVERTISING RULE

- In 1960, subsection (4) added to Section 206 of the Advisers Act
- In 1961, Rule 206(4)-1 adopted
- On January 1, 1962, Rule 206(4)-1 became effective
- Rule 206(4)-1 has never been substantively amended



ADVERTISING RULE PROPOSALS

- Deputy Director of the IM Division announced plans to consider revisions to Rule 206(4)-1 in light of ongoing developments in technology and social media
- Rule advanced to the SEC's short-term rulemaking agenda in March, 2018
- Rule proposals expected in 2019
- Potential for a Guidance Statement summarizing and restating SEC staff positions in no-action letters and enforcement actions



ADVERTISING RULE PROPOSALS: ISSUES UNDER CONSIDERATION

- “Proscriptive” prohibitions currently in the rule, or “principles-based” antifraud standard
 - Past specific recommendations
 - Client testimonials
- Bifurcated standards for retail clients and sophisticated clients
- Codification of social media and electronic communication guidance
- Scope of “advertisements” covered by the rule



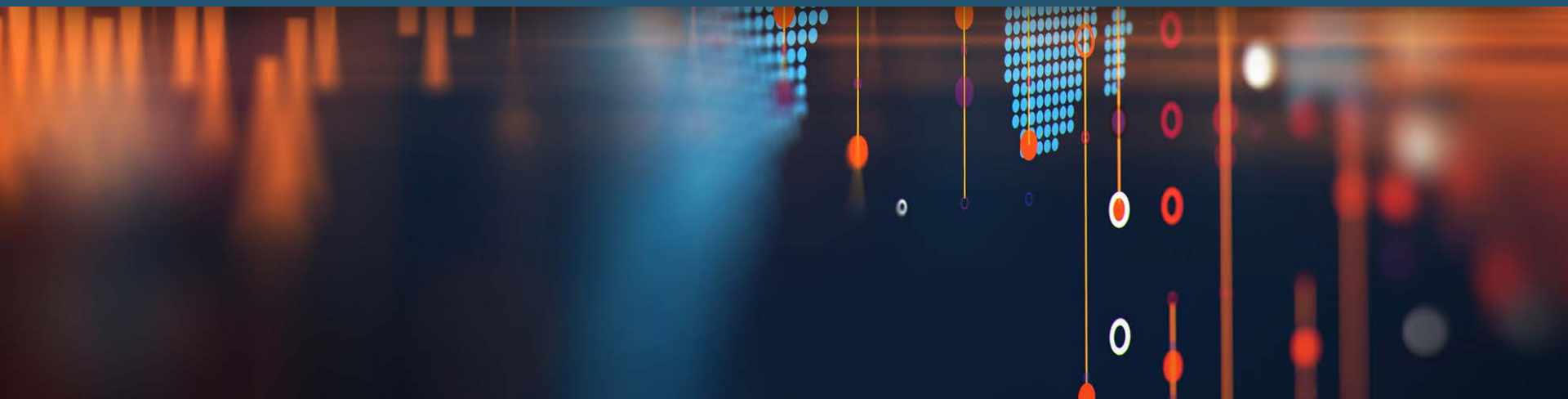
CASH SOLICITATION RULE PROPOSALS

- Reconsideration of Rule 206(4)-3 to coincide with 206(4)-1
- Rule proposal expected to coincide with Advertising Rule proposal
- Issues under consideration:
 - “Bad Actor” prohibition and streamlined exemptive relief
 - Content and oversight of disclosure document
 - Clarification of indirect solicitation arrangements





GIPS 2020



GIPS 2020 OVERVIEW

- **Pooled Fund Reports:** No longer required to create a single-fund composite if a pooled fund doesn't meet any existing composite definition
 - Managers of limited distribution pools (*i.e.*, private funds) must now create and distribute GIPS Pooled Fund Reports, which require specific pooled fund level performance measurements
 - Managers of broad distribution pools (*i.e.*, registered funds) can promote a GIPS compliance claim either through a GIPS Pooled Fund Report or in a GIPS advertisement
- **Portability:** Requirement that performance of an acquired firm or investment team be linked with that of the new firm now optional
 - Requirement that any non-compliant assets of an acquired firm or team be brought into compliance within one year of the acquisition relaxed to apply only on a prospective basis



GIPS 2020 OVERVIEW (CONT.)

