



SECURITIES INDUSTRY PRACTICE

# ALERT

## IMPORTANT MAINTENANCE MEASURES FOR REGISTERED INVESTMENT ADVISORS

Every year, hedge fund managers face the unenviable task of reviewing procedures and events to prepare for the upcoming year, and with the new “Plain English” requirements for registered investment advisors (RIA), this process has taken on added significance.

### **Tax Issues**

Managers must be cognizant of the tax consequences and fund’s investment objectives regarding wash sales. Similarly, under Financial Accounting Standards Board Interpretation No. 48 (FIN48), managers must have procedures to assess material tax positions and potential accrual of liabilities.

### **Fund Operation Issues**

Managers must carefully monitor redemptions to minimize transaction costs and prevent such costs from impacting the remaining investors. When closing funds or for managed accounts, managers must follow liquidation procedures in the managed account agreement and fund documents. Managers should also be mindful if the combination of redemptions and performance causes a fund to hit a Net Asset Value (NAV) trigger in a fund’s International Swaps and Derivatives Association (ISDA) Agreement. If so, waivers should be sought for triggers as soon as possible.

All fund expenses for a particular year should also be paid in that year, not the next. Annual reviews of director and officer or other liability insurance is essential as well as notifying the carrier of all claims and potential claims.

### **Human Resource Matters**

Managers should pay company expenses prior to the distribution of profits, and employee reviews should be performed annually to reduce employment-related litigation and protect management in the event of such litigation. Whistle-blower programs should be reviewed as well.

Compensation in the hedge fund as well as financial services industry in general requires careful planning. The compensation program should be adjusted now or as early as possible.

### **Fund Regulatory Matters**

The Form ADV requirements will undergo radical changes. Although a RIA must file its annual amendment to Form ADV Part I and Form ADV Part II within 90 days of the end of its fiscal year, and annually—or at least offer to provide a copy of its updated Form ADV Part II (or its equivalent)—RIAs must now “translate” Form ADV into plain English. Clients may also be told where they can obtain a copy of it, or it could be sent with another mailing such as the annual Privacy Policy Notice.

On an annual basis, managers need to confirm or reconfirm the eligibility of investors who participate in IPOs or new issues. “Negative consent” letters are permitted. Similarly, Employee Retirement Income Security Act (ERISA) investors must also confirm or reconfirm their ERISA status on an annual basis. Again, a negative consent letter is appropriate.

The RIA's chief compliance officer must also annually review the manager's compliance policies and procedures in writing and present the findings to senior management. Outside counsel, such as those here at Fox Rothschild, could be particularly helpful for guidance and in protecting a particularly sensitive review under the attorney-client privilege.

Managers must also file any Form 13F for the exercise of investment discretion when there is \$100 million or more in applicable securities within 45 days of the end of the year when a manager reaches the \$100 million filing threshold. Managers must also annually review blue sky filings for each state and meet any renewal requirements. Further, Form D filings for a continuous offering need to be amended annually.

Preliminary annual renewal fees for state-registered and Securities and Exchange Commission (SEC) RIAs were due in December 2010, while additional fees imposed were due early February 2011.

### Portfolio Check

All trade errors should be addressed and documented by the end of the year, and all soft dollar programs and commission balances should be reviewed as well. Audits are always of concern. Managers must provide investors with audited financial statements in accordance with U.S. GAAP within 120 days of the end of the year—and if they fail to do so, must arrange for an annual surprise audit with their auditor.

Finally, managers whose funds are beneficial owners of five percent or more of a registered voting equity security and who have reported these positions on Schedule 13G must update these filings annually within 45 days of the end of the year.

In sum, these matters are critical in the care and maintenance of RIAs, private equity and hedge funds.

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Fox Rothschild securities industry attorneys are available to discuss all of these issues. If you have any questions regarding the information in this alert, please contact:

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