

# Action Required: Impact of Corporate Transparency Act on Investment Managers

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***This advisory provides a general summary of the Corporate Transparency Act and its requirements as they relate to investment managers. This advisory is not intended to, and does not, provide legal, compliance or other advice to any individual or entity.***

The Financial Crimes Enforcement Network (FinCEN) of the US Treasury Department has issued a final rule (Final Rule) implementing the beneficial ownership reporting requirements of the Corporate Transparency Act (together with the Final Rule, the CTA). The CTA took effect on January 1, 2024, and compliance dates are fast approaching, as discussed below.

This advisory provides a high-level summary of the CTA and its application to investment management firms. Investment managers should be aware that, with limited exceptions, their management entities (including investment advisers and general partner and managing member entities), investment vehicles (including funds and their trading subsidiaries), special purpose entities and other entities within their organizations generally will fall within the scope of the CTA. Investment managers should analyze whether each entity in their organizations is required to report under the CTA or can avail itself of a reporting exemption.

## High-Level Overview

### Scope

The stated purpose of the CTA is to combat the use of shell companies for illicit activities such as money laundering, terrorism financing and other illegal activities.

To effect this purpose, the CTA implements a far-reaching reporting regime applicable to any "*Reporting Company*," which is defined as any entity (whether a corporation, limited liability company or other entity type) that is:

1. created by the filing of a document with the secretary of state or a similar office under the law of a State<sup>1</sup> or Indian tribe; or
2. is formed under the laws of a foreign country and registered to do business in the United States by the filing of a document with a secretary of state or a similar office under the laws of a State or Indian tribe.

Absent an exemption, the CTA thus will capture all entities in a typical investment management structure, including the sponsor, its investment funds and any trading or other subsidiaries. However, the CTA does not apply to entities with no US nexus, such as a non-US investment fund that is managed by a non-US manager, does not offer interests to US investors and does not register to do business under the laws of a State or Indian tribe.

### ***Reporting Obligations***

Absent an available exemption, each Reporting Company is required to report the following "*Beneficial Ownership Information*" to FinCEN through the electronic filing website:

- Information about the Reporting Company:
  - full legal name and all trade names or d/b/a names;
  - principal place of business (or, in the case of a foreign Reporting Company, its primary location in the United States);
  - State, tribal, or foreign jurisdiction of formation (and in the case of a foreign Reporting Company, the State or tribal jurisdiction where it first registers); and
  - unique taxpayer ID number (which for a domestic entity must be a TIN (such as an Employer Identification Number), and for a foreign entity may be a similar foreign unique identifier if the entity has no US TIN).
- Information about each of the Reporting Company's Beneficial Owners<sup>2</sup> (as defined below):
  - full name, date of birth and current address; and
  - a unique identifying number from a valid US passport, driver's license or other specified identification document (together with an image of the document).

### ***"Beneficial Owner" Definition***

A "*Beneficial Owner*" of a Reporting Company is any **individual** (i.e., a natural person) who *directly or indirectly* either (i) "exercises substantial control" over the Reporting Company; or (ii) owns or controls at least 25 percent of the "ownership interests" of the Reporting Company.

An individual "exercises substantial control" over a Reporting Company if the individual:

1. serves as a senior officer<sup>3</sup> of the Reporting Company;
2. has authority over the appointment or removal of any senior officer or a majority of the board of directors (or similar body) of such Reporting Company;
3. directs, determines or has substantial influence over important decisions made by the Reporting Company; or
4. has any other form of substantial control over the Reporting Company.

The Final Rule gives a non-exhaustive list of examples of important decisions. The definition is designed to be broad-ranging and open-ended. The Final Rule expressly states that substantial control may be exercised by, among other things, through "any . . . contract, arrangement, understanding, relationship, or otherwise." The substantial control analysis thus will be highly facts

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and circumstances dependent and will require investment management firms to thoughtfully review the substantive functions and roles of key personnel in determining their CTA reporting obligations.

In addition to exercising substantial control, an individual is considered a Beneficial Owner when the individual *directly or indirectly* owns or controls at least 25 percent of the Reporting Company's "ownership interests."

