

MAYER | BROWN



INVESTMENT MANAGEMENT REGULATORY UNIVERSITY

APRIL 30, 2025
MAY 7, 2025

AGENDA

1. Hot Topics in Investment Adviser Regulation
2. Key Considerations for the Use of Rated Note Feeders and CFOs
3. Private Funds Developments
4. Enforcement and Investigation Trends Affecting Investment Advisers and Other Fiduciaries

The background of the slide features a large, circular seal of the U.S. Securities and Exchange Commission. The seal is embossed on a light-colored, textured surface. It depicts an eagle with wings spread, perched on a shield with vertical stripes. The outer ring of the seal contains the text "U.S. SECURITIES AND EXCHANGE COMMISSION" and the Roman numeral "MCMXXXIV" at the bottom. Two thin vertical lines intersect the seal, one near the top and one near the bottom.

HOT TOPICS IN INVESTMENT ADVISER REGULATION

PANEL I

PANEL I

HOT TOPICS IN INVESTMENT ADVISER REGULATION



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HOT TOPICS

- Trump 2.0
- The “Gensler Effect” ... and now the “Atkins Diet”?
- What will be the fate of rules not yet finalized?
 - CIP Programs for RIAs and ERAs
 - Predictive Data Analytics
 - Safeguarding/Custody
 - Outsourcing
 - IA/IC ESG Disclosure Rules
 - Cybersecurity Risk Management
- Updated Marketing Rule FAQs



INCREASING ACCESS TO ALTERNATIVE INVESTMENTS TO RETAIL INVESTORS

Alternative Investment Funds for DC Plans

While there is over \$60B of real estate assets in 401(k) plans, ERISA fiduciaries have had concerns regarding the permissibility of providing 401(k) plan participants with access to direct or indirect investments in alternative asset classes



The prior Trump Administration viewed providing retirement plan investors with access to private markets in a favorable light and, in 2020, issued an Information Letter



The second Trump Administration will maintain the same position and will not present any regulatory roadblocks discouraging the adoption of these products by plan fiduciaries for their 401(k) plans



ALTERNATIVES INVESTMENT PRODUCTS FOR DEFINED CONTRIBUTION PLANS

POTENTIAL STRUCTURES

- Designated Investment Alternatives
 - Need to address Look-Through Issues
 - SEC No-Action Letters
- Target Date Funds
- Managed Account Solutions

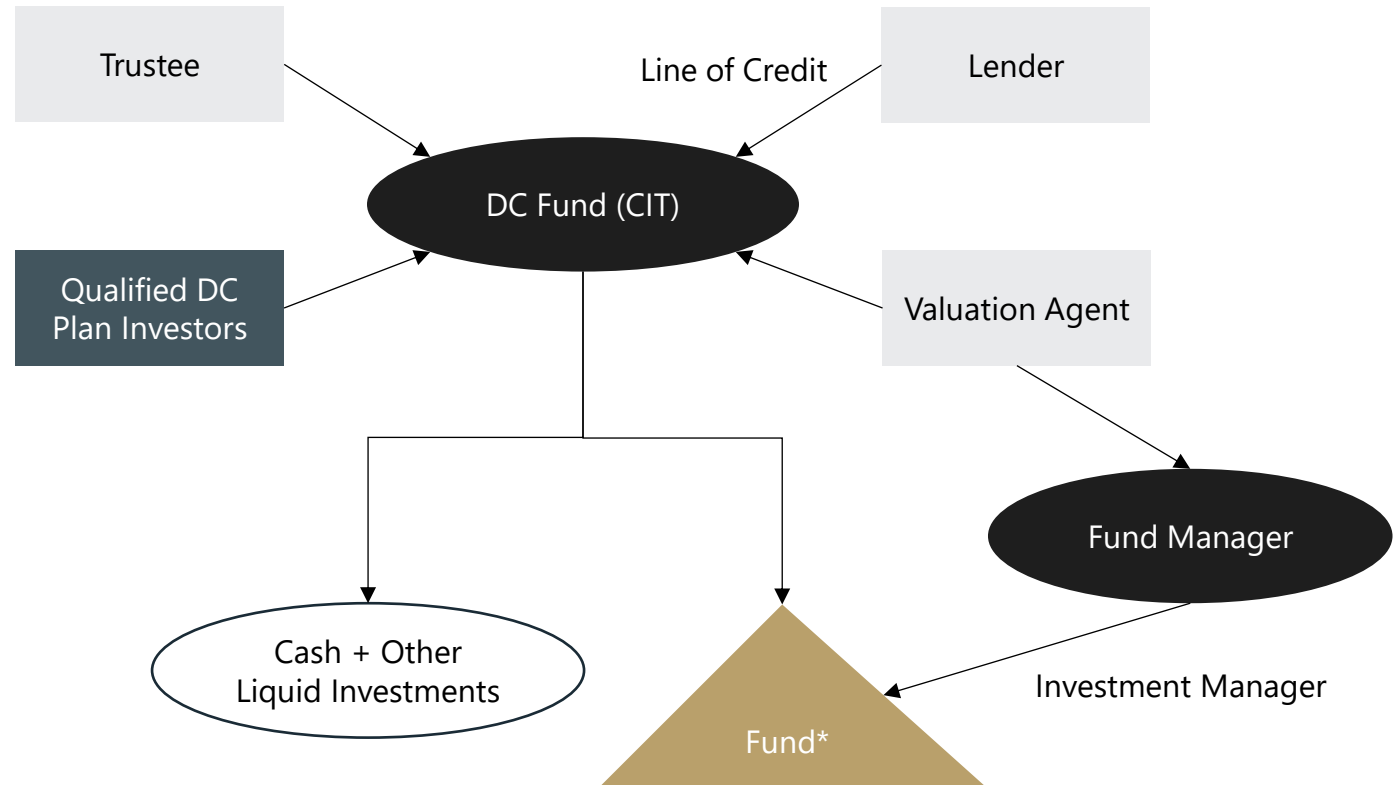
LITIGATION RISKS



TYPICAL LEGAL STRUCTURE FOR THE DC FUND

- State Regulated Trust Company
- Daily Valuation
- Flexibility re Manager Roles
- Fees
- Open-end fund
- Embedded liquidity Sleeve with a complimentary investment strategy to the private fund
- Line of credit provides enhanced liquidity

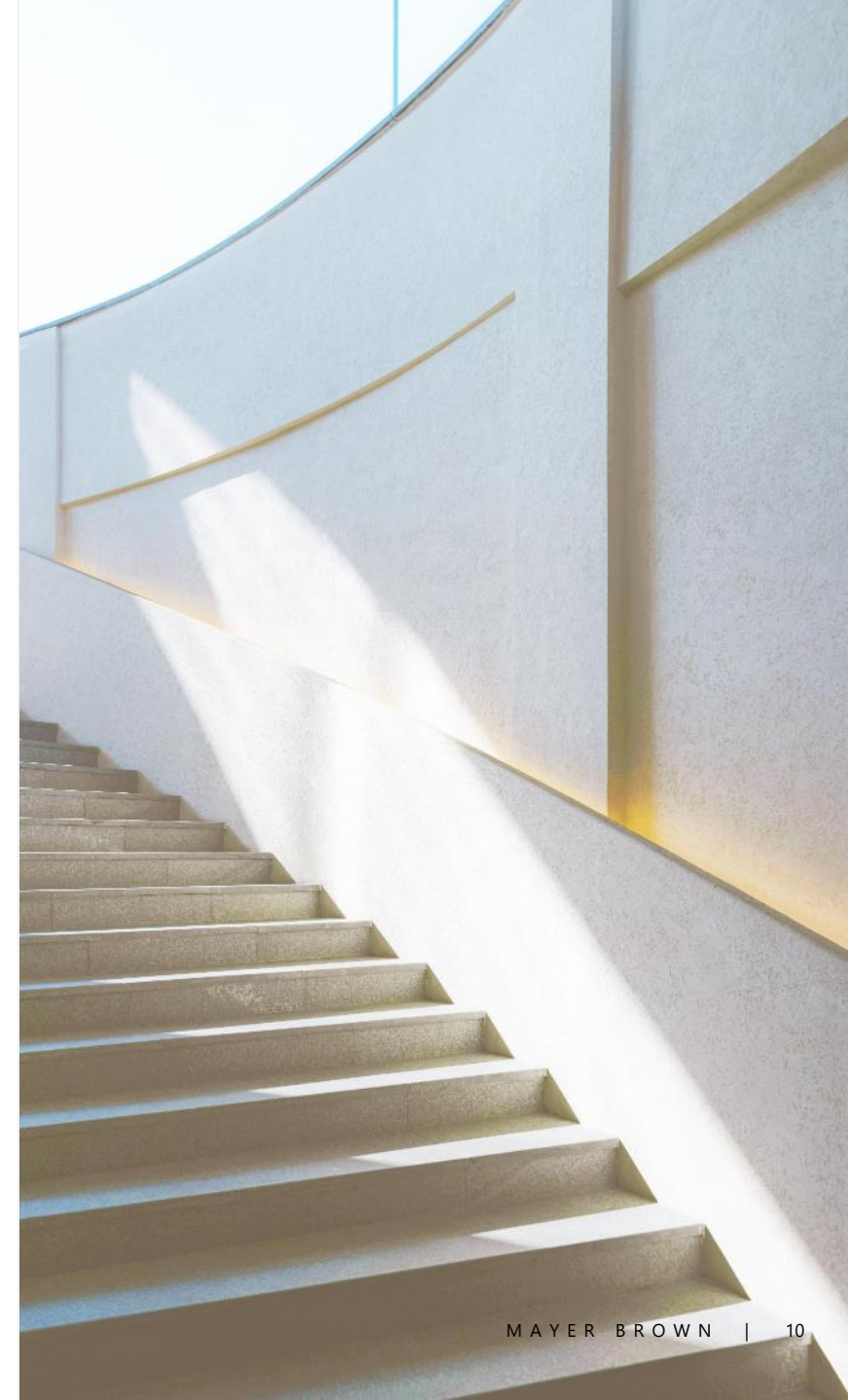
ANTICIPATED STRUCTURE OF THE DC FUND



* The Fund can invest in other private funds managed by the Fund Manager.

FAVORABLE REGULATORY ENVIRONMENT

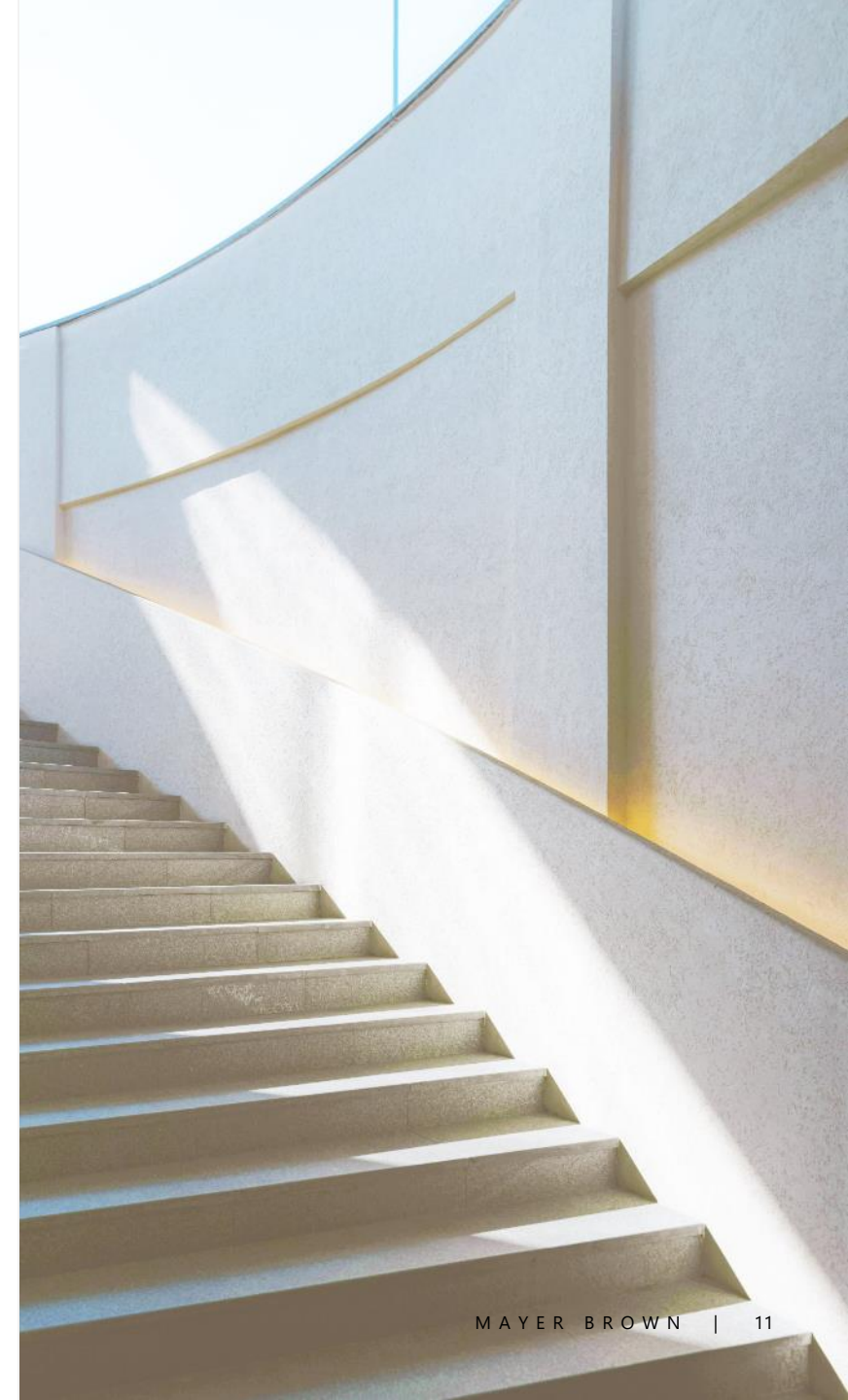
- Department of Labor
 - New appointees to EBSA
 - Dan Aronowitz
- SEC
 - 403(b) Plans and CITs
- Industry Efforts Seeking Further Guidance



HOT TOPICS

EXAM PRIORITIES(?)

- Crypto
- Private Funds
- AML
- Reg S-P
- Cybersecurity
- Artificial Intelligence
- Fiduciary Standards
- Compliance Programs
- Never examined, recently registered, not recently examined



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KEY CONSIDERATIONS FOR THE USE OF RATED NOTE FEEDERS AND CFOs

PANEL II

PANEL II

KEY CONSIDERATIONS FOR THE USE OF RATED NOTE FEEDERS AND CFOs



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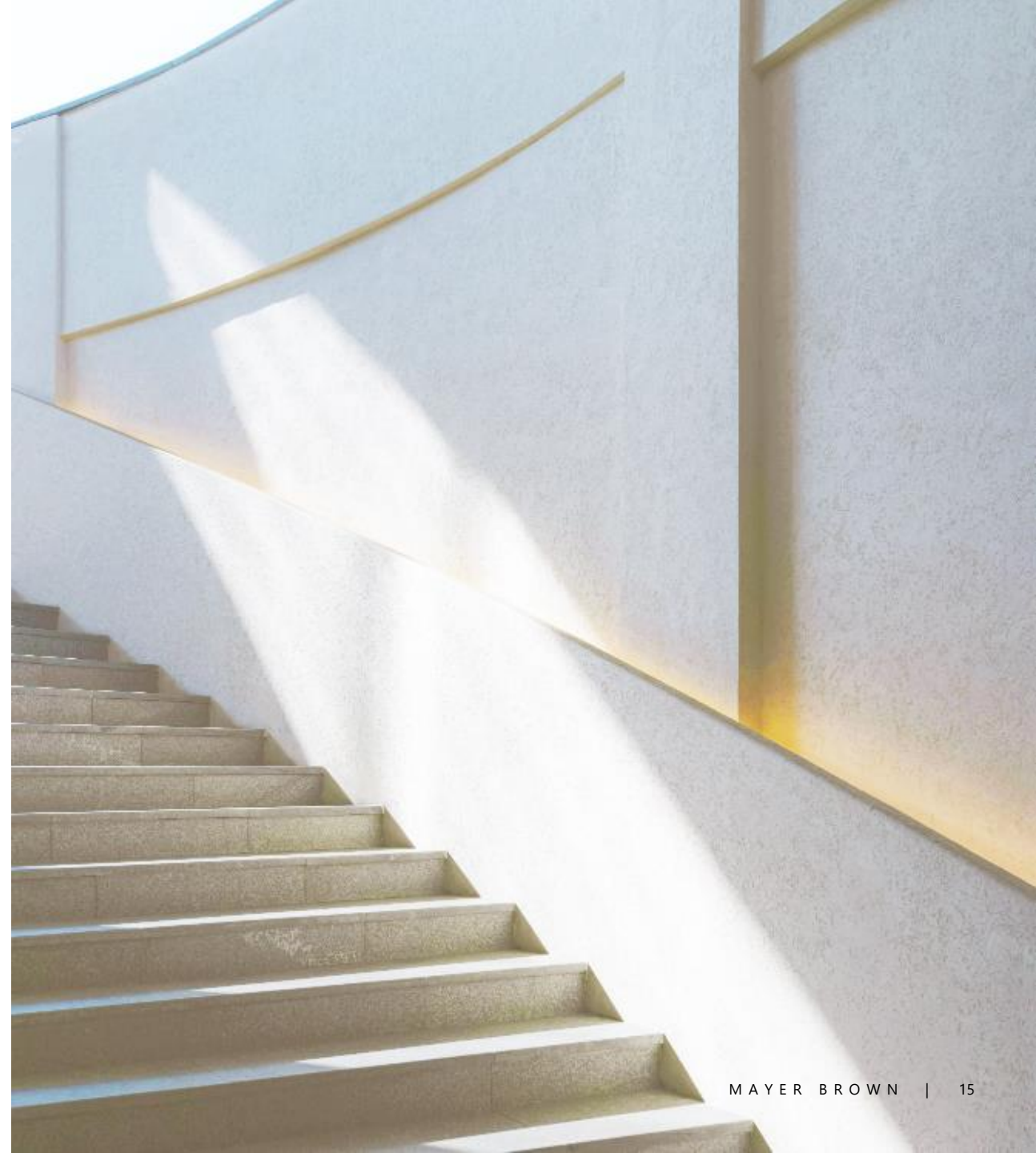
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NAIC CONSIDERATIONS FOR RATED FEEDER STRUCTURES

