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Securities Law Considerations for Sponsors of Qualified Opportunity Zone Funds

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INTRODUCTION

The 2017 tax act, enacted in December 2017, included various incentives for taxpayers to make investments that might spur economic development and job growth.[1] One of the key incentives involves qualified opportunity funds that make investments in qualified opportunity zones. If a taxpayer chooses to sell assets generating a capital gain and invests the amount of the gain in an opportunity fund that complies with relevant tax rules, the taxpayer can defer and often reduce taxes on that gain, and the subsequent sale of the opportunity fund investment generally will not be taxable, provided that the investment is held for at least 10 years. Opportunity zones were finalized by the Treasury Department and the Internal Revenue Service in 2018, and along with a few designated adjacent tracts, they represent 25% of the low-income census tracts (with a minimum of 100) in each jurisdiction.

Many institutional investment managers and real estate developers see the opportunity zone program as a way to establish a presence in new markets and expand their existing investor bases. For example, some managers of traditional real estate funds with little experience navigating the compliance regimes of tax-advantaged funds or investing in low-income areas are sponsoring opportunity funds in an effort to court high net worth individuals and impact investors. Conversely, many tax credit fund managers are seeking to expand into opportunity zone funds to leverage their long histories of investing in locations that are now classified as opportunity zones, as well as their extensive experience complying with specialized tax laws designed to encourage private sector investments in low-income communities. That being said, while traditional real estate fund managers will typically have experience with investment advisory and similar securities law regimes, managers of other tax-advantaged funds such as low-income housing tax credits, new markets tax credits, and historic rehabilitation tax credit funds may be less likely to have prior experience with a number of securities law regimes.

INVESTMENT CONTRACTS AND THE *HOWEY* TEST

Under the Securities Act of 1933, as amended, the definition of ''security'' mostly includes a list of items that people generally think of as securities—stock, bonds, debentures, notes, securities futures, and the like.[2] Notably absent from this list are interests in limited partnerships and limited liability companies.[3] Instead, the definition of ''security'' includes the deliberately cryptic term ''investment contract.'' When interests in partnerships and limited liability companies are investment contracts, those interests become securities that are subject to a full array of federal and state securities laws.

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[1] Pub. L. No. 115-97.

[2] *See* 15 U.S.C. §80b-2(a)(18).

[3] In this article, references to limited partnerships should be construed to include limited liability companies, references to the general partner or general partnership interests should be construed to include the managing member or managing member interests, and references to the limited partners and limited partner interests should be construed to include investor members and investor member interests.

The formative case interpreting what constitutes an investment contract for the purposes of the Securities Act is *SEC v. W.J. Howey Co.*,[4] where the Supreme Court determined that an investment in an orange grove was actually an investment in a security due to the characteristics of the sale contract. The three original requirements for establishing an investment contract pursuant to what has become known as "the *Howey* Test" were (1) an investment of money, (2) in a common enterprise, (3) with profits solely due to the efforts of others. Over time, there have been numerous other cases determining the boundaries of when these various conditions are met. Some of these cases have modified the prongs of the *Howey* Test themselves, such as a relaxation of the "solely" requirement,[5] or requiring only the expectation of profits rather than actual profits.[6] Further, a general partner interest typically will not be an investment contract because the value of such an interest is not derived primarily from the efforts of others.

However, federal courts have reasoned that in determining whether an investment is a security, the form of the investment "should be disregarded for substance and the emphasis should be on economic reality."[7] Indeed, from its inception, the *Howey* Test was intended as a "flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits."[8]

Many courts have applied the *Howey* Test broadly to conclude that a limited partner interest constitutes an investment contract and, therefore, a security for purposes of federal securities laws.[9] When a limited partner relies on the general partner to manage the day-to-day operations of the partnership, the limited partner interest may be sufficiently passive in nature so that it is an investment contract under the *Howey* Test.[10] As the court in *Mayer v. Oil Field Systems Corp.* stated, "[w]here the investing limited partners exercised no managerial role in the partnership's affairs, courts have held that limited partner interests are securities."[11] Some courts have interpreted the third-prong of the *Howey* Test even more broadly than the court in *Mayer*, refusing to read literally the term "solely," but rather adopting a "more realistic test, whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise."[12] Accordingly, many traditional (non-tax credit) real estate funds, other than those that invest directly in the real estate itself, such as "equity REITs," consider themselves to be funds investing in securities.

