CORE REGULATORY FORUM

Q1 UPDATE

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Regulatory Deadlines

- Form D – 15 Days after First Sale
- Schedule 13D/G – 10 Days after Triggering Transaction
- Form 13H – Promptly if mid-quarter changes
- Form 13F – May 15
- Form PF Large HF – May 30

Notable News Headlines

- "Fed raises rates by half a percentage point"… **CNBC**
- "Elon Musk Agrees to Buy Twitter"… **New York Times**
- "Why Vladimir Putin will fall"… **The Hill**

Upcoming Events

- CORE Webinar: SEC Rulemaking Developments and the Impact to Private Fund Managers
- CORE Roundtable Events:
  - Advertising Rule Compliance
  - Operational Due Diligence
  - Energy Managers
  - Real Estate Managers

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CORE-CCO

COMPLIANCE: OUTSOURCED RESOURCES AND EXPERTISE

Regulatory Updates and Enforcement

Introduction

In a January 2022 speech, Gary Gensler, Democratic Chairman of the Securities and Exchange Commission (***SEC***), acknowledged the recent passing of 94-year-old Robert Birnbaum, who previously served as the president of both the New York Stock Exchange and American Stock Exchange, and as a member of a special team at the SEC who authored a 1963 Special Study that helped reshape regulation of the U.S. financial markets. Gensler highlighted that the 1963 report, while applauding the legislative achievement of the federal securities laws, noted that "no regulation can be static in a dynamic society" and that "unanticipated changes in the markets and the broader public participation should be accompanied by corresponding investor protection." Gensler echoed that theme sharing two guiding principles for the current Commission in shaping the SEC's 2022 agenda:

- First, continuing to drive efficiency in the capital markets
- Second, modernizing rules for today's economy and technologies

Those principles set the stage for a flurry of rulemaking developments with Chair Gensler and the current Commission embarking on an aggressive regulatory agenda. Republican Commissioner, Elad Roisman, resigned his position in January (prior to the expiration of his term in 2023), leaving a four-member Commission with three Democrats and only one remaining Republican, Hester Peirce. As a result, many of the rule proposals and decisions that followed were passed in a split decision with Pierce the sole opponent. Democratic Commissioner, Allison Herren Lee subsequently announced her intention in March not to seek a second term as Commissioner, agreeing to serve until her replacement is appointed. President Biden has nominated Mark Uyeda, a career attorney at the SEC who has previously served in the Division of Investment Management and as an advisor to former Chairman Jay Clayton, among other roles, to replace Commissioner Roisman, and Jaime Lizarraga, a long-time advisor to Speaker of the House, Nancy Pelosi, to replace Commissioner Lee.

Recent SEC Rulemaking

Following are summaries of key rulemaking developments in Q1 2022 that are expected to impact private fund managers and other institutional advisers directly or indirectly. Newly proposed rules from Q1 are in the comment process with numerous comments from industry trade groups and other representatives received to date. In addition, several proposals from 2021 are still pending. No material rules were finalized in Q1.

Form PF Amendments

In January 2022, the SEC considered proposals to amend Form PF, the reporting form for private funds designed to provide the SEC and Financial Stability Oversight Counsel (***FSOC***) with important, confidential information about the operations and strategies of private funds and enhance their ability to monitor systemic risk, bolster regulatory oversight of private funds and enhance investor protection. The proposed amendments would result in additional reporting by large hedge fund advisers, large liquidity fund advisers, and all private equity fund advisers, and would reduce the threshold for large private equity fund reporting. Specifically, amended Form PF would require the following:

- Immediate Reporting – The amendment would require immediate reporting within one business day for certain events that may present risks or material implications to fund investors or indicate systemic risks, including the following:
    - Large Hedge Funds
        - Extraordinary investment losses
        - Significant margin and counterparty defaults
        - Material changes in prime broker relationships
        - Changes in unencumbered cash
        - Key operations events
        - Significant withdrawals or redemptions

  - All Private Equity Funds
    - Execution of adviser-led secondary transactions
    - Implementation of general partner or limited partner clawbacks
    - Removal of a fund's general partner
    - Termination of a fund's investment period
    - Termination of a fund

- Large Private Equity Fund Reporting – The amendment would reduce the threshold for reporting as a large private equity fund adviser from $2 billion to $1.5 billion in RAUM and would require such funds to report additional information, including the following:
  - Fund strategies
  - Use of leverage and portfolio company financings
  - Controlled portfolio companies and their borrowings
  - Fund investments in different levels of a portfolio company's capital structure
  - Portfolio company restructurings or recapitalizations
- Large Liquidity Fund Reporting – The amendment would require such funds to report additional information, consistent with reporting required by registered money market funds, including the following, among others:
  - Liquidity information
  - Valuation information
  - Net asset value information
  - Yield information
  - Subscription and redemption information
  - Portfolio securities data

The form would be amended to include new current reporting sections to facilitate the immediate reporting requirements, although the SEC has requested comment as to whether they should instead create a new form for current reporting.

SEC Proposed Rule – https://www.sec.gov/rules/proposed/2022/ia-5950.pdf

Private Fund Rulemaking

The SEC proposed significant new rulemaking for private fund managers in February 2022. The proposed rules are consistent with recent themes in private fund examinations, enforcement cases and the most recent Private Fund Risk Alert published in January. The proposal would create significant new reporting requirements for private fund managers, similar to the reporting required of registered mutual funds. In addition, the rule would mandate or prohibit certain practices, regardless of what general partners have negotiated with limited partners or what has been disclosed to and approved by investors or a limited partner advisory committee (***LPAC***). All requirements would apply to registered investment advisers (***RIAs***) or those required to be registered. However, some would also apply to exempt reporting advisers (***ERAs***). Following is a summary of the proposed rules.