- **Insurers want their fixed income investments to be treated as bonds** – reported on **Schedule D** and receiving a risk-based capital (**RBC**) charge based on their NAIC designation
- **Insurers also want their fixed income investments to be filing exempt (FE)** – so that they automatically receive the NAIC designation associated with their rating by a NRSRO (referred to by the NAIC as a Credit Rating Provider or CRP) rather than having to be filed with and analyzed by the NAIC's Securities Valuation Office (**SVO**)
- Recent NAIC initiatives will make it more challenging for insurers to achieve these goals:
 - A new principles based bond definition (**PPBD**) became effective on January 1, 2025
 - Starting on January 1, 2026, the SVO will have the authority to challenge and potentially override NAIC designations derived from CRP ratings on a security-by-security basis



RBC FACTORS FOR LIFE INSURERS (PRE-TAX)

NAIC Designation	NRSRO Equivalents	Life RBC Factor (%)		NAIC Designation	NRSRO Equivalents	Life RBC Factor (%)
1.A	Aaa/AAA	0.158		3.A	Ba1/BB+	3.151
1.B	Aa1/AA+	0.271		3.B	Ba2/BB	4.537
1.C	Aa2/AA	0.419		3.C	Ba3/BB-	6.017
1.D	Aa3/AA-	0.523		4.A	B1/B+	7.386
1.E	A1/A+	0.657		4.B	B2/B	9.535
1.F	A2/A	0.816		4.C	B3/B-	12.428
1.G	A3/A-	1.016		5.A	Caa1/CCC+	16.942
2.A	Baa1/BBB+	1.261		5.B	Caa2/CCC	23.798
2.B	Baa2/BBB	1.523		5.C	Caa3/CCC-	30.000
2.C	Baa3/BBB-	2.168		6	All Lower	30.000

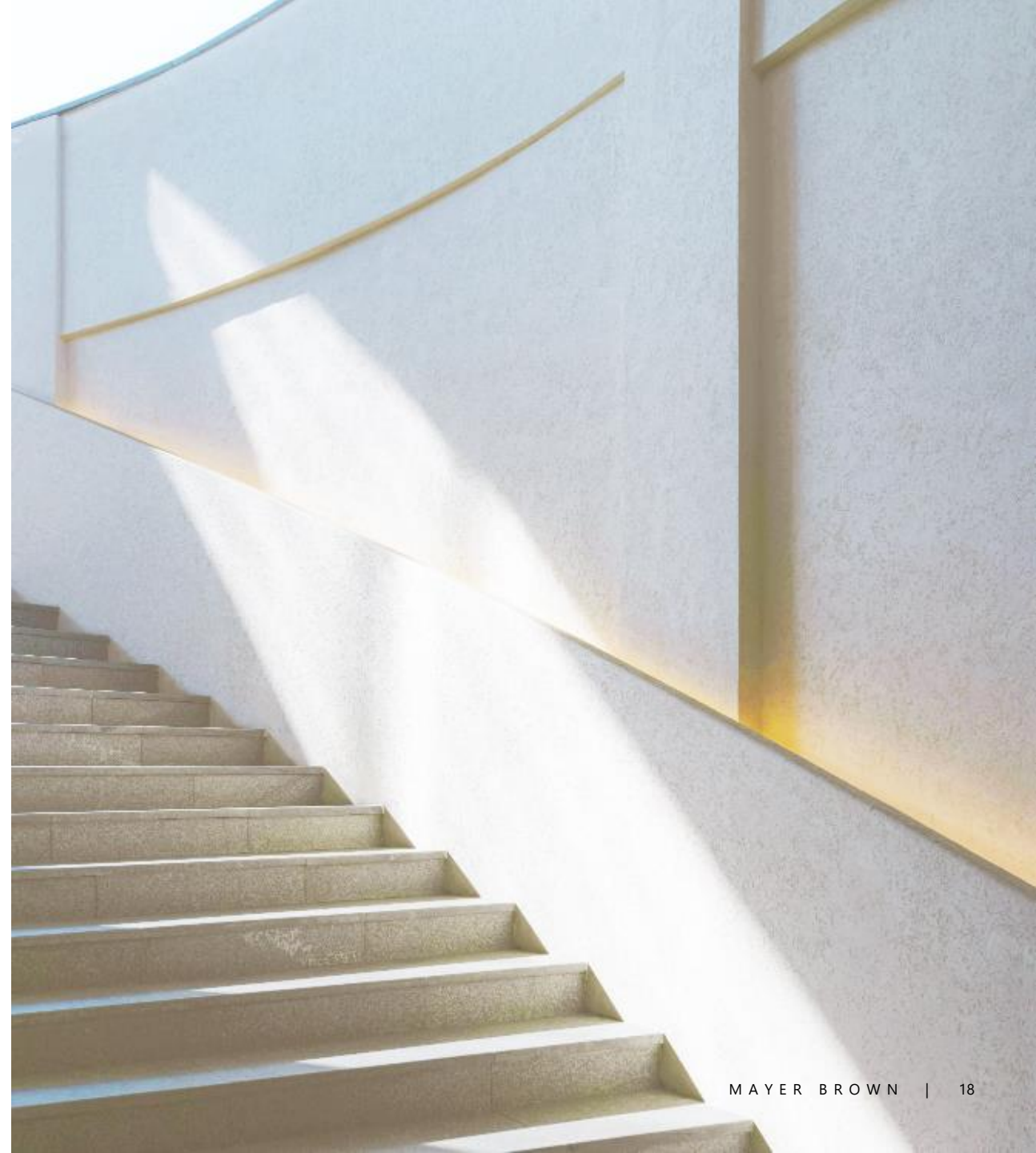


ALL DEBT SECURITIES MUST SATISFY THE PPBD TO QUALIFY AS BONDS

- The new *SSAP No. 26* defines a “bond” as:
 - a security
 - representing a creditor relationship
 - whereby there is a schedule for one or more future payments and
 - which qualifies as either:
 - an issuer credit obligation (**ICO**) or
 - an asset-backed security (**ABS**)
- There is no “grandfathering” of existing investments – all portfolio investments must satisfy the new definition effective on 1/1/2025

DEFINITION OF “SECURITY” FOR STATUTORY ACCOUNTING PURPOSES (SAME AS GAAP)

- Security: A share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has all of the following characteristics:
 - a. It is either represented by an instrument issued in bearer or registered form or, if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer
 - b. It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment
 - c. It either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests or obligations





ISSUER CREDIT OBLIGATIONS

- An **ICO** is a bond, the repayment of which is supported primarily by the general creditworthiness of an operating entity or entities
- Issuers can be either operating companies or holding companies that have the ability to access the cash flows of operating company subsidiaries through their ownership rights
- The ICO definition includes:
 - US Treasury and US government agency securities
 - municipal bonds
 - corporate bonds
 - project finance bonds
 - securities for which repayment is “fully supported by an underlying contractual obligation of a single operating entity” (discussed on next slide)
 - bonds issued by REITs
 - bonds issued by funds that represent “operating entities” (discussed below)
 - convertible bonds (including mandatory convertible bonds)

TWO CONDITIONS ABS MUST SATISFY TO BE A BOND (DETERMINED AS OF THE DATE OF ORIGINATION)

- Condition #1: The assets owned by the ABS issuer must be either:
 - financial assets, or
 - cash-generating non-financial assets
 - defined as assets that are expected to generate a “**meaningful**” level of cash flows toward repayment of the bond through use, licensing, leasing, servicing or management fees, or other similar cash flow generation (and not just through the sale or refinancing of the assets)
 - “meaningful” criterion is deemed met if payment of 100% of the interest and at least 50% of the original principal relies on sources of cash other than sale or refinancing—but can also be met in other ways
- Condition #2: The holder of a debt instrument issued by an ABS issuer must be:
 - in a different economic position than if the holder owned the ABS issuer’s assets directly
 - as a result of “**substantive**” credit enhancement through:
 - guarantees (or other similar forms of recourse),
 - subordination and/or
 - overcollateralization
 - This means that the “first loss” tranche in an ABS structure is not a bond
 - Instead, it is classified as a “**residual interest**”

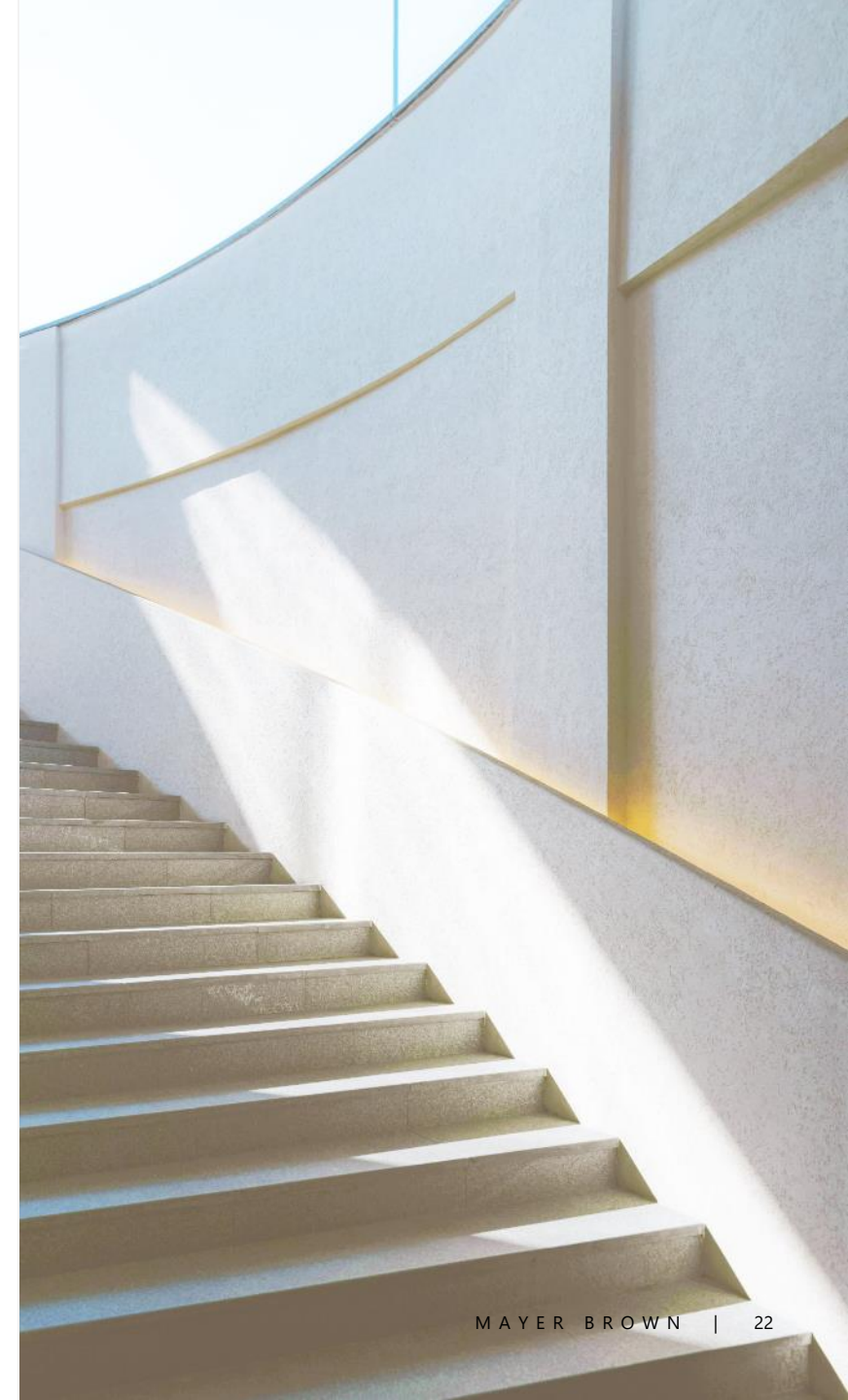


DEFINITION OF “FINANCIAL ASSETS”

- *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* defines a financial asset as cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right (a) to receive cash or another financial instrument from a second entity or (b) to exchange other financial instruments on potentially favorable terms with the second entity
- Financial assets do not include assets for which the realization of the benefits conveyed by the above rights depends on the completion of a performance obligation (e.g., leases, mortgage servicing rights, royalty rights, etc.). These assets represent non-financial assets, or a means through which non-financial assets produce cash flows, until the performance obligation has been satisfied

SPECIAL RULES APPLY WHEN ABS ARE BACKED BY EQUITY INTERESTS

- There is a **rebuttable presumption** that debt instruments collateralized by equity interests do not qualify as bonds because they do not reflect a creditor relationship in substance.
- Notwithstanding this rebuttable presumption, it is **possible** for such a debt instrument to represent a creditor relationship if:
 - (1) the characteristics of the underlying equity interests lend themselves to the production of predictable cash flows and
 - (2) the underlying equity risks have been sufficiently redistributed through the capital structure of the issuer.
- A **documented analysis** supporting the predictability of cash flows must be completed *at the time the investment is acquired* to overcome the rebuttable presumption.
- A debt instrument that has been successfully marketed to unrelated investors may provide enhanced market validation in contrast to one held by a single insurer or group of affiliated insurers.



NON-EXHAUSTIVE LIST OF FACTORS TO BE CONSIDERED IN OVERCOMING THE REBUTTABLE PRESUMPTION

- Number and diversification of the underlying equity interests
- Characteristics of the equity interests (vintage, asset-types, etc.)
- Liquidity facilities
- Overcollateralization
- Waiting period for the distributions/pay-downs to begin
- Capitalization of interest
- Covenants (e.g., loan-to-value trigger provisions)
- Reliance on ongoing sponsor commitments
- Source(s) of expected cash flows to service the debt (*i.e.*, dividend distributions from the underlying collateral vs. sale of the underlying collateral)

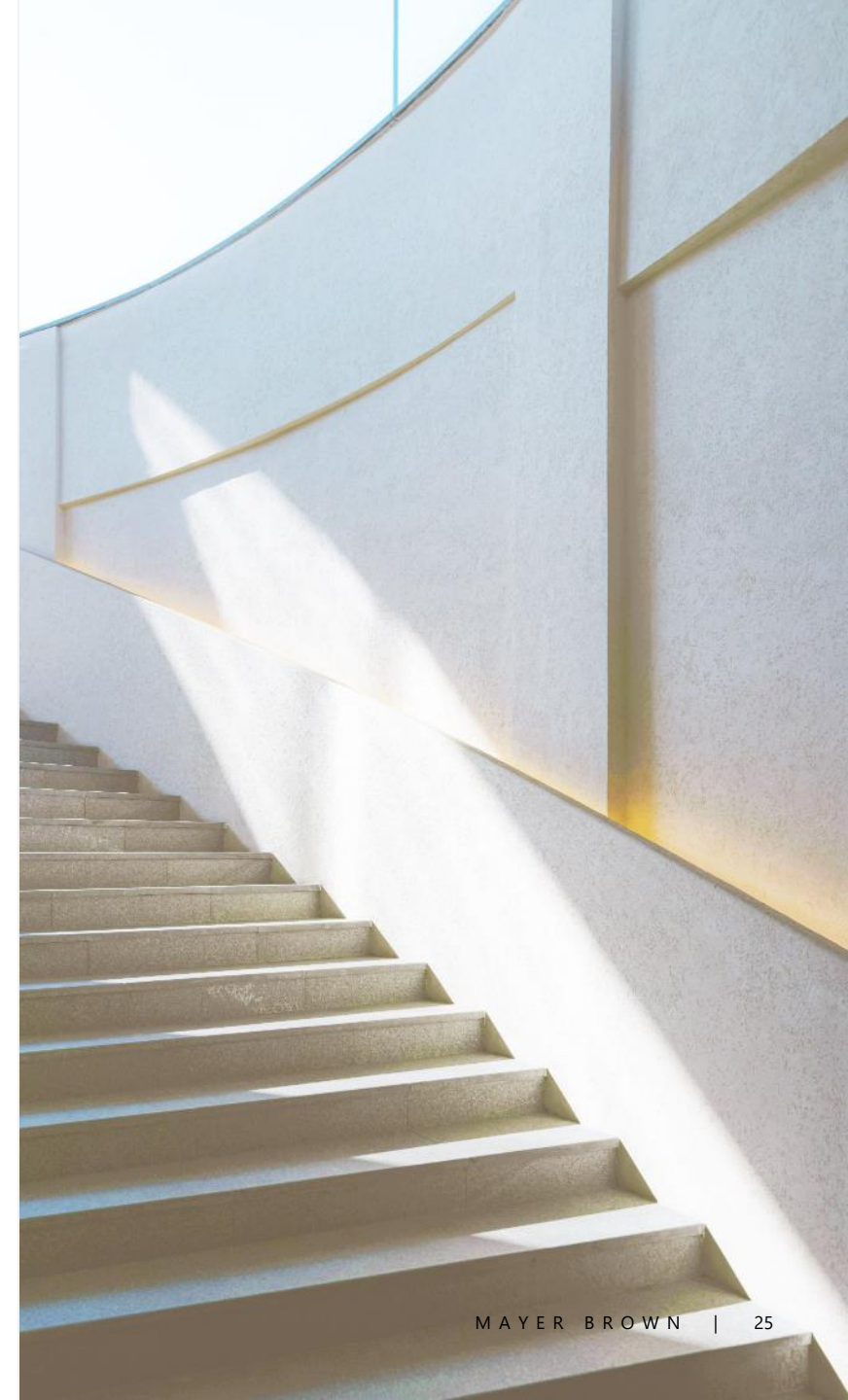


HOW ARE RATED FEEDER NOTES AND CFOs TREATED UNDER THE PPBD?