By contrast, there have been a number of cases where courts have found that limited partner interests are **not** investment contracts where, among other things, the limited partner retained substantial control over its investment under the partnership agreement and had significant negotiating leverage with few or no other third-party investors. The relevant analysis used in these cases generally turned on whether investors assumed "control over the significant decisions of the enterprise."[13] As the court in *Goodwin v. Elkins & Co.* stated, "whether a partnership interest constitutes a security depends on the **legal** rights and powers enjoyed by the investor."[14] In order to determine such legal rights, courts have looked to the terms of the partnership agreement that has been negotiated by the parties. If the partnership agreement "grant[s] the investors control over the significant decisions of the enterprise," such interests have been held not to be securities.[15]

In each of these cases, courts have found that a limited partner interest is not an investment contract where the limited partner was sophisticated about the type of investment such that it could adequately protect its interests,[16] there was only one limited partner (or a small number of limited partners), there was no public offering, the negotiation of the partnership agreement was a one-on-one negotiation between the limited partner and general partner,[17] and the limited partner retained control over its investment through the partnership agreement.[18] That said, limited partner interests should generally be presumed to be securities, because they usually involve passive investors who rely on the general partner or manager to produce

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[4] 328 U.S. 293 (1946).

[5] *See United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975).

[6] *See SEC v. Glenn W. Turner Enters, Inc.*, 474 F.2d 476, 482 (9th Cir. 1973).

[7] *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967).

[8] *Howey*, 328 U.S. at 299.

[9] *See Mayer v. Oil Field Sys. Corp.*, 721 F.2d 59 (2d Cir. 1983); *see also Shinn v. Thrust IV, Inc.*, 786 P.2d 285, 297 (Wash. Ct. App. 1990).

[10] *See SEC v. Merchant Capital, LLC*, 483 F.3d 747 (11th Cir. 2007).

[11] *Mayer*, 721 F.2d at 65.

[12] *Glenn W. Turner Enters.*, 474 F.2d at 482.

[13] *See Gordon v. Terry*, 684 F.2d 736, 741 (11th Cir. 1982).

[14] 730 F.2d 99, 107 (3d Cir. 1984).

[15] *See Gordon*, 684 F.2d at 741.

[16] *Steinhardt Grp. Inc. v. Citicorp*, 126 F.3d 144 (3d Cir. 1997).

[17] *See Marine Bank v. Weaver*, 455 U.S. 551, 560 (1982).

[18] *Steinhardt*, 126 F.3d at 153 - 154; *Bank of Am. Natl. Trust and Sav. Assn., Inc. v. Hotel Rittenhouse Assocs.*, 595 F. Supp. 800 (E.D. P.A. 1984); *Gordon*, 684 F.2d at 74.

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profits. Further, not all states define "security" in the same manner as the *Howey* Test and, accordingly, some instruments that are securities for federal law purposes may not be for state law purposes and vice versa.

OPPORTUNITY FUND SUBSIDIARY INTERESTS AS SECURITIES

Limited partnership interests in tax credit funds themselves clearly are securities—there is an investment of cash into the entity, the common enterprise is the partnership itself, and the profits, whether in the form of tax benefits or cash distributions, are generated solely from the efforts of the general partner. The underlying investments (in housing, rehabilitation, or other projects) made by those funds normally are structured so that they are unlikely to be securities. A direct interest in real property is not a security;[19] however, because the real estate typically is held through an LLC or limited partnership, the analysis as to whether the interest is a security is highly fact-specific.

Lower-tier partnerships normally would satisfy the first two prongs of the *Howey* Test, because (1) there is an investment of money through the fund's purchase of the limited partnership or LLC interest, and (2) there will almost always be a common enterprise because the partnership must have multiple partners. Whether a limited partnership or LLC interest satisfies the third element of the *Howey* Test, however, is highly dependent on the facts of each case, requiring a focus on the nature of the relationship between the parties and the contractual terms of the venture.[20] For example, most tax credit fund managers have a high degree of expertise and experience with tax credit projects, have the right to remove the developer under certain circumstances, and a track record of exercising such rights. Opportunity zone fund managers may not have the same level of expertise in the more diverse investments that may be made in qualified opportunity zones.