"*Ownership interests*" are broadly defined to include any equity, stock or similar interest (regardless of whether such interest confers voting rights), any capital or profit interest, any instrument convertible into an ownership interest, any option to purchase or sell ownership interests, or "any other instrument, contract, arrangement, understanding, relationship, or mechanism used to establish ownership." For purposes of determining whether the 25 percent threshold has been satisfied by an individual, all direct and indirect ownership interests are aggregated and options or similar interests in respect of ownership interests so held by such individual are deemed exercised (whether or not vested).

FinCEN expects every Reporting Company to have at least one Beneficial Owner but there is no upper limit on the number of reportable Beneficial Owners of a Reporting Company under the CTA.

### ***Compliance Dates***

There are three key compliance dates:

1. Reporting Companies formed or registered to do business in the United States prior to January 1, 2024, are required to submit Beneficial Ownership Information to FinCEN **no later than January 1, 2025.**
2. Reporting Companies formed or registered to do business in the United States on or after January 1, 2024 and prior to January 1, 2025, are required to submit Beneficial Ownership Information to FinCEN **within 90 days of formation.**
3. Reporting Companies formed or registered to do business in the United States on or after January 1, 2025, are required to submit Beneficial Ownership Information to FinCEN **within 30 days of formation.**

To the extent a Reporting Company's Beneficial Ownership Information changes or an entity no longer qualifies for an exemption, the entity must file an updated report (or initial report, in the case of an entity that loses its exempt status) with FinCEN within 30 calendar days following such change. As a result, Reporting Companies are responsible for monitoring all manner of changes. For example, if a Beneficial Owner marries, there may be an initial 30-day update period triggered by a change of residence and another update period triggered by a surname change.

### ***Access***

The database of information collected by FinCEN will not be publicly accessible. The following will have access to Beneficial Ownership Information:

1. United States federal agencies engaged in national security, intelligence or law enforcement activity for information to be used in furtherance of such activity;
2. a State, local or tribal law enforcement agency for use in a criminal or civil investigation (if a court of competent jurisdiction has authorized such agency to seek such Beneficial Ownership Information);

3. upon a request from a federal agency on behalf of a law enforcement agency, prosecutor, or judge of another country, on behalf of a foreign central authority or foreign competent authority, if the request is made under an applicable international treaty, agreement or convention or, if the request is not made under an international treaty, agreement, or convention, the request is an official request by a law enforcement, judicial, or prosecutorial authority of a trusted foreign country;
4. a financial institution (provided that the applicable Reporting Company has consented to such access), which financial institution is subject to customer due diligence requirements under applicable law for information to be used in facilitating such compliance; and
5. US Department of Treasury officers and employees who require Beneficial Ownership Information in connection with their official duties (including tax administration).

## ***Penalties***

It is unlawful for any person to willfully provide (or attempt to provide) false or fraudulent Beneficial Ownership Information or to willfully fail to report complete or updated Beneficial Ownership Information. The CTA provides for civil and criminal penalties for such violations, including a civil penalty of up to \$500-per-day and a fine of not more than \$10,000 and/or imprisonment for up to two years.

## **Application to Investment Managers**

Investment managers will need to analyze each entity in their organizational structure to assess whether the entity must report under the CTA or can take advantage of a reporting exemption. The CTA provides 23 entity exemptions from the filing obligation. For ease of analysis, however, we review below each of the common entities within a typical investment management structure and only the most relevant exemptions.

### ***Top-Level Entities***

Top-level entities typically consist of:

1. the general partner, managing member or other entities acting in a similar capacity (GP Entities) with respect to hedge funds, private equity funds or other commingled vehicles (collectively, Funds);
2. the investment adviser firm that will serve as the investment manager, management company or sponsor of Funds (Adviser Entities); and
3. other entities engaged in distinct lines of business (such as broker-dealers, futures commission merchants, swap dealers, and similar entities) that sit at or near the top of an investment management structure (Financial Services Businesses).