- They neither automatically qualify for, nor are automatically disqualified from, bond treatment
- It is necessary to look through the structure and evaluate the underlying portfolio of assets that generate the cash flows for repayment
- Consider the regularity and certainty of the cash flows
 - In particular, whether the assets are debt instruments that generate periodic, scheduled payments of principal and interest
 - The expectation is that rated feeders and CFOs for private credit funds, direct lending funds and similar strategies will qualify for bond treatment
 - If cash flows vary or are irregular (e.g., due to discretion of an underlying fund manager or the need to sell underlying investments, such as private equity portfolio assets), it will be harder to qualify the structure for bond treatment

WHAT HAPPENS IF A DEBT SECURITY FAILS TO SATISFY THE PPBD?

- A debt security that fails the bond definition is a “non-bond debt security” (**NBDS**) governed by *SSAP No. 21—Other Admitted Assets*
- NBDS are admitted assets only if the underlying collateral primarily qualify as admitted assets. (Examples of what would not qualify: student loans, consumer loans, railcar leases)
- NBDS are reported on **Schedule BA**, initially at cost and subsequently at the lower of amortized cost or fair value
- NBDS are segregated on Schedule BA based on the PPBD characteristic they lacked (creditor relationship, substantive credit enhancement or meaningful cash flows)
- NBDS need to be filed with the SVO to receive an NAIC designation, i.e., they are not eligible for the filing exemption under which a CRP rating is used to determine the NAIC designation





RBC FOR NON-BOND DEBT SECURITIES

- NBDS are not filing-exempt, meaning that they no longer derive an NAIC designation from a CRP rating
- For life insurers:
 - If an NBDS has a designation assigned by the SVO, that will flow through the AVR and will determine the RBC, using the bond RBC factors
 - If an NBDS does not currently have an SVO-assigned designation, it needs to obtain one
- For P&C and health insurers:
 - An NBDS is classified under “Other Invested Assets” with an RBC factor of 20%
 - It is possible that the NAIC may decide in the future to allow an SVO-assigned designation to determine the RBC for P&C and health insurers as well, but that is not currently the case

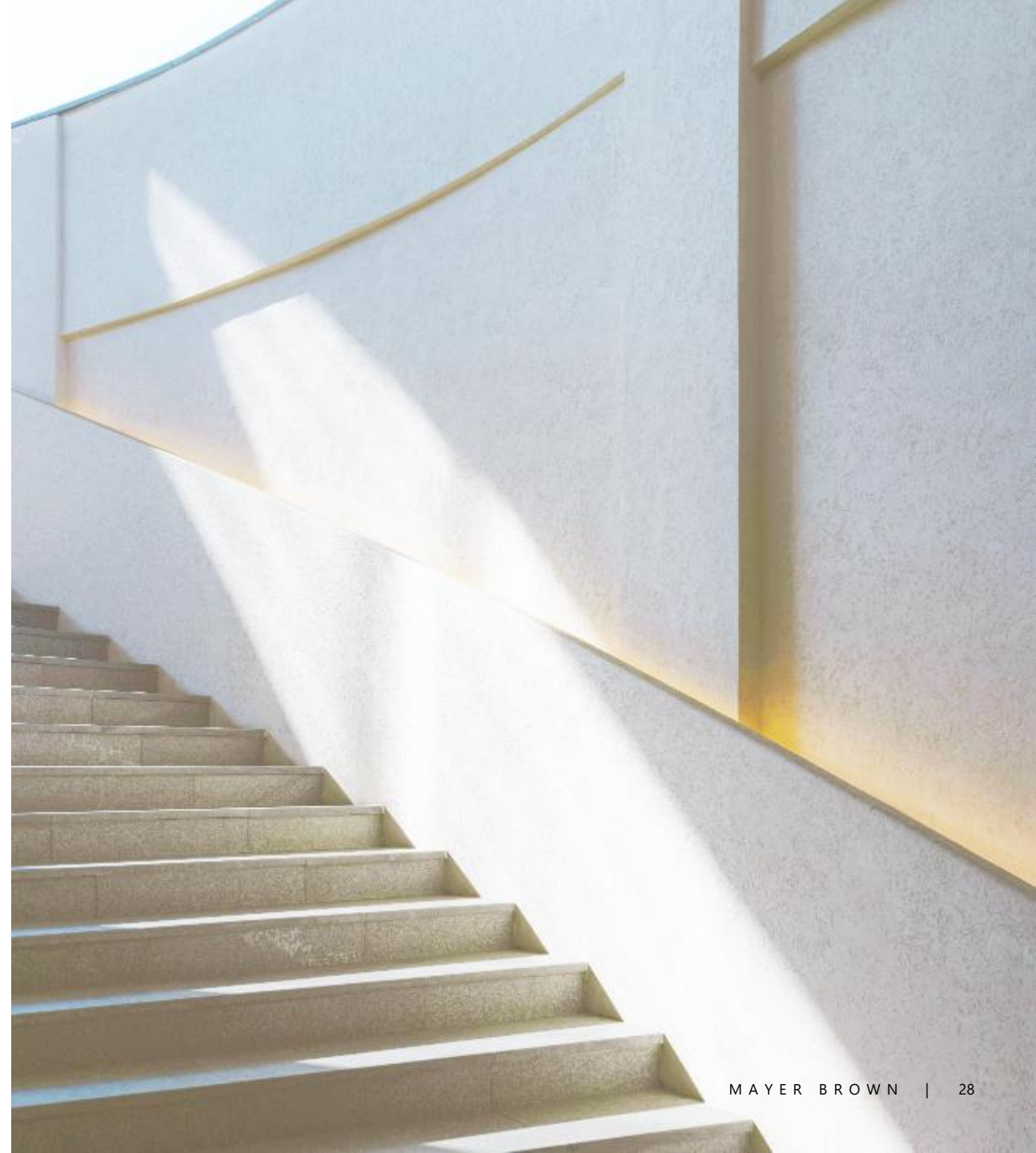
“RESIDUAL INTERESTS” – DEFINED BASED ON THE SUBSTANCE RATHER THAN THE FORM OF AN INVESTMENT

- The definition of “residual interest” was adopted on 9/21/2023 and became effective on 12/31/2023
- A residual interest or a residual security tranche exists in investment structures that are backed—directly, or indirectly through a feeder fund—by a discrete pool of collateral assets
- These collateral assets generate cash flows that provide interest and principal payments to debt holders, and once those contractual requirements are met, the resulting excess funds generated by (or with the sale of) the collateral assets are provided to the holder of the residual interest
- The residual interest holder thus absorbs losses resulting from assets in the collateral pool not performing as expected, before any losses are borne by the debt holders
- Consequently, the residual interest holder may ultimately receive nothing, a reduced amount from original projections, or large returns, based on how the underlying collateral assets perform



RBC AND ACCOUNTING TREATMENT OF RESIDUAL INTERESTS

- Effective with the 2024 RBC calculation, residual interests receive an RBC charge of 45% (increased from 30%) for life insurers and 20% for P&C and health insurers (no change)
- Additional criteria apply in determining whether a residual interest qualifies as an “admitted asset” (an asset that counts toward the insurer’s surplus)
 - If the senior debt in the structure consists of one or more bonds, then the underlying collateral does not need to consist of admitted assets in order for the residual interest to be an admitted asset
 - If the senior debt in the structure consists of NBDS, then the underlying collateral must be admitted assets in order for the residual interest to be an admitted asset



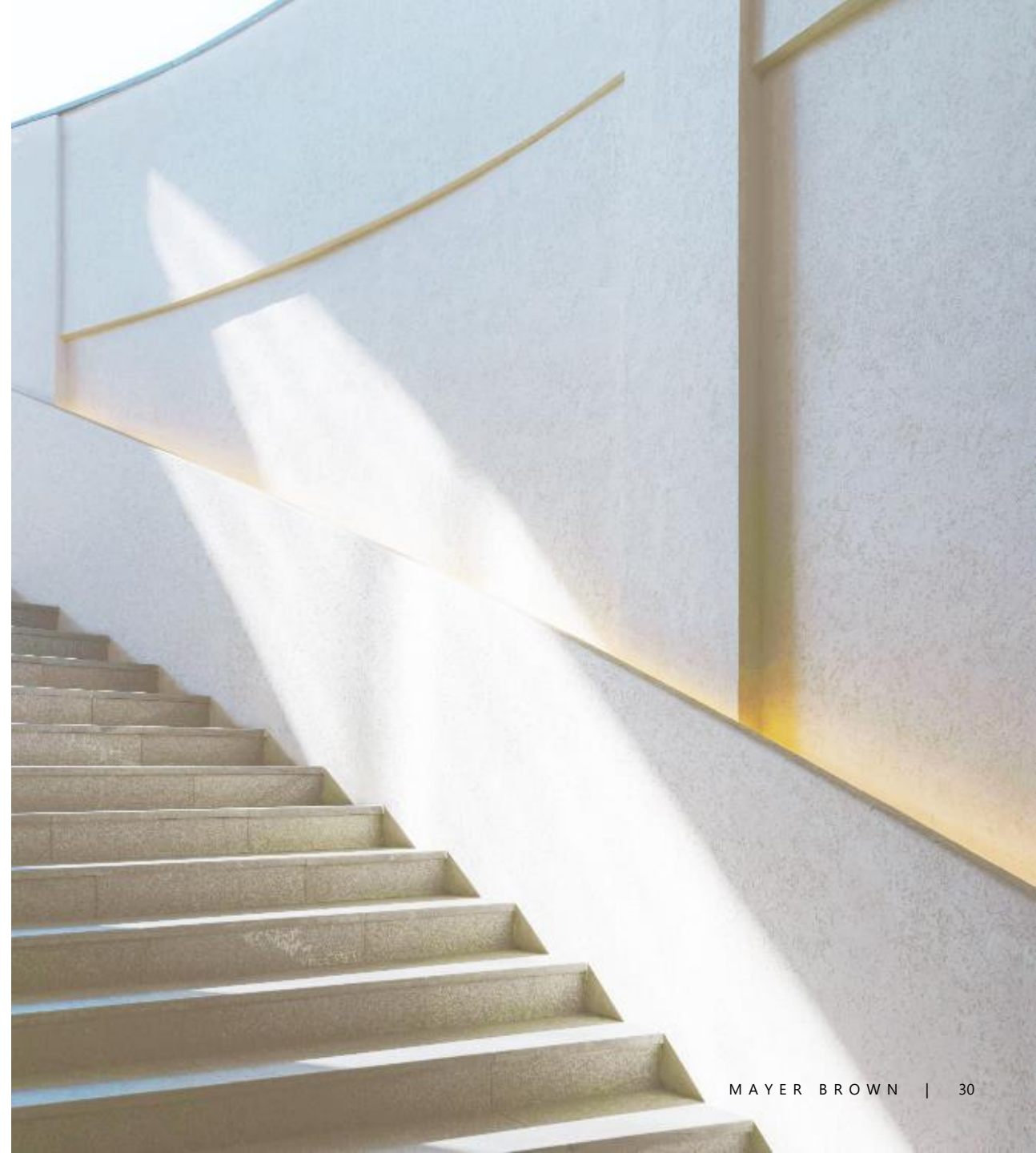


EFFECTIVE 1/1/2026, THE SVO WILL BE ABLE TO CHALLENGE DESIGNATIONS ON FILING-EXEMPT SECURITIES

- The SVO will be able to challenge the NAIC designation assigned through the FE process if it believes the CRP rating “may not be a reasonable assessment of investment risk of the security for regulatory purposes” and its own assessment differs by three or more notches
- The challenge process will require the insurer to file information with the SVO that is comparable to what is required for non-FE securities
- The insurer may submit any other information it wishes to support the CRP rating, including inviting the CRP to participate in the process
- Both sides will present their case to a subgroup of the NAIC Valuation of Securities (E) Task Force consisting of state insurance regulators
- That group of regulators will decide whether or not to substitute the SVO’s assessment for the designation assigned through the FE process

NAIC PPBD IMPACT TO RATED FUND STRUCTURES

- Avoid applying traditional equity features to notes
 - Senior noteholder giveback for indemnities is problematic
 - Avoid discretionary distributions by the sponsor
 - Use standard noteholder draw-down conditions
 - No excuse or exclusion provisions
 - Draw-downs after the end of the investment period need to be limited
- Add additional debt features to bolster bond treatment
 - Appointment of a third-party trustee or paying agent
 - Use of an independent director to establish bankruptcy remoteness of note issuer
 - Grant of security interest



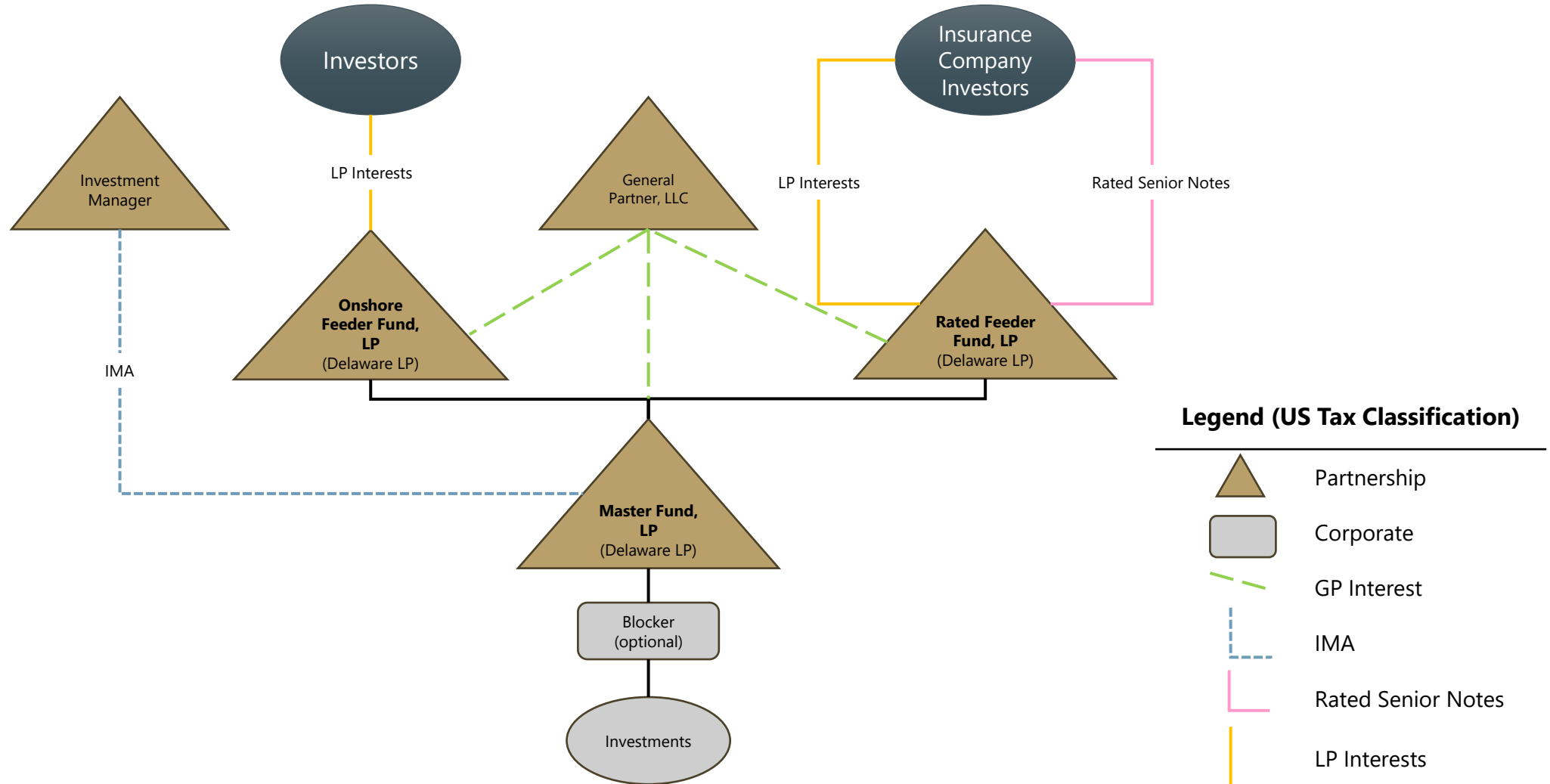


NAIC PPBD IMPACT TO RATED FUND STRUCTURES CONT'D

- Increased equity to satisfy the “substantive credit enhancement” requirement
 - Credit enhancement must result in a holder of the debt security being in a “different economic position” than if investing directly in the underlying portfolio
 - Credit enhancement cannot be nominal or lack economic substance. It must function as true, substantive first loss.
 - The amount of credit enhancement required will be specific to each transaction or structure
- Stapling interests (debt and equity) is still possible
 - Tranches must be separate securities (not a single investment unit)
 - Separate CUSIPs are preferable
 - Bond tranches will be reported on Schedule D
 - Residual tranches will be reported on Schedule BA