Due to the stringent requirements to qualify for tax credits, as well as the often limited expectation of profit from investing in lower-tier partnerships, the lower-tier investments of tax credit funds typically are structured so that they are unlikely to be securities. In contrast, opportunity fund managers may not be able to structure their investments in a manner that prevents them from being characterized as securities. The opportunity zone law itself encourages some decisions that increase the chances that an opportunity fund's investments will be securities. For example, if an opportunity fund owns its projects directly, then 90% of all of its assets must be qualified opportunity zone business property. On the other hand, if the project is held by a subsidiary entity, **all** of that subsidiary entity's assets count toward the 90% threshold so long as at least 70% of that subsidiary's tangible assets are qualified opportunity zone business property and certain other conditions and limitations are adhered to. Furthermore, at the time of this writing there are unanswered questions in the opportunity zone regulations—such as determining what constitutes an "active trade or business" or how staged exits ultimately can be effected in multi-property funds —that create uncertainty about how the opportunity zone fund properties will need to be managed and how the investments in those properties will need to be structured.

In some instances, it may be impossible to structure a lower-tier partnership interest so that it would be unlikely to be a security. For example, the lower-tier partnership would often be controlled by a joint venture that ultimately is controlled by a third-party developer with few, if any, approval rights from the limited partner, which makes it more likely to be deemed a security.[21] Further, because developers or managers of other types of businesses are used to controlling their own operations, they may be less inclined to cede control to an investor than developers of low-income housing properties, particularly because the developers of low-income housing generally have numerous approval rights and restrictions with respect to their projects.

INVESTMENT COMPANY ACT EXCLUSIONS

Absent an exception, an issuer would need to register as an investment company if either it is engaging or proposes to engage (1) primarily in the business of investing, reinvesting, or trading in securities, or (2) in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities with a value exceeding 40% of its total assets, exclusive of government securities and cash items, on an unconsolidated basis.[22] If the structure of a future opportunity zone investment is unknown, then it may be difficult to not propose engaging primarily in the business of investing in securities, which could require the opportunity zone fund to seek an exclusion from the definition of

[19] *See* Pacesetter I L.P., SEC No-Action Letter, 1986 WL 67085, at *1 (July 18, 1986).

[20] *See Shinn*, 786 P.2d at 297-298.

[21] *See, e.g.*, *Williamson v. Tucker*, 645 F.2d 404 (5th Cir. May 1981).

[22] 15 U.S.C. §80a–3(a).

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investment company. Further, even where a significant part of an issuer's assets is directly owned, the second test may be incidentally tripped if the subsidiary's assets, net of cash and government securities, exceed 40% of the fund's assets and the interests in that issuer are deemed securities, particularly in the early period of the fund when a significant amount of the fund's assets may be in temporary investments.

There are three exceptions from being deemed an investment company under the Investment Company Act that are available to typical real estate investment funds: 15 U.S.C. §80a-3(c)(1), or the ''100 and under'' exception; 15 U.S.C. §80a-3(c)(7), or the ''qualified purchaser'' exception;[23] and 15 U.S.C. §80a-3(c)(5)(c), or the mortgage exemption.[24] Section 3(c)(5)(c) of the Investment Company Act exempts certain issuers that are primarily engaged in purchasing or otherwise acquiring mortgages and other liens on and interests in real estate. The SEC requires that an entity relying on §3(c)(5)(c) for its Investment Company Act exemption have at least 55% of its portfolio invested in ''qualifying assets'' (which in general must consist of mortgage loans, mortgage-backed securities that represent the entire ownership in a pool of mortgage loans, and other liens on and interests in real estate) and another 25% of its portfolio invested in other real estate-related assets.

Determining whether a fund qualifies for the 15 U.S.C. §80a-3(c)(1) exception is not as simple as looking at the number of investors in the fund. Rather, a web of regulations, enforcement actions, and interpretations has created many instances where the fund must ''look through'' an investor to its beneficial owners, or combine multiple investors into a single beneficial owner. Further, under some circumstances, an owner and a beneficial owner may not have the same meaning. The qualified purchaser exemption presents a much brighter line and eliminates the limit on the **number** of investors, but also places significant limitations on **who** may invest in the fund. The vast majority of qualified purchasers are individuals who own greater than $5 million of investments and entities that own and invest on a discretionary basis not less than $25 million of investments—a threshold that is not easily reached, particularly given the nuanced definition of ''investments.''[25]

The definition of a security under the Investment Company Act is similar to the definition under the Securities Act.[26] What constitutes an ''investment security,'' however, is much narrower and excludes government securities, securities issued by employees' securities companies, and securities issued by majority-owned subsidiaries of the owner that are not investment companies and not themselves relying on the Investment Company Act §3(c)(1) or §3(c)(7) exceptions described below. The SEC has taken the position that, where a person owns 50% of the limited partnership interests of a real estate partnership and has the ability to remove the general partner for any reason, then the real estate partnership would be treated as a majority-owned subsidiary that is outside the definition of ''investment security.''[27] Thus, a lower-tier partnership can be structured so that it is excluded from the 40% test even if the partnership interests are securities under the Securities Act.

