

International: Private Funds Speed Read

In brief

To close out 2022, US states passed a range of rules broadly applicable to all businesses, while global regulators took steps to regulate ESG and crypto-assets comprehensively. While the digital asset industry bore the brunt of enforcement, regulators will give private equity, real estate and hedge fund managers much to think about in 2023.

Below is a high-level round-up of regulatory, enforcement and market developments relevant to private fund managers.

In depth

Running the business

Hiring?

- US Employees? [US FTC Proposes a Ban on Non-Compete Clauses](#)¹
- In New York City or California? Newly effective [salary transparency rules](#) require disclosing salary information (excluding carry or bonuses) in job postings.

Marketing a Fund?

- SEC-registered investment advisers² should have updated materials to reflect the [Marketing Rule requirements](#) effective November 2022 (the SEC staff issued [helpful guidance](#) on gross and net performance two months later).
- To New York City Pensions? The pensions' cap on alternative assets [was increased from 25% to 35%](#) of their assets, freeing up around USD 4.6 billion for new allocations to funds. But note: [special lobbying and marketing rules apply!](#)
- Social Media Influencer? A US court decided that an influencer was "selling" a real estate fund for purposes of Section 12 of the US Securities Act of 1933; an [Australian court similarly decided that a "influencer"](#) should have been licensed.

Handling Client Data?

- Private funds and non-SEC-registered investment advisers. The new [FTC Safeguards Rule](#) creates more detailed requirements for information security programs and requires a "qualified individual" to oversee the program (deadlines extended to 9 June 2023);
- Connected to California?³ [More revisions](#) to privacy notices and policies are necessary (effective 1 January 2023).

¹ On 5 January 2023, the US Federal Trade Commission voted 3-1 to propose a rule; the rule will be available for public comment for 60 days after it is published in the Federal Register. **Would the rule apply outside the United States?** We don't anticipate that the FTC will pursue enforcement actions against US employers who have employees with non-competes outside the United States. Arrangements with international employees should be evaluated separately from a local law perspective.

² Like other rules under Advisers Act, Section 206(4) the rule affects: all clients (globally) of US-domiciled registered investment advisers and US-domiciled clients of non-US registered investment advisers. Exempt advisers are not in-scope but the rule may still change market practice.

Organized as a private entity?

- The [US Corporate Transparency Act](#) requires disclosure of beneficial owners of US and some non-US entities (effective 1 January 2024).⁴ Most-- but not all-- funds advised by SEC-registered advisers are excluded.

Advising the Fund

Running an ESG Strategy?

A cross-border cornucopia of rules and proposals may affect you.

- [In the EU or marketed to the EU?](#)⁵ [EU SFDR "Level 2" disclosures](#) are required by 30 June, 2023.
- [For US plan asset investors?](#) [US DoL reverses prohibition](#) on considering ESG factors
- [To Texas State Pensions?](#) [Texas Government prohibiting holding interests in investment companies listed as boycotting](#) fossil fuel related investments.
- SEC ESG proposal for US and non-U.S. private funds and separately managed accounts has been delayed.⁶

Real Estate?

[Proposed IRS regulations](#) would prohibit non-US investors from using a "foreign-owned" domestic corporation to create a domestically controlled REIT. Final comments on the Proposed Regulations are due to the IRS on 27 February 2023.

Trading US Listed Equities? [New N-PX filing requirements \(including for unregistered entities\)](#) mandate disclosure of how "institutional investment managers"⁷ vote on "say on pay"/executive compensation matters.⁸ Although the first filings are not due until 2024, managers should start tracking their records effective 1 July 2023.

Trading US Equities? New conditions for new [Rule 10b5-1 plans](#) effective 27 February 2023 and new requirements for Forms 4 and 5 for beneficial ownership reports filed on or after 1 April 2023.

Trading Digital Assets?

- [Smart Contracts](#): the CFTC claimed fraud against an individual for manipulating smart contract data. Managers should update insider trading policies to address this.
- [Security or Commodity?](#): When the regulators claim fraud, it doesn't matter whether it is for a security or commodity because they have general antifraud authority. Insider trading policies should be updated to address commodities fraud.
- [Using UK or HK Market Infrastructure?](#): a recent consultation could [change the way cryptoasset businesses operate in the UK](#), while [the HKMA issued consultation conclusions](#) for its crypto-asset discussion paper.

³ Non-California managers could be in-scope if they have: California-based clients, employees or service providers and fee revenue in excess of USD 25 million.

Any funds that hold licenses in California, pay taxes in California, have an office or have a significant number of clients should consider conducting a more in-depth analysis

⁴ The rules cover certain non-US entities registered to do business in the United States. While SEC- and CFTC-registered entities (and most of their funds) are excluded, exempt advisers and family offices are in-scope. Some real estate funds and fund SPVs may also be in-scope.

⁵ While EU regulated firms are obviously in-scope, SFDR disclosures also apply directly to non-EU firms marketing funds into the EU under national private placement regimes. In addition, pressure from EU-based investors may lead non-EU firms to decide to voluntarily comply with SFDR disclosure standards.