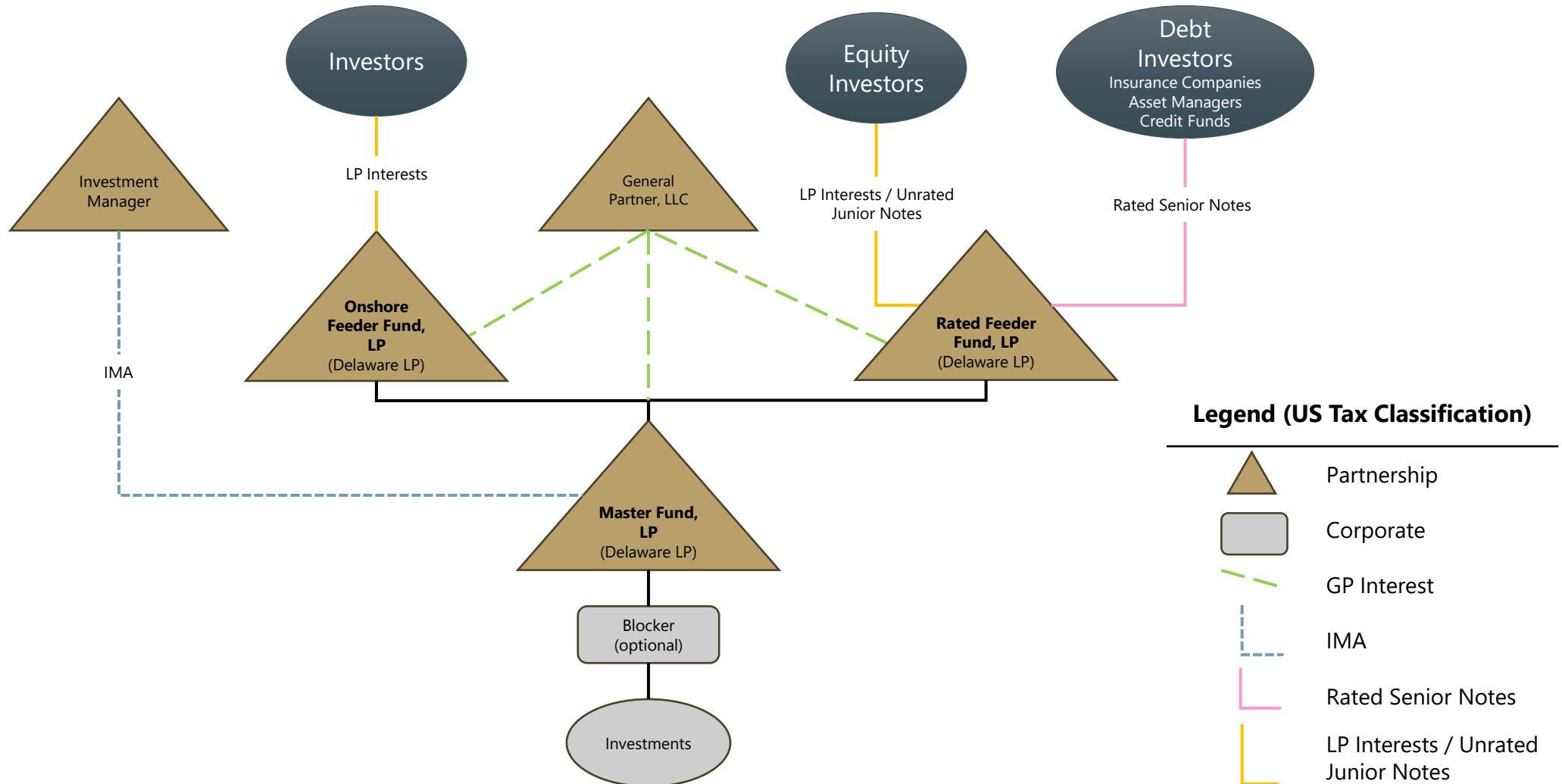
TYPICAL RATED NOTE FEEDER STRUCTURE - VERTICAL

RATED NOTES PRIVATE FUND STRUCTURE



TYPICAL RATED NOTE FEEDER STRUCTURE - HORIZONTAL

RATED NOTES PRIVATE FUND STRUCTURE



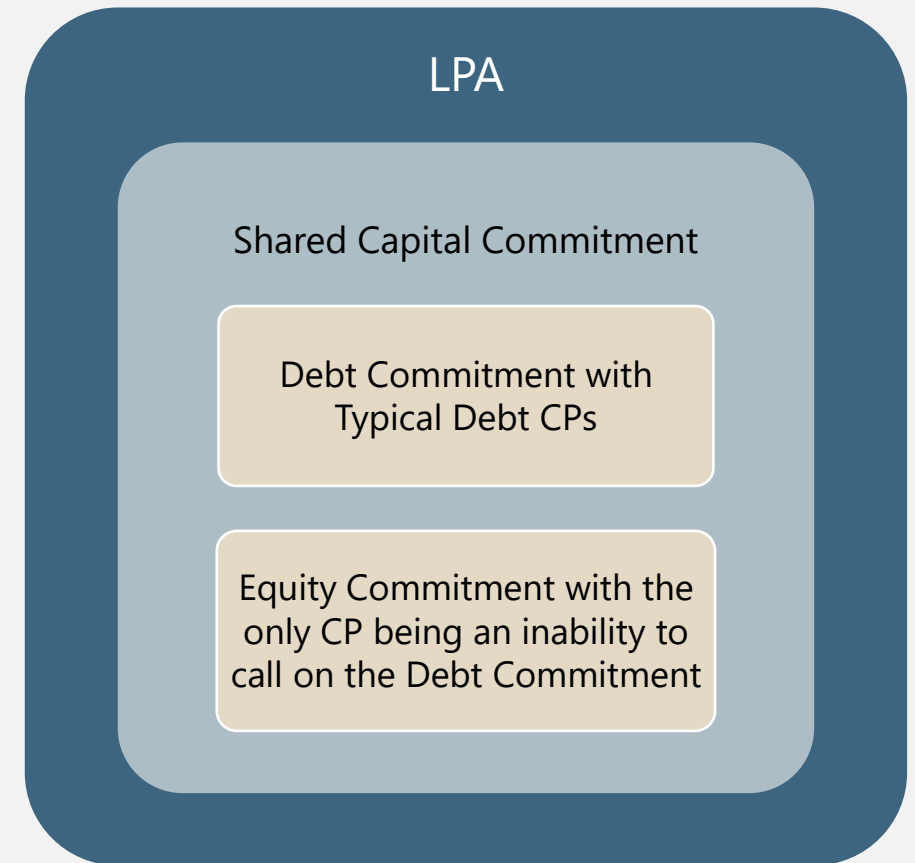
DIFFERENCES BETWEEN RATED FEEDER NOTES AND LP INTERESTS

FUND FEATURE	TYPICAL LP INTEREST	RATED NOTES	STRUCTURAL GAPS TO ADDRESS
Capital Commitments Drawdowns	Investor-by-Investor	Pro Rata and Pari Passu	Limits the ability to call capital on a non-pro rata basis
Distributions	Investor-by-Investor	Pro Rata and Pari Passu	The subordinate LP interest is effectively levered and is subordinate to the rated notes
Rebalancing	Allowed	Limited Rebalancing	Interest should be paid on the Rated Notes on each date such amounts are outstanding.
Fee Arrangements	Investor-by-Investor	Partial	Subordinate LP interest becomes recipient of fee discounts
Giveback / Recycling Obligations	Allowed	Not Allowed	Subordinate LP interest responsible for giveback and recycling obligations
Excuse / Exclusion	Allowed	Not Allowed	Effectively limited



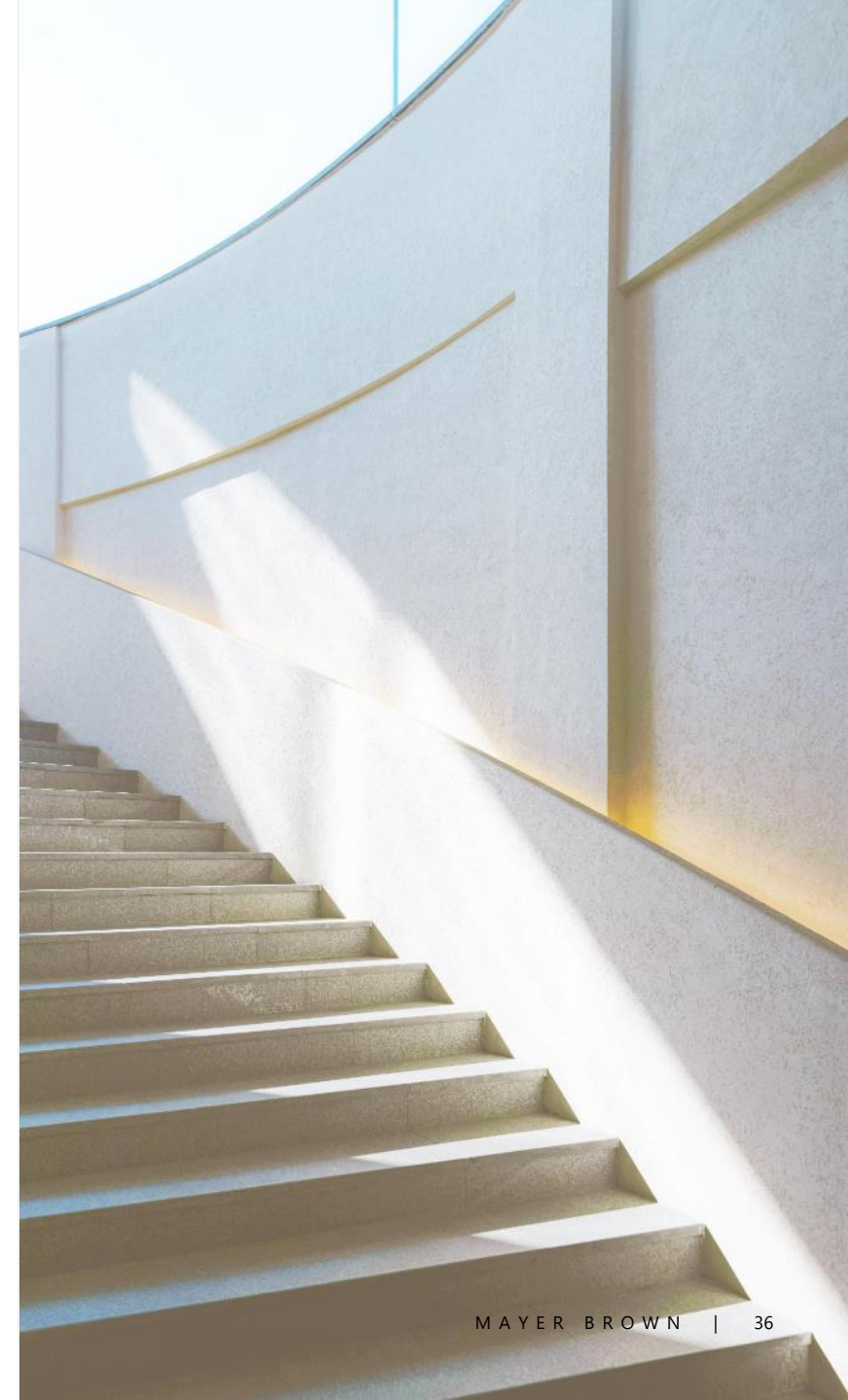
SUBSCRIPTION CREDIT FACILITY- RATED NOTE FEEDERS

- Risk of unenforceability for a debt commitment to fund in the event of a bankruptcy of the feeder or main fund.
- Day 1 Equity Commitment presents a solution.
- Although the SCF market has embraced the day 1 equity commitment, other solutions can be considered:
 - Bankruptcy Remote Feeder Funds
 - Equity Commitment Letters
- Each solution includes its own challenges and benefits.

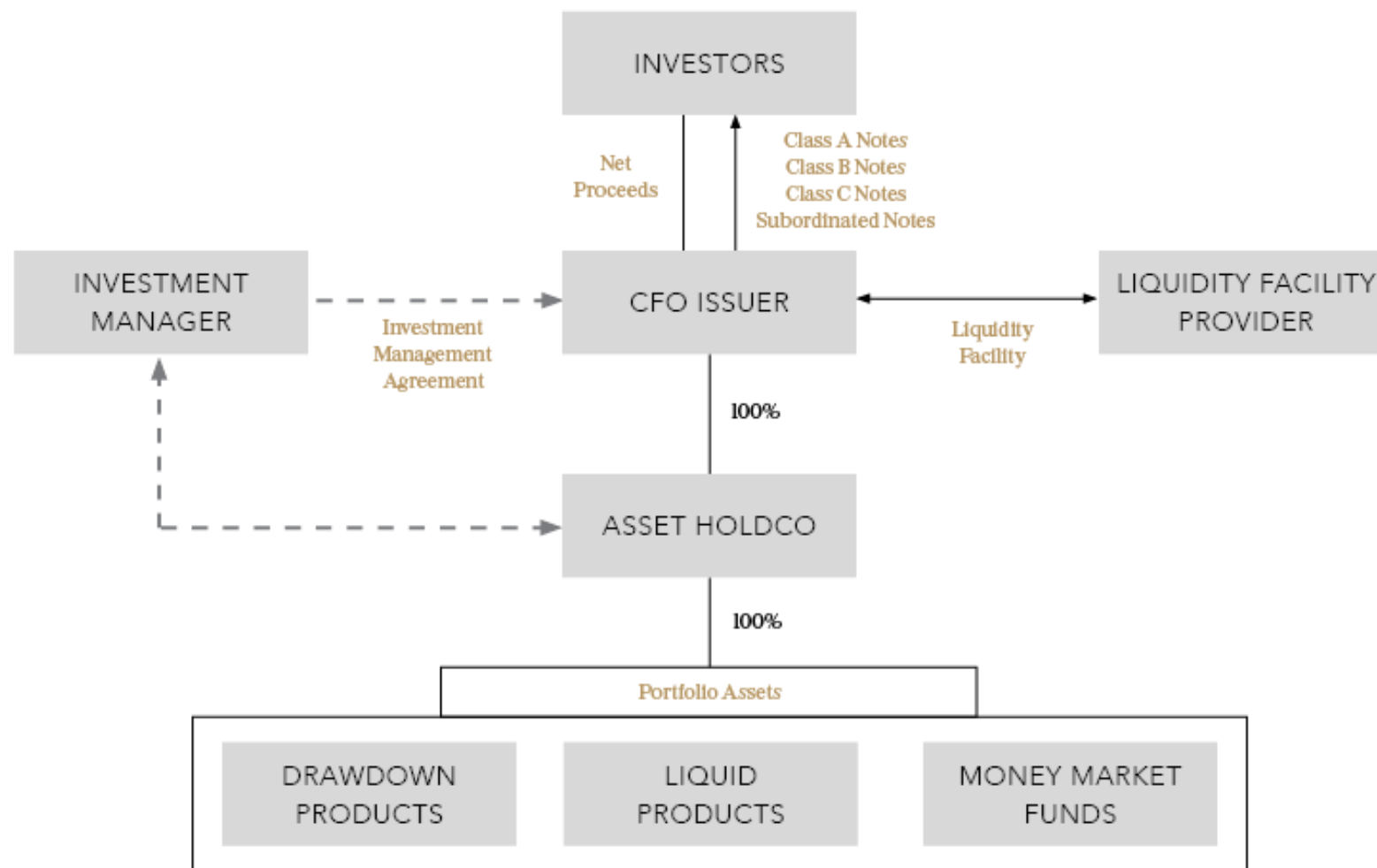


COLLATERALIZED FUND OBLIGATIONS

- Collateralized Fund Obligation (“CFOs”) utilize CLO and CDO technology to securitize interests in private equity, credit, infrastructure and other funds. Primarily used for:
 - Capital efficiency: insurance companies utilizing securitization to achieve capital efficiency by turning their fund exposures into rated exposures.
 - Fundraising: by asset managers as another means of deploying capital to new funds.
- Underlying assets can include LP interests in private equity funds, hedge funds, energy funds, infrastructure funds, venture capital funds, and credit funds. In addition, some CFOs include a broader range of investments such as equity stakes in CLOs or other asset-backed securitizations, co-investments in portfolio companies or syndicated loan assets.
- CFOs have features of CLOs, NAV facilities and rated feeders, in each case, with key differences from each.
 - CFOs utilize the tranche and collateral structure of CLOs while incorporating the loan-to-value metrics found in NAV facilities.