The Volcker Rule and the Public Welfare Exemption

In addition, investment funds that do not need to register solely because of an exception under §3(c)(1) or §3(c)(7) of the Investment Company Act generally are ''covered funds'' under the ''Volcker Rule.''[28] The Volcker Rule severely limits the ability of many banks and other regulated financial institutions to make investments for their own account in §3(c)(1) and §3(c)(7) funds. Typically, tax credit funds would qualify for the ''public welfare'' exemption[29] from being a covered fund. It is unclear, however, whether all opportunity funds would fall within this exemption.

The ''public welfare'' exemption allows those who would otherwise be prohibited from making investments in covered funds under the Volcker Rule to make ''investments designed primarily to promote the public welfare.''[30] The statute governing public welfare investments, 12 U.S.C. 24 (Eleventh), does not enumerate a list of those investments that are for the ''public welfare;'' it simply states that investments for the public welfare include promoting ''the welfare of low- and moderate-income communities or families (such as by providing housing, services, or jobs).'' In interpretative regulations, the Comptroller of Currency, Department of Treasury, offers guidance on what constitutes ''public welfare investments.''[31] In addition to investments that benefit ''low- and

[23] 5 U.S.C. §80a–2(a)(51). For the most part, a ''qualified purchaser'' includes an individual that owns greater than $5 million of investments and other persons that own and invest for its own account, or for the account of other qualified purchasers, more than $25 million of investments.

[24] 15 U.S.C. §80a–3(c).

[25] 17 C.F.R. §270.2a51-1(b).

[26] 5 U.S.C. §80a–2(a)(36).

[27] Westin Hotels Limited Partnership, SEC No-Action Letter (Dec. 16, 1985).

[28] 12 C.F.R. §248.10(b)(1)(i).

[29] 12 C.F.R. §248.10(c)(11)(ii)(A).

[30] 12 U.S.C. §1851.

[31] *See* 12 C.F.R. §24. The analysis used by the Comptroller of Currency, Department of Treasury is used to interpret 12 U.S.C.

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moderate-income communities,'' this definition includes ''areas targeted by a governmental entity for redevelopment,'' or investments receiving consideration under 12 C.F.R. §25.23 as a ''qualified investment'' for purposes of the Community Reinvestment Act.[32] The Treasury regulations also offer specific examples of those investments that qualify as being for the public welfare, including affordable housing investments, economic development and job creation investments (for small businesses in low- and moderate-income areas or other targeted redevelopment areas), and investments in community and economic development entities (CEDEs), among other investments for the public welfare.[33] Though it is not certain whether all opportunity funds will qualify under the public welfare exemption, the primary purpose of the opportunity zone legislation is to benefit economically-distressed communities.[34] The law specified that a business will not even qualify as an opportunity zone if any portion of its proceeds is used ''to provide. . .any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack[,] or other facility used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises.''[35] That said, it is unclear whether an investment in other ''sin'' activities, such as financing cannabis dispensaries, athletic facilities, stores that sell lottery tickets, or hotels that offer massage services, would qualify as public welfare investment or would be permitted activities of opportunity funds at all.

Though the Treasury regulations offer a glimpse into the mindset of regulators concerning investments for the public welfare, it remains indeterminate as to whether all opportunity funds would qualify for the public welfare exception to the Volcker Rule. Accordingly, the Volcker Rule may present important structural issues where the targeted investor base consists of large financial institutions. Conversely, the ''public welfare'' exemption may also expand the potential investor base for traditional real estate fund managers, as many opportunity funds, such as those that invest in low-to-moderate income housing, likely would fall within the exemption.

INVESTMENT ADVISERS

An investment adviser includes anyone who, for compensation, is engaged in the business of providing advice to others or issuing reports or analyses regarding securities, subject to limited exceptions.[36] Advising a fund itself does not necessarily make one an investment adviser. In fact, a qualified opportunity zone fund might not be a fund at all—it could be a direct investment by a single person that wants to operate a business in the opportunity zone. If the fund's assets are not deemed securities, then the sponsor would not be giving advice regarding securities. That said, if the fund's portfolio consists of securities and the manager is engaged in the business of advising that fund for compensation, then it would be an investment adviser.