⁶ The proposal affects SEC-registered *and* exempt investment advisers with "significant" ESG strategies (non-U.S. advisers who file on Form ADV are equally affected). The proposal requires additional disclosures on Form ADV for funds or offerings that consider ESG factors as part of one or more "significant" investment strategies. The new rule will likely not be adopted until the end of Form ADV season (Q1 2023). The recent SCOTUS decision in *West Virginia v. EPA* may call into doubt the SEC's authority on climate change disclosures.

⁷ "Institutional investment managers" are managers that in the course of their business exercise investment discretion over 13F securities (generally US-listed securities and related options and warrants) with an aggregate value of at least USD 100 million. The term includes non-US managers, unregistered managers and *potentially* some types of family offices.

⁸ Funds and managers are required to make certain disclosures on the description and order of proxy voting, the number of shares voted or not voted, as well as the number of shares loaned and not recalled.

National Security Reviews Cut Across Asset Classes. Recent US CFIUS actions considered investments in real estate, biotech, clean tech, dating apps and much more. Advisers should consider national security implications across a wider range of investments than ever before. For more detail, please see [the Baker McKenzie Foreign Investment blog](#).

Foreign Source Income in Hong Kong? The HK government passed a law to [tax foreign-source income](#) locally (effective 1 January 2023). Many (though not all) funds are excluded.

“New” Tax on Thai Equities? Capital gains taxes will again be collected on sales of listed issuers on the Thai stock exchange after a more-than-30-year exemption.⁹

Regulators Are Looking At...

[SEC Spring Cleaning Agenda](#)

The following key rules (and many more) are likely to be adopted this spring:

- [Climate Change Disclosure](#)
- [Cybersecurity Risk Governance](#)
- [Special Purpose Acquisition Companies](#)
- [Modernization of Beneficial Ownership Reporting](#)
- [Share Repurchase Disclosure Modernization](#)
- [New amendments to the Custody Rule](#)
- [Amendments to Securities Transaction Settlement Cycle](#)
- [The Private Fund Advisers Rule](#)

In total, 52 items have been included on the Spring Reg. Flex Agenda, 23 proposed and 29 at the final stage. The [CFTC](#) is also getting into the act with an expanded regulatory agenda.

SEC Enforcement Priorities. [The Division of Enforcement released their 2022 results, while the Division of Examinations released their 2023 Priorities.](#)

Managers should expect scrutiny of:

1. Compliance with new SEC rules, including the Marketing Rule;
2. Private funds focus on fiduciary duty, conflicts of interest/disclosures/alternative data;
3. Fee and expense calculation and allocations, with a special focus on PE post-commitment-period management fees and valuation practices;
4. Use of emerging financial technologies, including crypto assets; and
5. Compliance with the Custody Rule (particularly timely delivery of audited financials and selection of permissible auditors).

UK Enforcement Priorities. 2023 is poised to be a year when, even by the usual standards of the sector, [an awful lot of things are going to happen](#).

Scanning the Horizon

US SEC Systematic Trading Registration? A potentially major new category of registration would affect proprietary trading firms, private firms that buy and sell securities to provide liquidity and large traders (USD 25 billion+) of government securities to register as a dealer.

⁹ The draft law (Royal Decree) is currently under the review of the Office of the Council of State of Thailand, and it will likely become public in early 2023. We expect further details once the draft Royal Decree becomes public. In the first year of resumption, the collection rate will be 0.05% (0.055% with local taxes), which will allow three months to prepare before the actual collection of the SBT will resume. In 2024, the SBT rate will be collected at the full rate of 0.1% (0.11% with local taxes).

US Government Review of Outbound Transactions? Either US Presidential or Congressional action might create some sort of "reverse-CFIUS" review limiting investments by US funds and other US investors in non-US companies in sensitive industries.¹⁰

ESG Reporting for EU-Domiciled Managers? In November 2022, the Corporate Sustainability Reporting Directive (CSRD) was approved and would require large EU companies to comply with EU sustainability reporting standards. National rules will be adopted over an 18-month period.

Final SEC Private Fund Adviser Rule Slated for April. The final rule for this [major shake-up of U.S. regulation of private fund managers](#) is coming. Expect a transition period before the rule takes effect along with wide-ranging effect on unregistered and non-US managers.

Changes Afoot for US Private Placements? SEC Commissioner Crenshaw floated the not-new idea of [tightening the US private placement regime](#).

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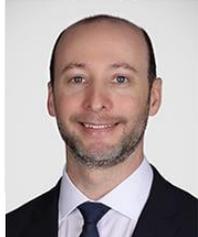
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¹⁰ Including companies involved in industries such as energy, medical, communications, defense, transportation, aerospace/space launch, robotics, AI, semiconductors, shipbuilding, water/water purification. Certain proposed legislation (the National Critical Capabilities Defense Act of 2022 (NCCDA)) would require notification and review of outbound investment transactions in countries of concern or entities headquartered in those countries or concerning national critical capabilities (e.g., China and Russia). Absent congressional action, a Biden executive order implementing a similar review process is also possible.



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