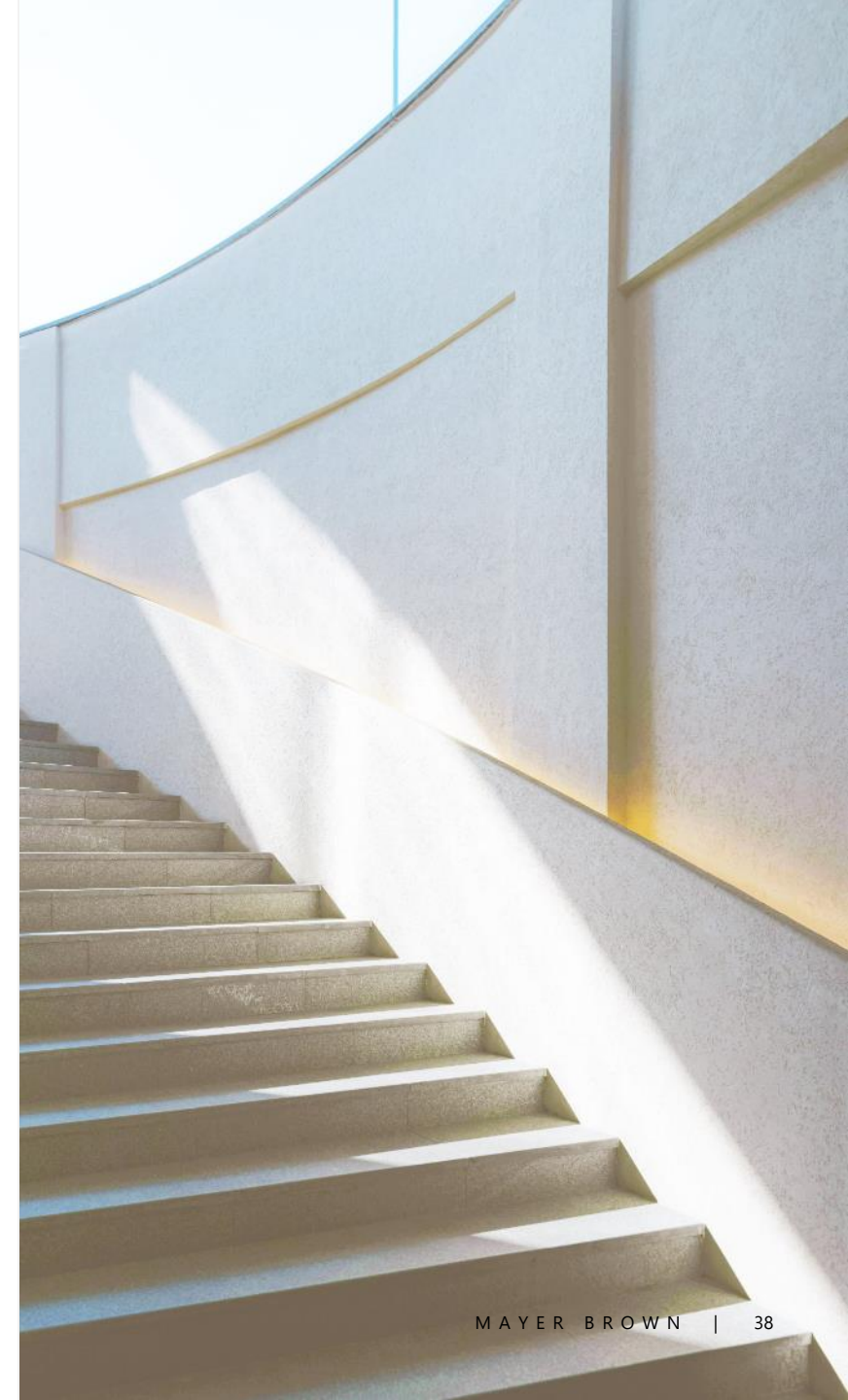
COLLATERALIZED FUND OBLIGATIONS - STRUCTURE



CFOs

FLEXIBILITY TO ADDRESS STRUCTURAL CHALLENGES

- Predictability of cashflows: Underlying Fund Interests don't have specified or consistent periodic payments.
 - Accordingly, the capital structure of the CFO must include the ability to defer or capitalize significant current interest or other payment obligations otherwise owing.
 - Alternatively, a CFO might utilize a liquidity facility, cash flow swap, or a similar arrangement to ensure timely payments of scheduled principal and interest on CFO Securities. Delayed draw notes, or a cash reserve account, both mitigate the risk of cash flow disruptions to investors and help the CFO achieve the desired rating.
- Capital Calls: Unless the Underlying Fund Interests are fully funded when acquired by the CFO Issuer, the capital structure of the CFO must include available capital with sufficient flexibility to allow the CFO Issuer to make its required capital contributions.
 - This flexibility can also be obtained through a revolving liquidity facility, issuing delayed draw notes, or by establishing a cash reserve account.



QUESTIONS?

BREAK

(15 MINUTES)

PRIVATE FUNDS DEVELOPMENTS

PANEL III



PANEL III

PRIVATE FUNDS DEVELOPMENTS

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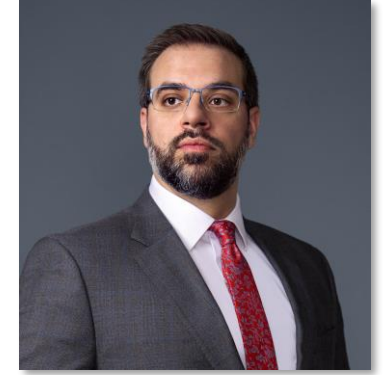
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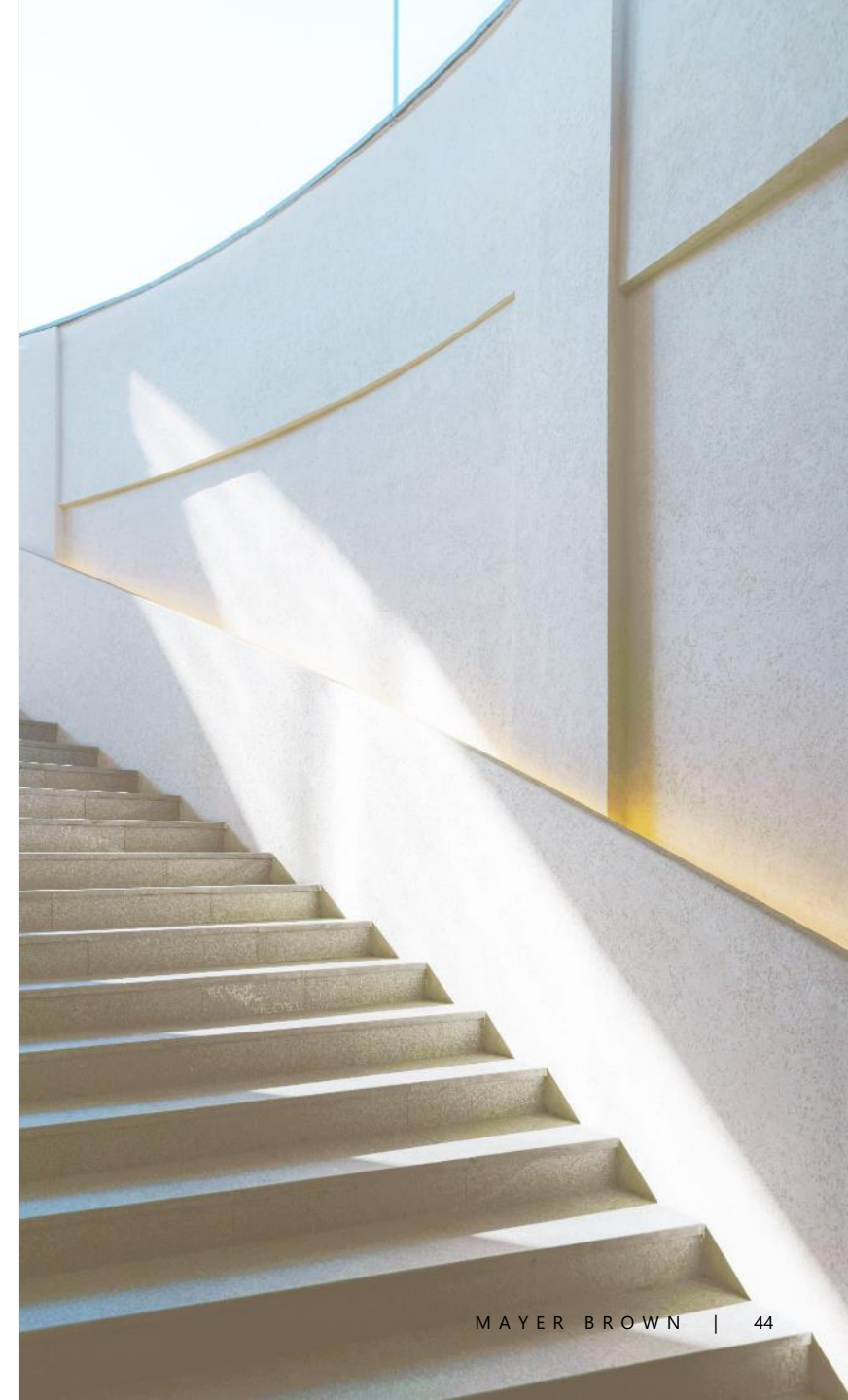
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PRIVATE FUNDS DEVELOPMENTS

- Regulatory Rollercoaster
- Investment Trends and Themes
- Anti-Money Laundering and Customer Identification Programs
- Tariffs, China, Global Trade (We Didn't Start the Fire 🎵)



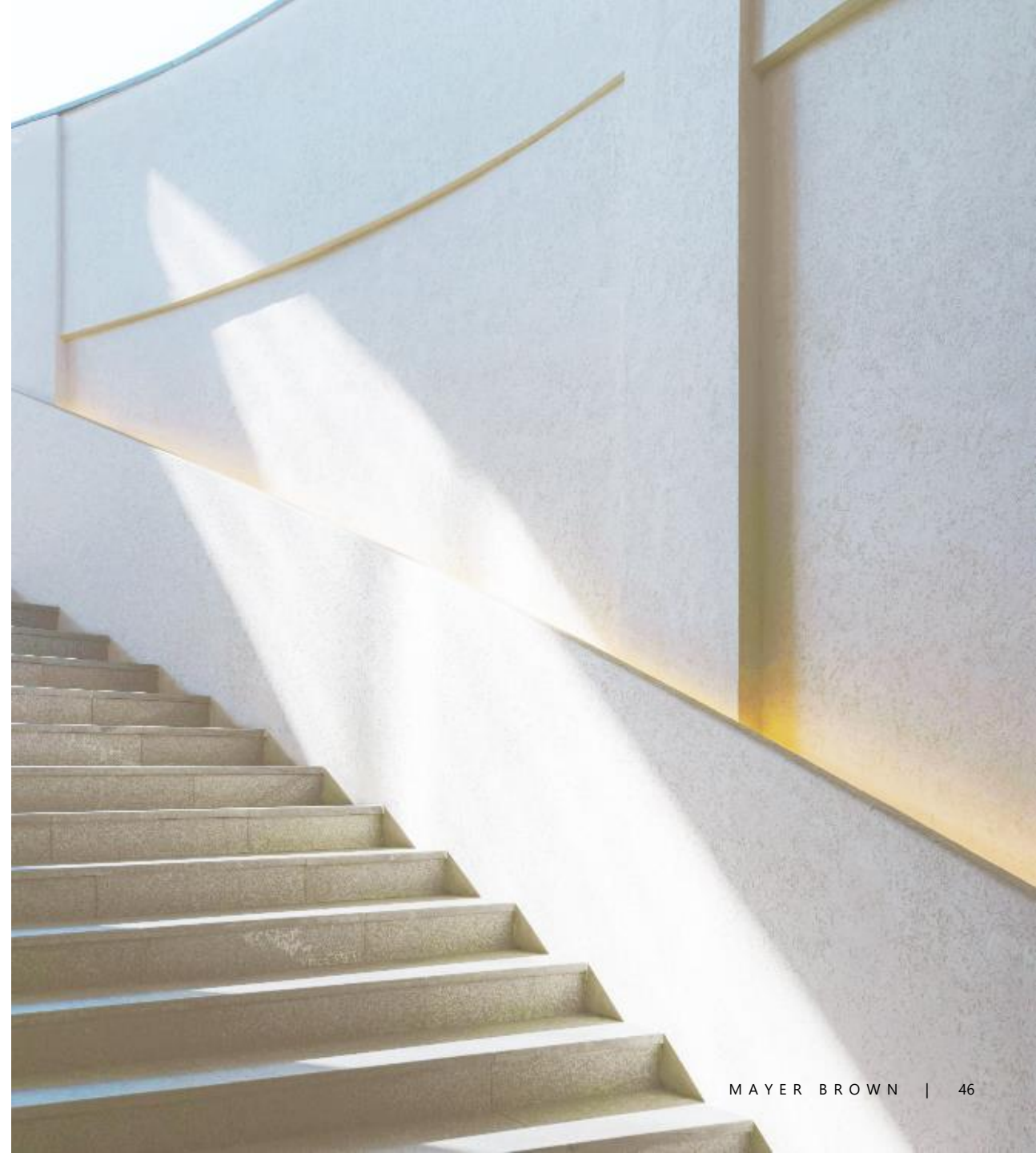


REGULATORY ROLLERCOASTER

- Death of the Private Funds Rule
 - How has the industry changed?
- New life for Rule 506(c)
 - Key considerations
- Marketing Rule Guidance
 - More gross than before, but exercise care
- CTA Post-Mortem
 - Where do we go from here?

INVESTMENT TRENDS AND THEMES

- The continued push and pull of ESG and DEI
- More of the same – continuation funds and co-investments
 - What are we seeing?
 - What do you need to think about?