All investment advisers, whether or not they are required to register, are subject to the antifraud provisions of the Investment Advisers Act of 1940, as amended (Advisers Act), and are subject to a fiduciary duty under the Advisers Act to act in the best interest of their clients. This fiduciary duty extends to many items that would not be included in the fiduciary duties of a general partner or managing member under most state laws. These duties include a duty of loyalty, as well as a duty of care that includes duties to provide advice in the client's best interest, a duty of best execution, and a duty to act and to provide advice and monitoring over the course of the relationship. Unlike many state law fiduciary duties, fiduciary duties under the Advisers Act may not be waived.[37]

Registering as an Investment Adviser

Determining investment adviser registration requirements is highly dependent on the manager's location, the amount of assets under management, and the nature of the accounts that it manages. The Advisers Act regime is relatively unique among securities laws in that, for the most part, an adviser is exclusively subject to the substantive provisions of either federal or state investment advisory laws, but not both. While there are numerous exceptions, the general rule of thumb is that if the manager has less than $100 million of assets under management, it is subject to state registration, and if it has greater than $110 million of assets under management, it is subject to federal registration (with special rules applying in that gray area).[38] A significant exception to that rule is that the federal jurisdiction threshold is only $25 million of assets under management for managers located in

§24 (Eleventh), which is the relevant federal law referred to in the Volcker Rule. *See* 12 U.S.C. §1851(d)(E).

[32] *See* 12 C.F.R. §24.3.

[33] *See* 12 C.F.R. §24.6.

[34] IRS, *Opportunity Zones Frequently Asked Questions*.

[35] I.R.C. §1400Z-2(d)(3)(A)(iii).

[36] 15 U.S.C. §80b–2(a)(11).

[37] *See, e.g.*, Proposed Comm'n Interpretation Regarding Standard of Conduct for Inv. Advisers; Request for Comment on Enhancing Inv. Adviser Regulation, Release No. 4889 (April 18, 2018).

[38] *See* 15 U.S.C. §80b-3 (Dodd-Frank Act §410); 17 C.F.R. §275.203A-1.

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New York or Wyoming.[39] Calculating assets under management is set by regulation and differs significantly from how one might calculate assets under management for accounting or track record purposes.

Certain managers may be able to qualify for a limited exemption from the Advisers Act known as the private fund adviser exemption.[40] U.S.-based managers can rely on this exemption where the adviser acts solely as an adviser to private funds, such as Investment Company Act §3(c)(1) and §3(c)(7) funds, and has less than $150 million of assets under management attributable to those private funds. That said, managers cannot rely on this exemption to the extent they would be required to register at the state level. Further, while this exemption preempts most of the substantive requirements of the Advisers Act, a manager relying on this exemption would still be an ''exempt reporting adviser'' that needs to file an abbreviated version of Form ADV, is subject to SEC examinations, and is still subject to certain substantive provisions of the Advisers Act, including pay-to-play rules.

Compensation

Real estate managers often take a fee for structuring and negotiating an underlying investment. If the underlying investment is a security, then a transaction-based fee could be illegal without registration as a securities broker-dealer. Additionally, registered investment advisers are not permitted to accept performance fees, such as promote or carried interest, unless all of the fund's investors are qualified clients.[41] The threshold for being a qualified client is significantly higher than that of an accredited investor, but significantly lower than that of a qualified purchaser.

In addition, each state has laws defining broker-dealer, agent, and related registration requirements and, as noted above, states may regulate investment advisers as well. Under the Uniform Securities Act, adopted in large measure by many states, an issuer selling its own securities is exempt from broker-dealer registration. An employee or other individual who represents an issuer may also be exempt if no commission or other remuneration is paid for soliciting investors. On the other hand, there is no such exemption in a number of states. Accordingly, any state in which offers and sales are to be made should be checked to ensure compliance.

[39] SEC, *Form ADV: General Instructions*.

[40] 17 C.F.R. §275.203(m)-1.

[41] 17 C.F.R. §275.205-3. A ''qualified client'' generally includes individuals with at least $1 million of assets under management with the manager, most individuals with a net worth of greater than $2 million, qualified purchasers, and certain key executives and employees of the manager.