Each of the following is exempted from the definition of a Reporting Company. Adviser Entities and Financial Services Businesses in a manager's organizational structure are most likely to find these exemptions potentially relevant.

- ***Registered Investment Adviser (RIA)***. Any entity that is registered as an investment adviser with the Securities and Exchange Commission (SEC) under the Investment Advisers Act of 1940, as amended (the Advisers Act). Further, while there is no express guidance from FinCEN on this point, we are of the view that "relying advisers" that register with the SEC through a "filing adviser's" Form ADV (and are disclosed on Schedule R thereof) fall within the

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RIA exemption.

- **Venture Capital Fund Adviser (VC Fund Adviser).** An investment adviser described in Section 203(l) of the Advisers Act and has filed Item 10, Schedule A and Schedule B of Part 1A of Form ADV with the SEC.
- **Commodity Exchange Act Registered Entity.** Any entity that: is a registered entity as defined in Section 1a of the Commodity Exchange Act, as amended (CEA) or is: (A) a futures commission merchant, introducing broker, swap dealer, major swap participant, commodity pool operator or commodity trading advisor, each as defined in Section 1a of the CEA or a retail foreign exchange dealer as described in Section 2(c)(2)(B) of the CEA; and (B) registered with the Commodity Futures Trading Commission (CFTC) under the CEA.
- **Large Operating Company.** Any entity that: (A) employs more than 20 full-time employees in the United States, with "full-time employee[s] in the United States" (as described in the CTA); (B) has an operating presence at a physical office within the United States; and (C) filed a federal income tax or information return in the United States for the previous year demonstrating more than \$5,000,000 in gross receipts or sales, as reported as gross receipts or sales (net of returns and allowances) on the entity's IRS Form 1120, consolidated IRS Form 1120, IRS Form 1120-S, IRS Form 1065, or other applicable IRS form, excluding gross receipts or sales from sources outside the United States, as determined under federal income tax principles. Employees across affiliated entities cannot be aggregated (i.e., the applicable entity itself must have more than 20 full-time employees and employees at affiliated entities do not count for this purpose). However, for an entity that is part of an affiliated group of corporations that filed a consolidated return, the applicable gross receipts or sales is the amount reported on the consolidated return for such group.
- **Registered Broker-Dealer.** Any broker or dealer, as those terms are defined in Section 3 of the Securities Exchange Act of 1934 (Exchange Act), that is registered under Section 15 of the Exchange Act.
- **Subsidiaries.** Any entity whose ownership interests are controlled or wholly owned, directly or indirectly, by one or more exempt entities set forth above.

It should be noted that there is no Reporting Company exemption for "private fund advisers" exempt from SEC registration pursuant to Rule 203m-1 of the Advisers Act, which is a commonly relied upon exemption from investment adviser registration. In addition, investment managers should be aware that the CTA generally does not provide for any "flow-through" exemptions for upper-tier entities; for example, an entity that owns interests in an exempt RIA cannot itself rely upon the RIA exemption and must independently consider whether any exemption applies.

For GP Entities, the relevance of the Reporting Company exemptions above heavily depends on the facts and circumstances. For example, a GP Entity that is a newly formed special purpose general partner for Funds formed as limited partnerships may (but do not necessarily) qualify as a "relying adviser" of the Fund structure's Adviser Entity or, in more limited (and unusual structures), as a subsidiary of an RIA or large operating company. A GP Entity that is a managing member of Funds organized as limited liability companies is likely to be the Adviser Entity itself or a subsidiary thereof. Investment managers should, therefore, plan strategically when forming new GP Entities in connection with Fund launches, as there may be opportunities to streamline CTA reporting obligations based on the investment manager's prior practices and existing entities.

## **Funds**

With respect to Funds, the CTA provides a limited Reporting Company exemption for "pooled investment vehicles," which are defined to include:

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- any investment company that is registered with the SEC under the Investment Company Act of 1940, as amended (Investment Company Act); and
  - any private fund (i.e., a fund that would be required to register as an investment company but for the exclusions set forth in Section 3(c)(1) or 3(c)(7) of the Investment Company Act and that is "identified by its legal name by the applicable investment adviser in its Form ADV . . . filed with the SEC or will be so identified in the next annual updating amendment to Form ADV."