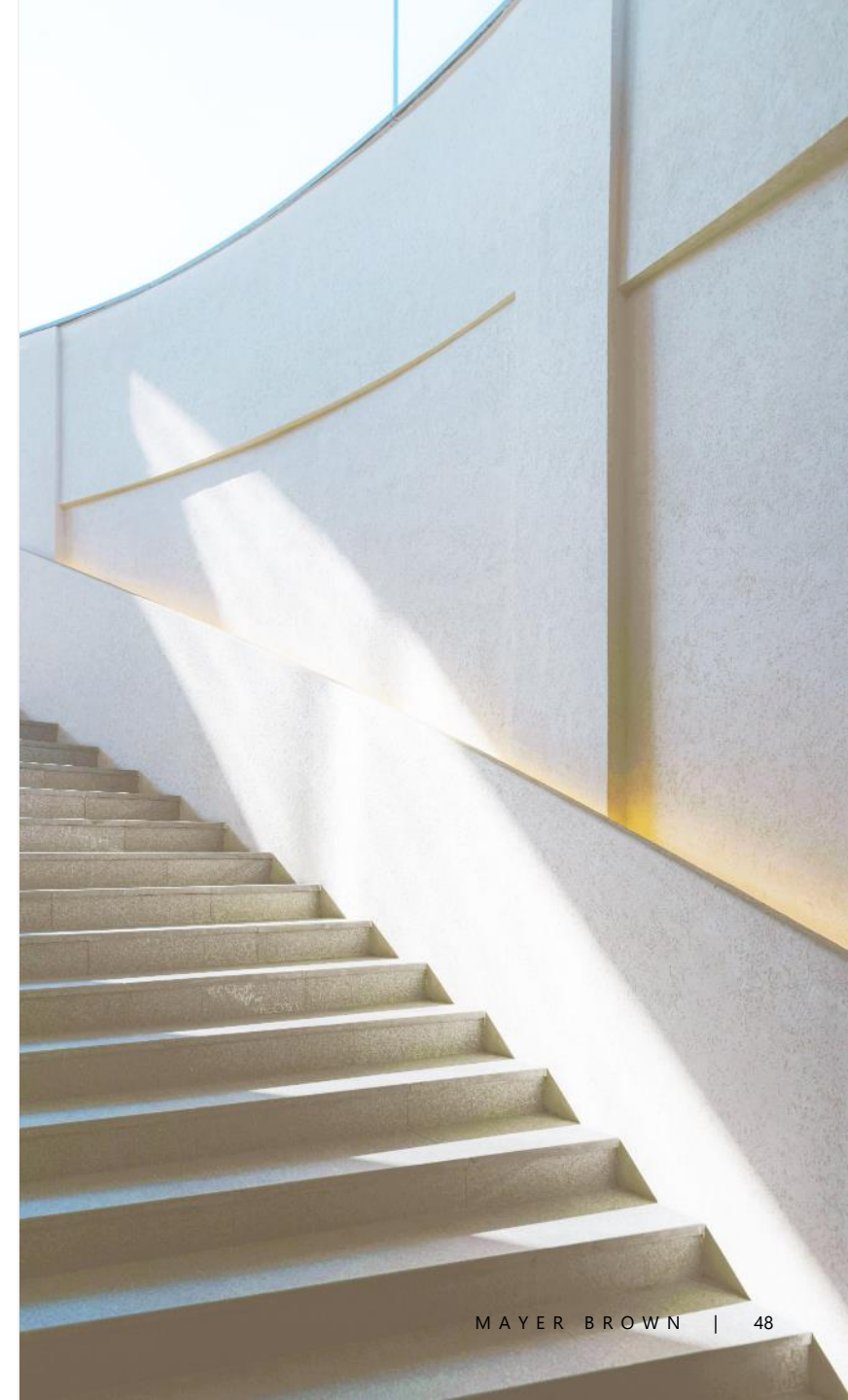


CFIUS - INTRODUCTION

- CFIUS is an interagency committee chaired by the Secretary of the Treasury that is authorized to review certain transactions involving foreign investment in the United States to determine the effect of such transactions on the national security of the United States.
- CFIUS can recommend that the President block or unwind a transaction for national security concerns.
- CFIUS can also impose requirements on a transaction to mitigate any national security risks (e.g., a US-citizen board, a CFIUS-approved US-citizen security officer, or the sale of sensitive assets).
- CFIUS is a confidential process on the part of the government, though annual reports with aggregate data are released.

CFIUS - INTRODUCTION

- CFIUS has jurisdiction over three types of investments:
 - “Covered control transactions,” - transactions “by or with any foreign person which could result in foreign control of any U.S. business” (i.e., the traditional scope of CFIUS jurisdiction);
 - “Covered investments,” - small, non-controlling investments by foreign persons:
 - in sensitive “TID U.S. businesses,” (which deal in Critical **T**echnology, Covered Investment Critical Infrastructure or Sensitive Personal **D**ata), and
 - in which a foreign person gains a board or observer seat, access to material nonpublic technical information (non-financial), or involvement in substantive decision-making other than voting its shares with respect to the “Covered real estate transactions” - in which the real estate at issue is located in proximity to specified ports and specified sensitive government and military installations.



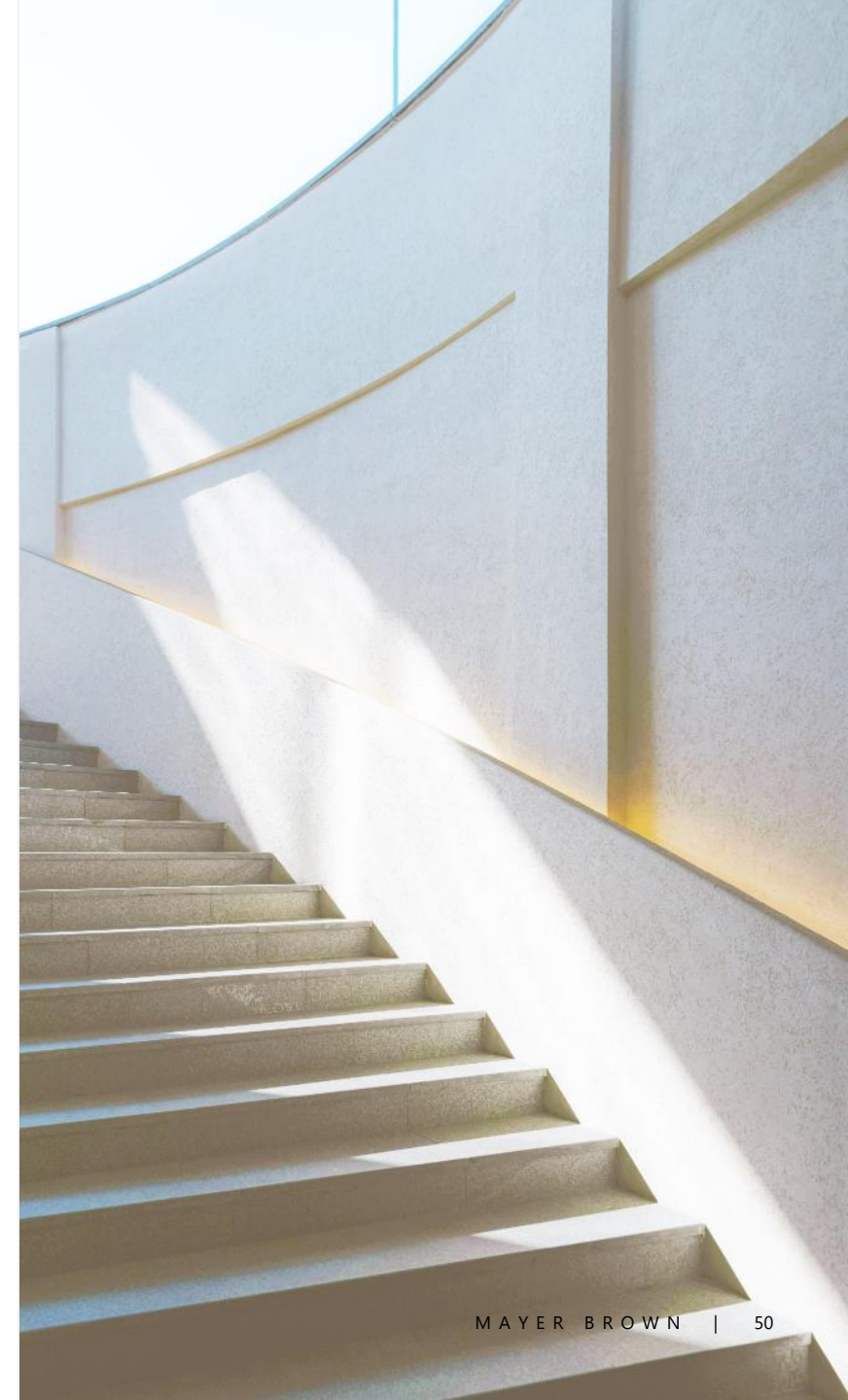


CFIUS – MANDATORY FILINGS

- Filings are mandatory in two circumstances:
 - The acquisition of a “substantial interest” (a voting interest, direct or indirect, of 25 percent) in a TID U.S. business by a foreign person in which a foreign government has a “substantial interest” (a voting interest, direct or indirect of 49 percent); for determining indirect interests, parents (50% or more) are deemed to have 100%.
 - Covered Investments and Covered Control Transactions involving TID U.S. businesses that:
 - (1) produce, design, test, manufacture, fabricate, or develop “critical technologies”, and
 - (2) a “U.S. regulatory authorization” would be required to export, re-export, transfer (in-country) or retransfer the technologies to certain foreign persons involved in the transaction.

CFIUS – VOLUNTARY FILINGS

- Otherwise, CFIUS is a voluntary process - either or both parties to a prospective transaction may notify CFIUS and initiate a review.
- However, the only way to receive a legal guarantee that CFIUS will not force a divestment or mitigation terms on a transaction is to file.
- Parties receive two types of a legal “safe harbor:”
 - If CFIUS clears the transaction and effectively approves it (which could include the negotiation of a mitigation agreement); or
 - If CFIUS determines that the transaction is not subject to its jurisdiction.
- For all transactions, either a short-form “Declaration” or a long-form “Notice” may be used.
 - When reviewing both Declarations and Notices, CFIUS may ask questions of the parties – which must respond quickly (2 business days for Declarations, 3 for Notices).



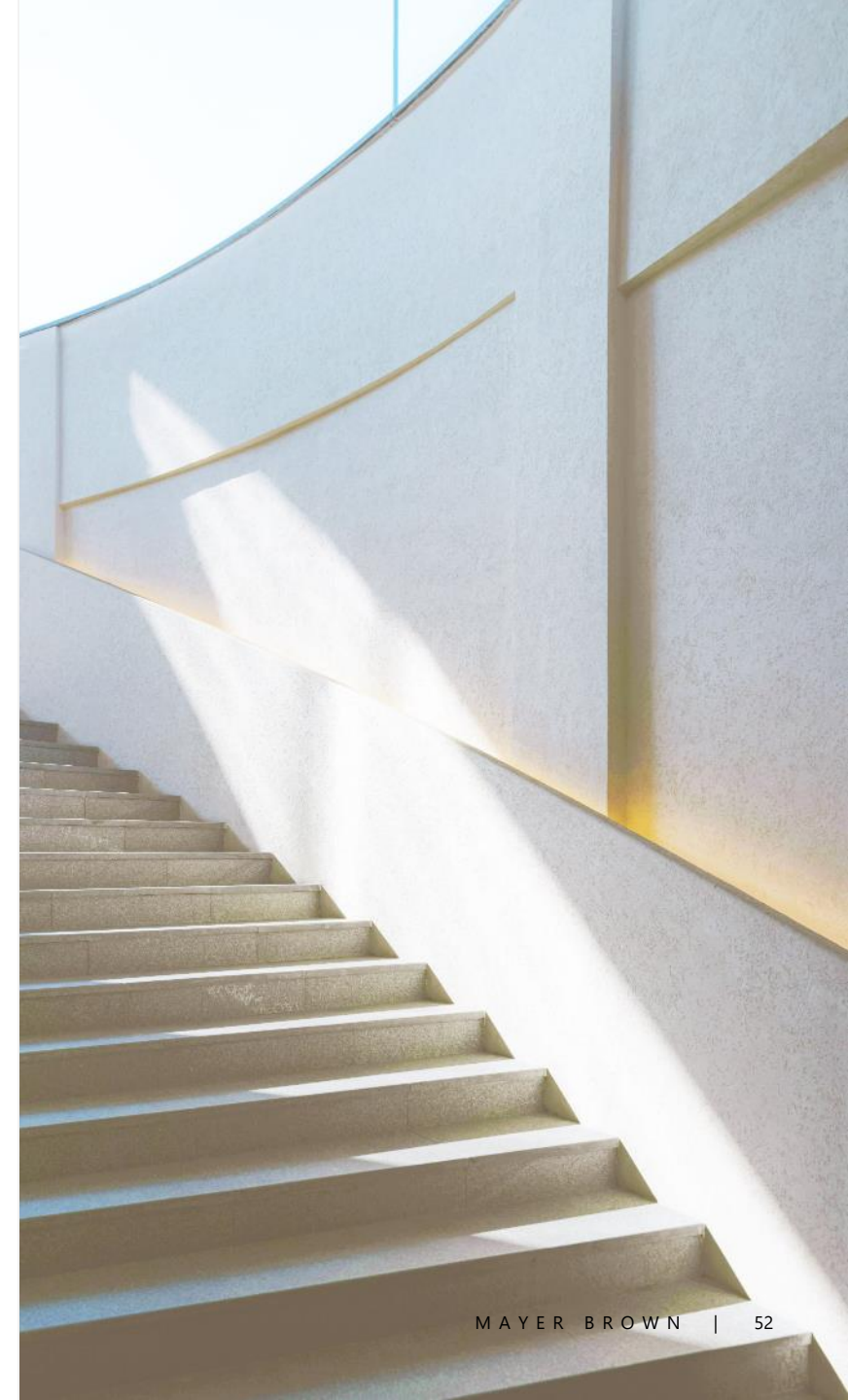


OUTBOUND INVESTMENT REGULATION

- In effect as of January 2, 2025.
- Sectoral focus:
 - (1) semiconductors and microelectronics,
 - (2) quantum information technologies, and
 - (3) certain artificial intelligence ("AI") systems.
- Requires the notification or prohibition of certain outbound investments and other transactions by US persons involving persons of countries of concern, and certain subsidiaries or parents thereof, engaged in activities involving three sensitive sectors.
- Requirements apply to:
 - US persons, including US citizens and lawful permanent residents, and any person in the US,
 - Entities organized under US law, and any foreign branches of those entities, and
 - Controlled foreign entities.

COVERED TRANSACTIONS

- Covered Transactions:
 - Acquisition of equity or contingent equity interest in a covered foreign person.
 - Conversion of loan or contingent equity interest into equity.
 - Greenfield investments.
 - LP or equivalent investments.
- Notable Exceptions:
 - LP has a binding contractual commitment that capital will not be used to engage in a prohibited transaction (if engaged in by a US person)
 - Transactions made after January 2, 2025 pursuant to a binding, uncalled capital commitment entered into before January 2, 2025.



COVERED FOREIGN PERSONS & PERSON OF A COUNTRY OF CONCERN

- Covered Foreign Person:
 - A person of a country of concern that engages in a covered activity; or
 - A person that directly or indirectly holds a board seat on, a voting or equity interest in, or any contractual power to direct or cause the direction of the management or policies of such persons, and through which it derives more than 50% of its annual revenue or annual net income, or incurs more than 50% of its annual capital expenditure or operating expenses, in each case based on certain aggregation and monetary thresholds.
- Person of a Country of Concern
 - Any individual who is a citizen or permanent resident of a country of concern, and is not a US citizen or permanent resident of the United States.
 - An entity with a principal place of business in, headquartered in, or incorporated in or otherwise organized under the laws of, a country of concern.
 - The government of a country of concern; any person acting for or on behalf of that government; or any entity, wherever located, with respect to which that government holds, individually or in the aggregate, directly or indirectly, 50% or more of the outstanding voting interests, voting power of the board, or equity interest, or otherwise possesses the power to direct or cause the direction of the management and policies.
 - Any entity, wherever located, in which one or more persons identified above individually or in the aggregate, directly or indirectly, holds at least 50% of the outstanding voting interests, voting power of the board, or equity interests.



PROHIBITED AND NOTIFIABLE TRANSACTIONS

Notifications must be filed no more than 30 days after the covered transaction or 30 days after the US person acquires actual knowledge that the transaction would have been covered at the time of the transaction.

SEMICONDUCTORS AND MICROELECTRONICS

- The Final Rule *prohibits* certain covered transactions related to the development, production, design, fabrication, packaging, installation, or sale of:
 - Certain electronic design automation software.
 - Certain fabrication or advanced packaging equipment or items designed exclusively for use in or with ultraviolet lithography fabrication equipment.
 - Integrated circuits based on certain technical, performance, or design parameters.
 - Certain supercomputers enabled by advanced integrated circuits that provide certain compute capacities.
 - The scope of *notifiable* transactions involving the semiconductor and microelectronics industry is broad and includes covered transactions in which the relevant covered foreign person or joint venture designs, fabricates, or packages any other integrated circuit not described above.



PROHIBITED AND NOTIFIABLE TRANSACTIONS (CONT.)

QUANTUM INFORMATION TECHNOLOGIES

- The Final Rule *prohibits* certain covered transactions related to:
 - The development of quantum computers or production of any critical components required to produce a quantum computer.
 - The development or production of certain quantum sensing platforms designed for military, government intelligence, or mass surveillance end uses.
 - The development or production of certain quantum networks or quantum communication systems.
- The Final Rule does not provide a category of *notifiable* covered transactions involving quantum information technologies.



PROHIBITED AND NOTIFIABLE TRANSACTIONS (CONT.)