- **Carve-Outs:** In a reversal of previous guidance, firms will now be permitted to allocate cash to carve-outs
- **Return Calculation Methodology:** Allows firms that control external cash flows into a pooled fund or the portfolios within a composite to present money-weighted returns (aka internal rate of return) if the pooled fund or portfolios within the composite meet certain criteria
 - Currently, must present time-weighted returns
- **Codification of Guidance Statements:** New structure incorporates all items (e.g., Guidance Statements and Q&As) that must be considered when creating a performance report without need for cross-referencing
- **Asset Owners:** Asset owner requirements for GIPS compliance that are distinct from those requirements applicable to firms



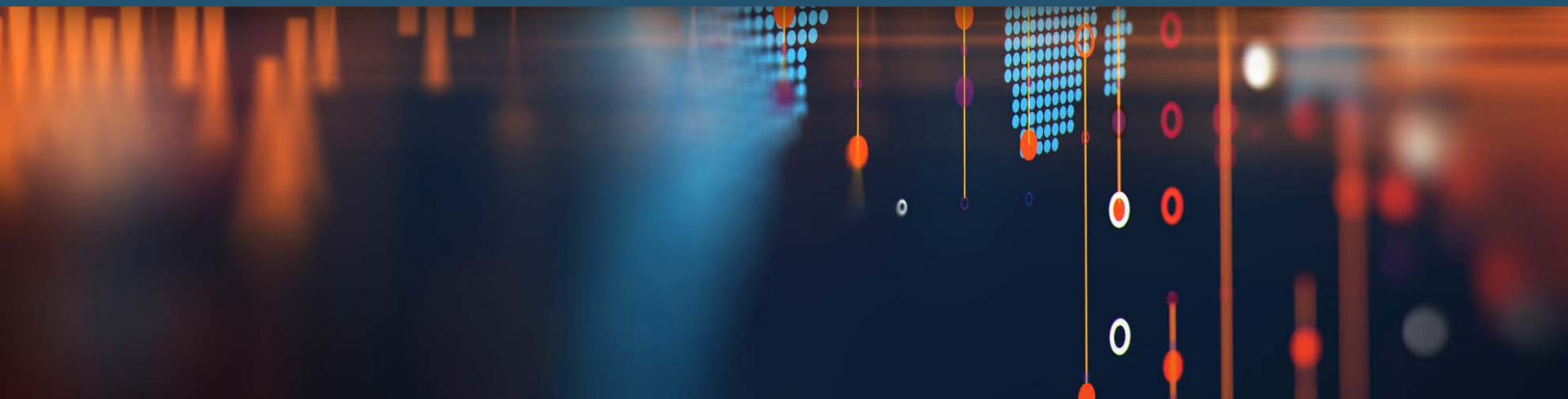
GIPS 2020 TIMELINE

- A general timeline and target effective dates for GIPS 2020 are as follows:
 - **August 31, 2018:** GIPS 2020 Exposure Draft released for public comment
 - **October 31, 2018:** GIPS Verification 2020 Exposure Draft released for public comment
 - **December 31, 2018:** Close of comment period for GIPS 2020 and Verification Exposure Drafts
 - **June 30, 2019:** Final GIPS 2020 edition released
 - **January 1, 2020:** GIPS 2020 effective date





CFIUS



FOREIGN INVESTMENT RISK REVIEW MODERNIZATION ACT OF 2018 (“FIRRMA”) AND THE COMMITTEE ON FOREIGN INVESTMENT IN THE UNITED STATES (“CFIUS”)

- FIRRMA enacted on August 13, 2018
- FIRRMA’s mandatory declaration provision expected to impact the private equity industry
- Investors affiliated with non-U.S. governments and investors targeting certain types of U.S. businesses designated by CFIUS required to file a notification of certain proposed investments
 - CFIUS then has 30 days either to approve the transaction or require a full CFIUS review
- Exceptions to the mandatory declaration requirements for non-U.S. persons that serve on advisory boards or committees of the fund:
 - The fund is managed exclusively by a general partner/managing member who is a U.S. person
 - The advisory board does not have the ability to control the fund, including investment decisions or decisions made by the general/managing member
 - The non-U.S. person does not have the ability to control the fund, including investment decisions, decisions made by the general/managing member, or compensation of the general/managing member
 - The non-U.S. person does not have access to material nonpublic technical information as a result of its participation on the advisory board
- FIRRMA amends CFIUS’ authority to review investments that could result in a non-U.S. person’s control of a U.S. business, subject to certain limitations



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