As a result, investment managers that are not RIAs will need to ensure that each of their Funds complies with the CTA and files as a Reporting Company. Independent sponsors, for example, often are not RIAs.

It should also be noted that while the CTA exempts CFTC-registered commodity pool operators and commodity trading advisors from the Reporting Company definition, there are no exemptions for commodity pools themselves (whether or not registered). Consequently, unless a commodity pool is also a private fund operated by an RIA that is identified on such RIA's form ADV or otherwise exempt, the commodity pool itself must file as a Reporting Company.

Non-US Funds that are formed outside of the United States and are not registered to do business in any State (or Indian tribe) fall outside the scope of the CTA. As most investment managers take the position that their Funds do not need to register or qualify to do business in any State, non-US Funds generally are not subject to any CTA obligations.

### ***Other Fund-Related Vehicles***

Adviser Entities commonly utilize a wide array of vehicles within their Fund structures, often below or, in some cases, parallel to their main Funds. These include but are not limited to master funds, trading vehicles, blocker corporations, special purpose entities, co-investment vehicles, intermediate holding companies, and carried interest "splitter" vehicles (collectively, Other Vehicles). The Reporting Company exemption for subsidiaries does not apply to subsidiaries of "pooled investment vehicles," and Other Vehicles are not themselves exempt from the CTA solely by virtue of being wholly owned by a Fund that is exempt as a "pooled investment vehicle."

Each Other Vehicle must qualify in its own right for one of the Reporting Company exemptions set forth above. In practice, an Other Vehicle is unlikely to be exempt as a Reporting Company other than those limited situations in which the Other Vehicle is itself an exempt "pooled investment vehicle," such as where the Other Vehicle is a master fund or holding company that relies on Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act and also is listed in an RIA's Form ADV, or where the Other Vehicle is owned by an exempt pooled investment vehicle and, depending on the specific facts and circumstances, meets the conditions to qualify as an exempt indirect subsidiary of an RIA by virtue of its ownership interests being controlled thereby.

Finally, private equity funds are likely to raise additional issues as they typically acquire or invest in portfolio companies with which the Funds, their Adviser Entities and their affiliates may share relationships of varying depth and complexity. In the case of a private equity fund, the Fund or its affiliates (each, a Fund Party) often owns 25 percent or more of the ownership interests of the portfolio company and/or has an active role in the management, decision-making or policy direction of a portfolio company, whether through the authority to appoint directors or executive officers or otherwise (i.e., exercises substantial control). A portfolio company of a private equity fund often will not be an exempt Reporting Company, and the Fund will need to determine which individuals within

the fund structure to identify as Beneficial Owners of the portfolio company.

## Summary

Investment managers should promptly analyze their management structures and Fund complexes to determine each entity's CTA compliance obligations and the availability of any Reporting Company exemptions. In addition, investment managers should carefully review their Funds and related documentation to ensure they have adequate authority to request from Beneficial Owners all of the information necessary to submit accurate and complete Reporting Company filings. For example, Fund subscription agreements should include a provision requiring investors to timely provide all information necessary for the Fund to comply with applicable law, including, expressly, the CTA, and indemnify the Fund for failing to provide such information or providing inaccurate information.

[1] "State" is defined in the CTA to include any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, American Samoa, Guam, the United States Virgin Islands, and any other commonwealth, territory or possession of the United States.

[2] For any entity formed or registered to do business on or after January 1, 2024, information (substantially similar to the information provided about Beneficial Owners) also must be provided with respect to such entity's "Company Applicants". A "Company's Applicants" are those individuals (no more than two) who (i) directly file the entity's formation or registration document with the secretary of state or a similar office under the law of a State or Indian tribe; or (ii) control or supervise such filing.

[3] The CTA defines "senior officer" as any individual holding the position or exercising the authority of a President, Chief Financial Officer, General Counsel, Chief Executive Officer, Chief Operating Officer or any other officer, regardless of official title, who performs a similar function, of a Reporting Company.

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