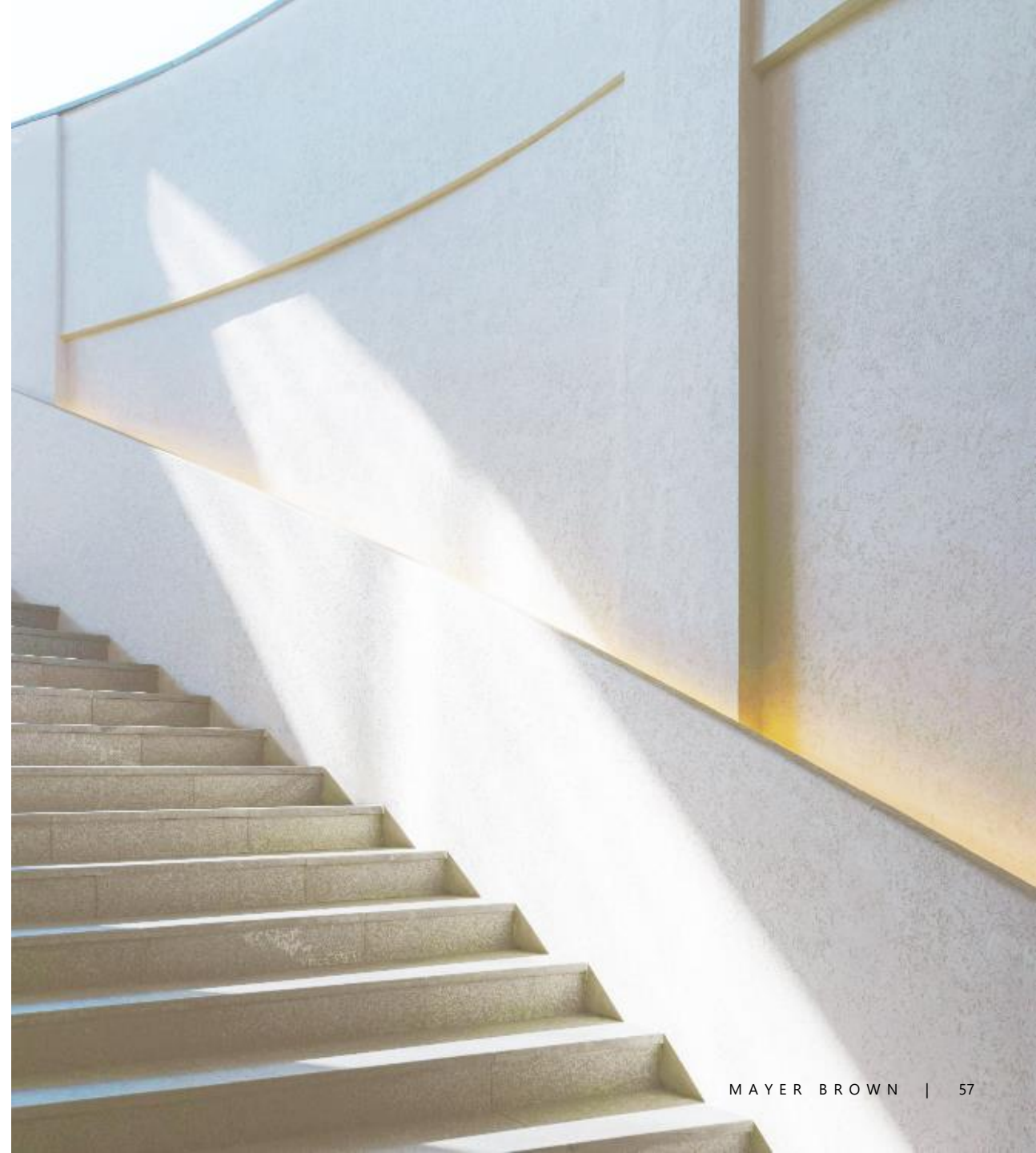
AI SYSTEMS – DEFINED AS:

- A machine-based system that can, for a given set of human-defined objectives, make predictions, recommendations, or decisions influencing real or virtual environments—i.e., a system that:
 - Uses data inputs to perceive real and virtual environments;
 - Abstracts such perceptions into models through automated or algorithmic statistical analysis; and
 - Uses model inference to make a classification, prediction, recommendation, or decision.
- Any data system, software, hardware, application, tool, or utility that operates in whole or in part using a system described above.
- With respect to these AI systems, the Final Rule *prohibits* certain covered transactions related to:
 - The development of any AI system designed to be exclusively used for, or intended to be used for, certain end uses (including military end uses and government intelligence or mass-surveillance end uses); or
 - The development of any AI system that is trained using specified thresholds of computing power.
- With respect to *notifiable* transactions and AI systems, the Final Rule requires notification of certain covered transactions related to the development of any AI system not otherwise covered by the prohibited transaction definition, where that AI system is:
 - Designed or intended to be used for certain end uses or applications; or
 - Trained using a specified threshold of computing power.



PENALTIES

- Civil: \$368,136 or twice the amount of the transaction that is the basis of the violation.
- Criminal: \$1 million and up to 20 years imprisonment
- The Final Rule also provides Treasury with the authority to require divestment of any prohibited transactions.



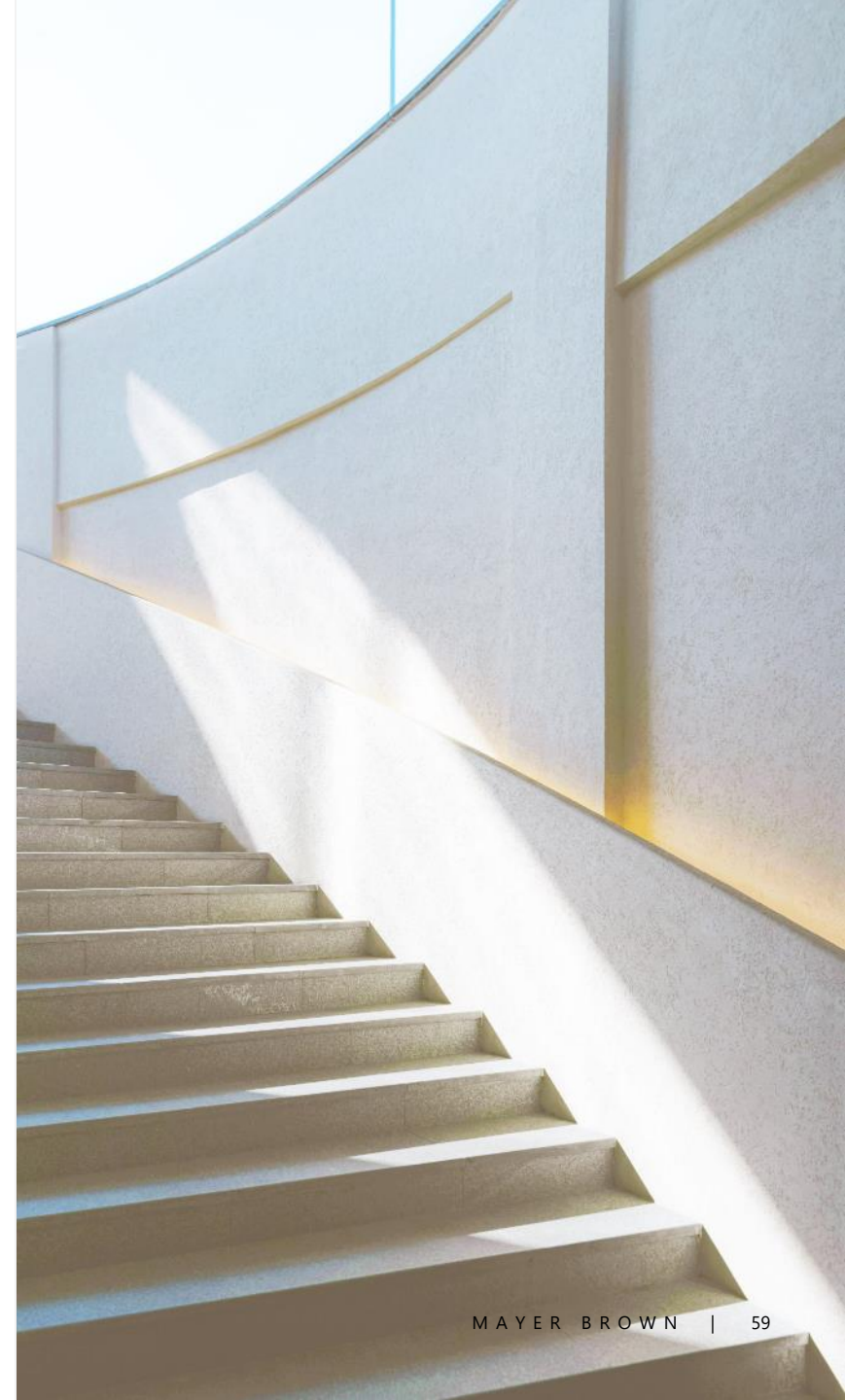
AN OVERVIEW OF FinCEN'S ANTI-MONEY LAUNDERING RULE FOR INVESTMENT ADVISERS

- Interim Final Rule Addressing the Corporate Transparency Act
- Overview of FinCEN's Anti-Money Laundering Rule for Investment Advisers
- Risk-Based Customer Due Diligence
- Suspicious Activity Reports (SARs)
- Independent Audits



INTERIM FINAL RULE ADDRESSING THE CORPORATE TRANSPARENCY ACT

- The Corporate Transparency Act (“CTA”) requires reporting companies to **register** with FinCEN and to **disclose** their ultimate, natural-person **beneficial owners**.
 - In September 2022, FinCEN issued a final rule requiring most domestic and foreign entities to report their beneficial owners to FinCEN.
- Since then, CTA has been the subject of litigation **challenging its constitutionality** under various theories and various injunctions, suspensions and reinstatements of its obligations.
- On March 21, 2025, FinCEN issued an **Interim Final Rule** that **exempts** all domestic entities from beneficial ownership information reporting requirements under the CTA and its implementing regulations.
 - Foreign entities that register to do business in US states or tribal jurisdictions (without acting through a US entity) will still need to report beneficial ownership information.



OVERVIEW OF FinCEN'S ANTI-MONEY LAUNDERING RULE FOR INVESTMENT ADVISERS

- **Overview**

- Certain SEC-registered investment advisers ("RIAs") and exempt registered advisers ("ERAs") (collectively, "Covered Advisers") will be classified as "financial institutions" under the Bank Secrecy Act ("BSA"). Covered Advisers exclude:
 - RIAs registered solely as mid-sized advisers, multi-state advisers, or pension consultants.
 - RIAs with no assets under management ("AUM") reported on Form ADV.
 - Non-US located RIAs and ERAs, except with regard to activities with a US nexus.
- This classification will subject Covered Advisers to direct and comprehensive Anti-Money Laundering ("AML") compliance obligations when the Rule becomes effective on January 1, 2026.

- **Key Requirements**

- Establishing a risk-based AML program (i.e., P&Ps, designated officer, training, independent audits)
- Conducting ongoing customer due diligence
- Filing suspicious activity reports ("SARs")
- Complying with enhanced recordkeeping obligations



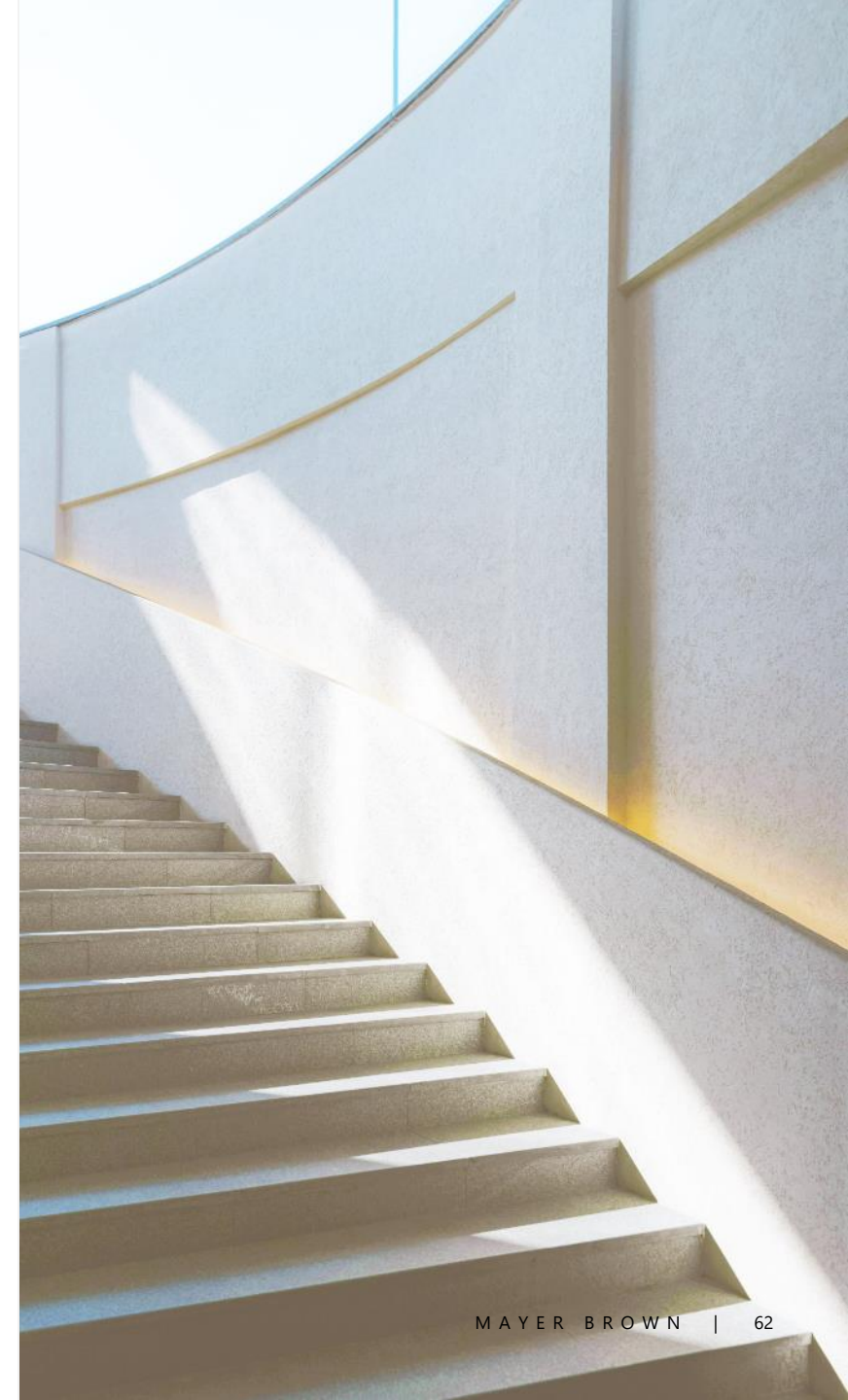
RISK-BASED CUSTOMER DUE DILIGENCE (“CDD”) REQUIREMENTS

- Understand the Nature and Purpose of Customer Relationships to Develop Customer Risk Profiles
 - Covered Advisers are not required to have formal risk-rating models or methodologies.
 - They have discretion to apply risk factors based on their activities and products.
 - Risk factors may include geographic risk, client type, and transaction patterns.
 - Enhanced due diligence and stricter monitoring measures are recommended for higher-risk clients.
- Ongoing Monitoring to Identify Suspicious Transactions and Update Customer Information
 - Covered Advisers are not categorically required to perform media searches or particular screenings for all customers, but they should conduct risk-based monitoring of such reports and events.
 - The obligation to update customer information will generally only be triggered when the investment adviser becomes aware of information relevant to assessing the potential risk posed by a customer.
- FinCEN and the SEC have jointly proposed a separate Customer Identification Program (“CIP”) rule



SUSPICIOUS ACTIVITY REPORTS (SARS)

- Covered Advisers are required to file SARs for any suspicious transaction relevant to a possible violation of law or regulation that meets certain requirements and may file SARs for any other suspicious transaction. Suspicious transactions include transactions that:
 - Involve funds derived from illegal activity or that disguise funds derived from illegal activity
 - Are designed or structured to evade reporting requirements under the BSA
 - Have no business or apparent lawful purpose, and are not expected for the customer
- SAR reporting must be supported by risk-based transaction monitoring
 - Transaction monitoring must incorporate customer risk profile (from CDD requirements)
 - Monitoring systems need not be automated, but must be appropriate for risk level
- Covered Advisers must maintain confidentiality of SARs, particularly from a subject



SAR FILINGS: EXAMPLES OF POTENTIALLY SUSPICIOUS ACTIVITY


- A prospective investor provides documentation that is clearly or seemingly fraudulent and is evasive in responding to requests for clarification.
- After establishing a new Investor relationship, an IA becomes aware of a negative news report alleging that Investor is involved in a corruption scheme regarding a certain amount of money, or payments to a certain jurisdiction. Shortly thereafter, Investor seeks to invest the same or a substantially similar amount of money in the fund. The funds will originate from a bank in the jurisdiction in which the corrupt activity allegedly occurred.
- An investor seeks to divest, and to use the entire proceeds to purchase digital assets and physical gold. The investor has not previously expressed any interest in such assets and, during discussions with the fund, cannot articulate an understanding of digital assets or a legitimate business (or other) reason for divestment.
- An employee of an IA overhears another employee explaining the types of transactions and other activity that will be flagged by the IA as suspicious and suggesting to the client how to document or structure investments to avoid detection.