Marketing an Investment Fund

If an opportunity fund will only own assets that are not deemed to be securities then, much like a traditional tax credit fund, its marketing should only be subject to the exemptive, antifraud, and brokerage provisions of state and federal securities laws. There are additional requirements with respect to advertising, however, if the sponsor will be an investment adviser. ''Advertising'' is construed extremely broadly to include just about anything other than a true one-on-one investor meeting or a response to an unsolicited question from a potential investor.[42] It does include road show presentations, private placement memoranda, and other marketing materials, even if they are confidential.

If the sponsor will be a registered investment adviser, then it would be subject to the ''advertising rule'' under the Investment Advisers Act.[43] The advertising rule explicitly prohibits, in any advertising, (1) testimonials; (2) past specific recommendations, subject to certain exceptions and the inclusion of specific legends; (3) charts and graphs, such as comparisons to public markets, without including a detailed explanation of all differences between the charts and graphs and the securities being recommended; (4) references to analyses that will be provided free of charge unless those analyses will actually be provided free of charge to anyone who requests it; and (5) including any statement of material fact that is untrue or misleading.[44] Certain facts that are de facto considered to be untrue or misleading, subject to specified exceptions under no-action letters[45] and case law, include presenting track record information that is not net of fees,[46] presenting track record from someone other than the adviser (even if it is the same investment team),[47] pre-

[42] 17 C.F.R. §275.206(4)-1(b). *See also* Investment Counsel Association of America, Inc., SEC No-Action Letter (March 1, 2004).

[43] 17 C.F.R. §275.206(4)-1.

[44] *Id.*

[45] A no-action letter is a non-binding statement from the SEC that, under the facts presented, the SEC would not recommend enforcement against the submitting party if it takes certain actions that otherwise might violate federal securities laws. Unlike IRS private letter rulings that are binding on the party to which it was issued but often cannot be relied upon by others, the SEC almost never will act in a manner inconsistent with a no-action letter and, unless the law specifically requires that a no-action ruling be obtained, will not recommend enforcement against similarly situated parties that follow the no-action letter.

[46] *See, e.g.*, Investment Company Institute, SEC No-Action Letter (Sept. 23, 1988).

[47] *See, e.g.*, South State Bank, SEC No-Action Letter (May 8, 2018).

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senting hypothetical track records,[48] and benchmarking.[49]

Even if the sponsor is not required to register under the Advisers Act, a sponsor that is an investment adviser is still subject to its duty of loyalty. The duty of loyalty extends to the marketing period and is deemed to include a requirement of full and fair disclosure. While advisers that are not required to be registered technically are not subject to the advertising rule, following the advertising rule tends to be a good practice to ensure that the adviser does not run afoul of the general antifraud provisions of the Advisers Act, as the advertising rule was created under those general antifraud provisions. Furthermore, a major focus of the SEC is disclosing with complete transparency all fees and expenses and potential conflicts of interest, and getting approval from investors prior to taking such actions that are not adequately described prior to the investors making their decision to invest in the fund.[50] These requirements could have a major effect on the look and feel of an offering document and, in the era of social media, this may require some managers to re-evaluate their overall marketing strategy.

Other Investment Advisers Act Requirements

In addition to rules relating to advertising and compensation, registration under the Advisers Act subjects the manager to an entirely separate regulatory regime. Other significant requirements relate to, among other things: examinations by federal regulators for compliance with laws; annual filing of a complete Form ADV; a delivery requirement for Part 2 of the Form ADV brochure, which in many ways is similar to a prospectus; recordkeeping; custody of assets; ''pay-to-play'' rules that may limit the ability of the firm and its associates to make political contributions; significant restrictions on certain types of related-party transactions; requirements for use of solicitors; additional privacy laws; restrictions on changes in control; adhering to a code of ethics; and a requirement to maintain and enforce a set of supervisory policies and procedures reasonably designed to prevent violations of applicable laws.

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[48] *See, e.g.,* Clover Capital Management, Inc., SEC No-Action Letter (Oct. 28, 1986).

[49] *See, e.g.*, Office of Compliance Inspections and Examinations, National Exam Program Risk Alert, *The Most Frequent Advertising Rule Compliance Issues Identified in OCIE Examinations of Investment Advisers* (Sep. 14, 2017).

[50] *See, e.g.*, SEC Office of Compliance Inspections and Examinations, 2019 Examination Priorities (2019).

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