FinCEN SUSPICIOUS ACTIVITY REPORTS

Suspicious Activity Report

[Home](#)[Step 1. Filing Institution Contact Information](#)[Step 2. Financial Institution Where Activity Occurred](#)[Step 3. Subject Information](#)[Step 4. Suspicious Activity Information](#)[Step 5. Narrative](#)



Suspicious Activity Report

Version Number: 1.2

OMB No. 1506-0065 (Report)
OMB No. 1506-0001, 1506-0006, 1506-0015, 1506-0019, 1506-0029, and 1506-0061 (Regulations)

Filing Instructions:

1. Complete the report in its entirety with all requested or required data known to the filer.
2. Click "Validate" to ensure proper formatting and that all required fields are completed.
3. Click "Sign with PIN" and enter your 8-digit PIN to electronically sign the report.
4. Click "Save" to save a local copy of the report.

Suspicious Activity Report

Home

Step 1. Filing Institution
Contact Information

Step 2. Financial Institution
Where Activity Occurred

Step 3. Subject
Information

Step 4. Suspicious
Activity Information

Step 5. Narrative

Part II Suspicious Activity Information

*29 Amount involved in this report ☐ Amount Unknown ☐ No amount involved \$.00

*30 Date or date range of suspicious activity for this report From To

31 Cumulative amount (only applicable when "Continuing activity report" is checked in Item 1) \$.00

When completing item 32 through 42, check all that apply

32 Structuring

- | | |
|---|---|
| a <input type="checkbox"/> Alters or cancels transaction to avoid BSA recordkeeping requirement | d <input type="checkbox"/> Transaction(s) below BSA recordkeeping threshold |
| b <input type="checkbox"/> Alters or cancels transaction to avoid CTR requirement | e <input type="checkbox"/> Transaction(s) below CTR threshold |
| c <input type="checkbox"/> Suspicious inquiry by customer regarding BSA reporting or recordkeeping requirements | z <input type="checkbox"/> Other <input type="text"/> |

33 Terrorist Financing

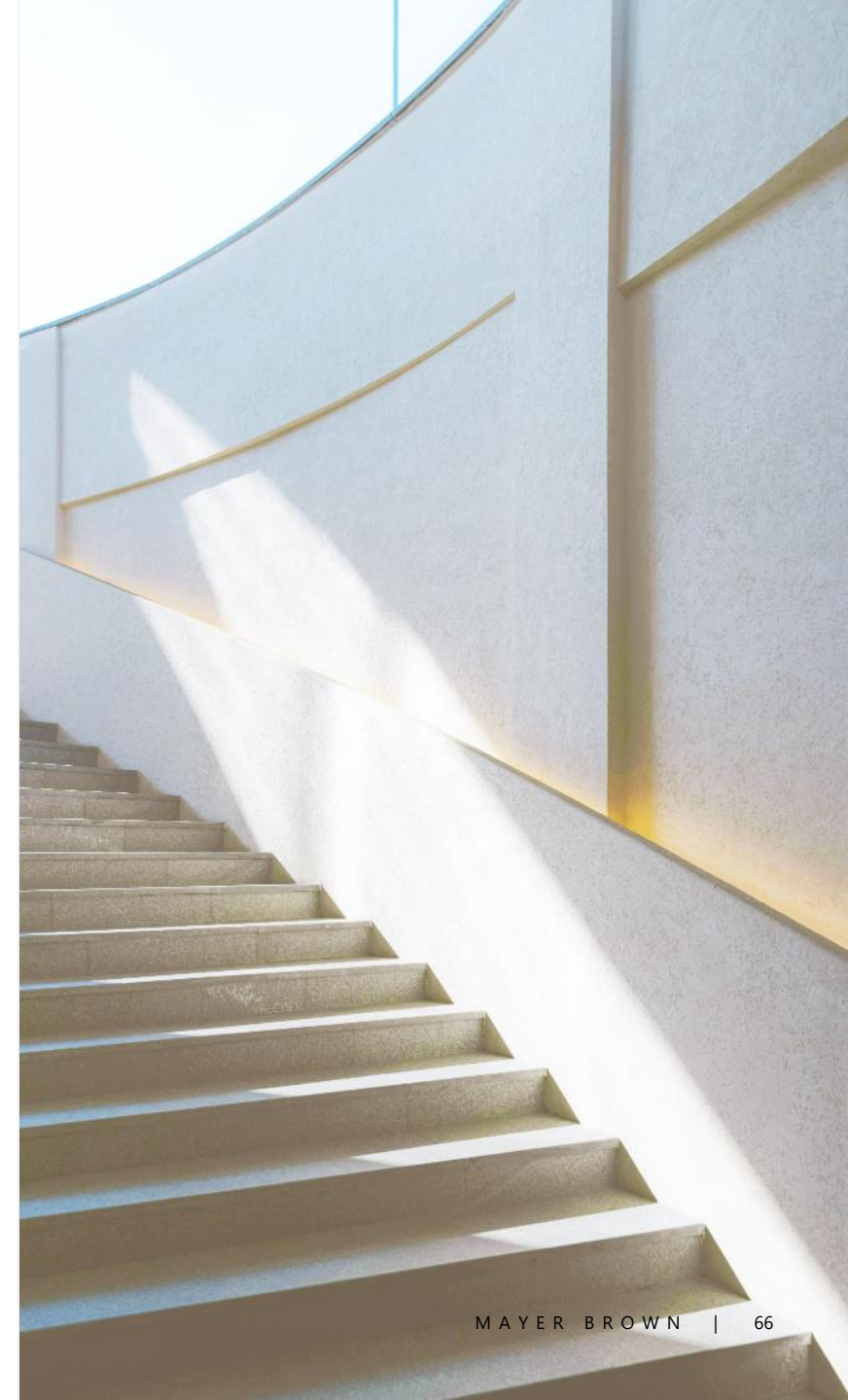
- | | |
|--|---|
| a <input type="checkbox"/> Known or suspected terrorist/terrorist organization | z <input type="checkbox"/> Other <input type="text"/> |
|--|---|

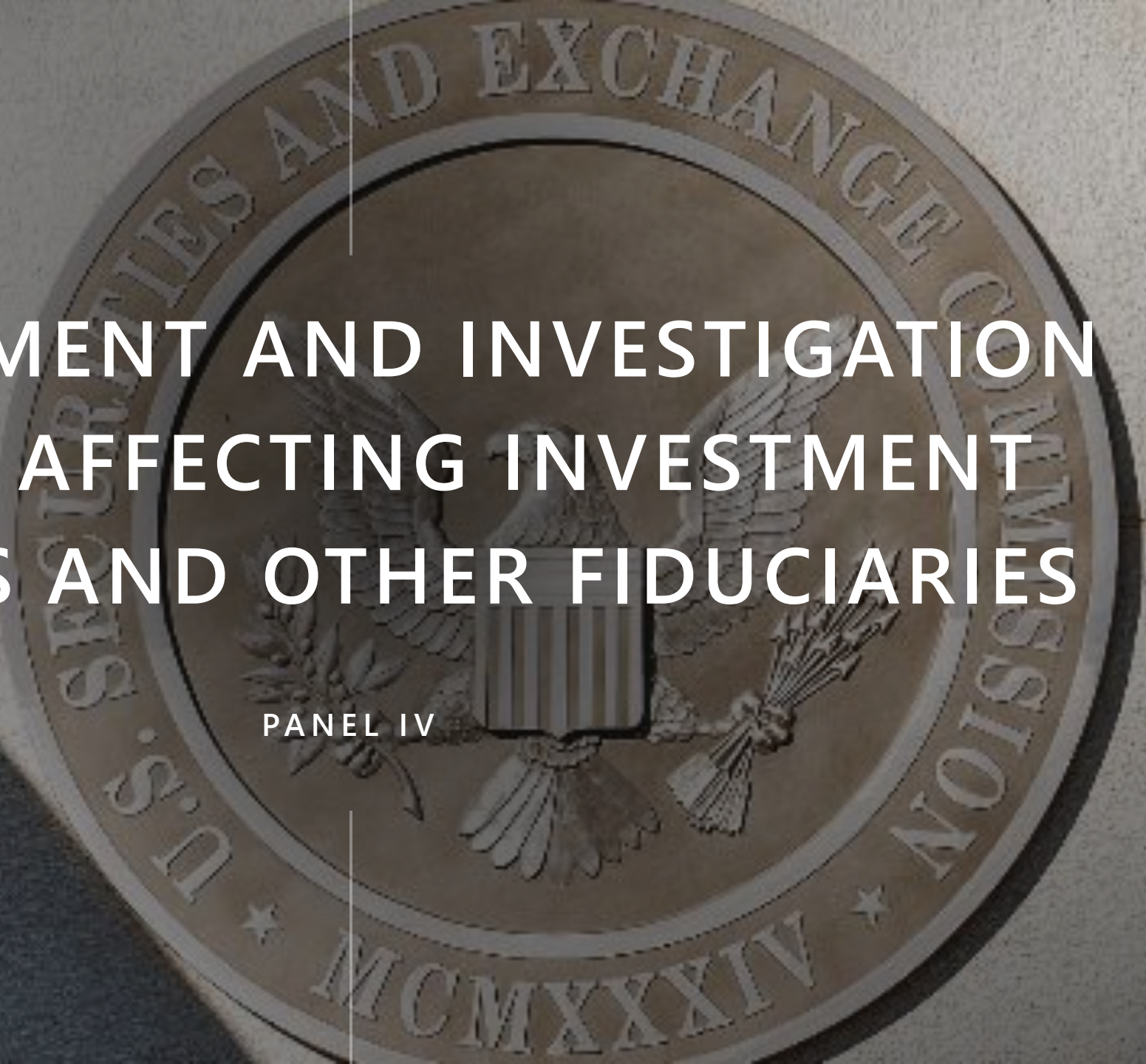
34 Fraud

- | | | | |
|--|--|---|---|
| a <input type="checkbox"/> ACH | e <input type="checkbox"/> Consumer loan | i <input type="checkbox"/> Mass-marketing | m <input type="checkbox"/> Wire |
| b <input type="checkbox"/> Advance fee | f <input type="checkbox"/> Credit/Debit card | j <input type="checkbox"/> Ponzi scheme | z <input type="checkbox"/> Other <input type="text"/> |

INDEPENDENT AUDITS

- **Independent Testing.** Independent audits may be conducted by (i) a qualified third party or (ii) internal personnel.
 - Individuals involved in implementing the Covered Adviser's AML/CFT operations may not participate in testing the AML/CFT program.
 - An AML/CFT officer or any party who directly reports to the AML/CFT officer generally would not be considered sufficiently "independent."
 - Covered Advisers with less complex operations and lower risk profiles may consider utilizing a shared resource as part of a collaborative arrangement with similarly less complex and lower risk profile advisers to conduct testing.
- **Frequency.** FinCEN has left the frequency of independent audits to each Covered Adviser's individual discretion, based on the Covered Adviser's risk profile and overall risk management strategy.



The background of the slide features a large, circular, embossed seal of the U.S. Securities and Exchange Commission. The seal is centered and slightly offset to the right. It contains an eagle with a shield on its chest, holding an olive branch and arrows. The words "U.S. SECURITIES AND EXCHANGE COMMISSION" are inscribed around the eagle, and the Roman numeral "MCMXXXIV" is at the bottom. The seal is set against a light-colored, textured background.

ENFORCEMENT AND INVESTIGATION TRENDS AFFECTING INVESTMENT ADVISERS AND OTHER FIDUCIARIES

PANEL IV

PANEL IV

CHICAGO PANELISTS

ENFORCEMENT AND INVESTIGATION TRENDS AFFECTING INVESTMENT ADVISERS AND OTHER FIDUCIARIES



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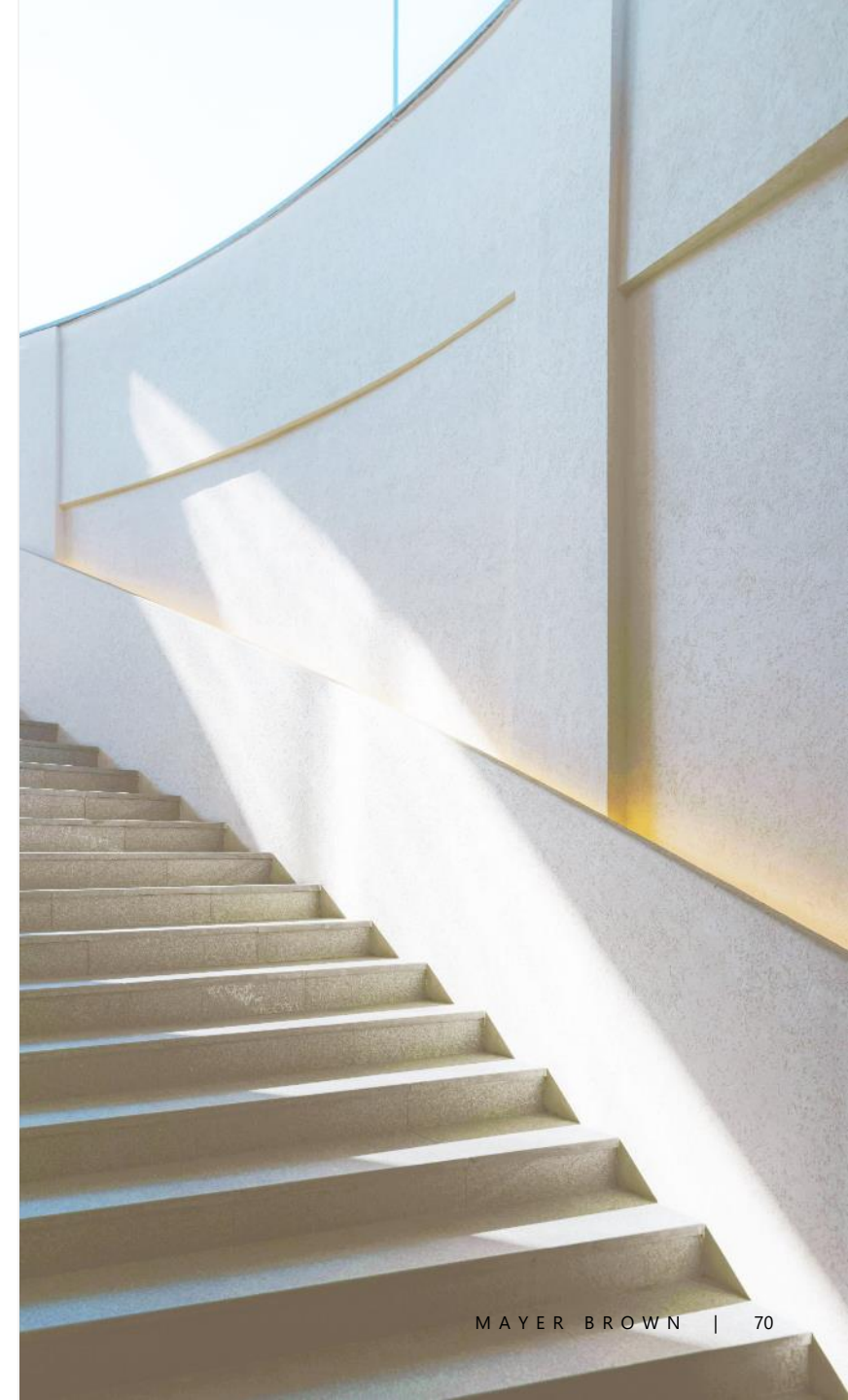
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ENFORCEMENT AND INVESTIGATION TRENDS

- Notable enforcement cases and lessons from 2024
- Changes to enforcement process under Uyeda (and Atkins)
 - Commission approval for formal orders
 - Return to a more formalized Wells process?
- What types of cases still get 3 votes on the current Commission (and what types of cases fall short)?
- AI and the long tail of AXA Rosenberg
- Crypto task force implications
- What to expect from Congressional investigations this year
- Red State AGs and Blue State AGs
 - Will Red State AG investigations continue?
 - Will Blue State AGs step into any void created by the SEC?



Enforcement Actions Filed in Fiscal Years 2019 to 2024

	FY 2024	FY 2023	FY 2022	FY 2021	FY 2020	FY 2019
Standalone Enforcement Actions	431	501	462	434	405	526
Follow-On Admin. Proceedings	93	162	169	143	180	210
Delinquent Filings	59	121	129	120	130	126
Total Actions	583	784	760	697	715	862

Standalone Enforcement Actions is a combined count of Civil Actions and Standalone APs.

Total Money Ordered (in millions)

	FY 2024	FY 2023	FY 2022	FY 2021	FY 2020	FY 2019
Penalties	\$2,100	\$1,580	\$4,194	\$1,456	\$1,091	\$1,101
Disgorgement	\$6,100	\$3,369	\$2,245	\$2,395	\$3,588	\$3,248
Total	\$8,200	\$4,949	\$6,439	\$3,852	\$4,680	\$4,349

THANK YOU



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