Quarterly Statements

The rule would require RIAs to prepare quarterly statements written in plain English, with data presented in a tabular format, and distribute the statements to limited partners within 45 days after the end of each quarter. Such statements would be intended to provide comparable information for investors to evaluate and monitor private fund managers. Advisers may choose to provide other information beyond the required information but with no more prominence.

- Fee and Expense Disclosure – The proposal noted that private funds are often more expensive than other asset classes because of the scope and magnitude of fees and expenses paid directly and

indirectly, with significant increases in recent years. Therefore, the proposal would require detailed disclosure with specific line items for each fee and expense, rather than broad categories, similar to what has been proposed by the Institutional Limited Partner Association.

- Fund Fees & Expenses – Would require specific disclosure regarding fund-level fees and expenses and specific information about amounts paid to the adviser, as follows:
  - Adviser Compensation – Would require detailed accounting of fees and other amounts allocated or paid by the fund to the adviser and its related persons, including:
    - Management and performance fees
    - Administrative fees and service fees
    - Other fees paid in addition to or in lieu of such fees
  - Fund Fees & Expenses – Would require detail of all other fees and expenses paid by the private fund, other than adviser compensation, including but not limited to the following. Any payment to the adviser for services provided by its related persons would need to be reported as adviser compensation, rather than a fund expense.
    - Organizational
    - Legal
    - Administration
    - Audit
    - Tax
    - Due Diligence
    - Travel
  - Offsets, Rebates and Waivers – Would require disclosure of adviser compensation and fund expenses before and after the application of any offsets, rebates or waivers. Also, would require disclosure of any offsets or rebates carried forward to subsequent periods.
- Portfolio Investment Disclosure – Would further require disclosure with respect to each "covered" portfolio investment in a single table covering each investment. Covered portfolio investments would include those that allocated or paid the fund manager or its related persons any compensation during the period. Disclosure would include:
  - Compensation – Would require detailed accounting of all compensation allocated or paid to the adviser or its related persons, attributable to the fund's interest in the covered portfolio investment. Information would be required to be reported in separate line items both before and after the application of any offsets, rebates or waivers.
  - Ownership Percentage – Would require disclosure of the fund's ownership percentage in the portfolio investment as of the end of the reporting period. If the fund does not have an ownership interest but holds debt, the adviser would list zero with a description of the investment.
- Calculation & Cross Reference – Would require disclosure regarding the way fees, expenses, payments, allocations, rebates, waivers and offsets are calculated. Such disclosure would also require cross-references to relevant sections of fund offering and governing documents.

- Performance Disclosure – The proposal would further require standardized fund performance based on the type of fund. The disclosure is intended to provide investors timely performance reporting at predictable intervals alongside corresponding fee and expense information to enable them to track progress over time, remain abreast of changes and compare information quarter-to-quarter. The proposed reporting requirements by fund type follow:
  - Liquid Funds – Open end funds with ongoing subscriptions and redemptions and funds that routinely invest in liquid assets would be required to report as follows:

    - Annual Returns – Net total returns for each calendar year since inception
    - Average Returns – Average annual returns over 1-, 5- and 10-year periods
    - Current Return – Cumulative net total return for current year as of most recent quarter

  - Illiquid Funds – Closed end funds that do not offer ongoing subscription or redemption rights and do not routinely invest in liquid assets would be required to report the following metrics since inception and without the impact of fund-level subscription facilities. The proposed rule would also require fund managers to provide a statement of contributions and distributions reflecting aggregate inflows and outflows and the fund's net asset value.

    - Total Fund IRR – Gross and net IRR
    - Total Fund MOIC – Gross and net multiple of invested capital
    - Realized & Unrealized Returns – Gross IRR and MOIC for the realized and unrealized portions of the portfolio shown separately

  - Prominent Disclosure – Fund managers would be required to include prominent disclosure of the criteria used and assumptions made in calculating performance, including assumed fee rates and methodology for net returns. The required disclosures must be in the quarterly statement and could not be provided through a link or separate document.

Mandatory Fund Audits

Private funds managed by RIAs would be required to obtain an annual audit of financial statements performed by an independent public accountant, registered with and subject to inspection by the Public Company Accounting Oversight Board (***PCAOB***). Audited financial statements must be prepared in accordance with generally accepted accounting principles (***GAAP***) and the audit conducted pursuant to investment company standards. Audits must be obtained at least annually and upon an entity's liquidation.

Audited financial statements must be promptly distributed to investors. The auditor must notify the SEC upon certain events, including termination or issuance of a modified opinion. Private fund advisers are currently permitted under Rule 206(4)-2, the Custody Rule, to elect either a financial statement audit or a surprise examination. However, SEC staff noted that they believe the financial statement audit provides additional protections not provided by surprise exams based on the review of valuation and other critical information.

Adviser-Led Secondaries

The SEC proposed that RIAs obtain an independent fairness opinion in connection with certain adviser-led secondary transactions where an adviser offers fund investors the option to sell their interests in a fund or exchange them for new interests in a new vehicle advised by the adviser. In addition to the fairness opinion, the adviser must distribute to investors, prior to the closing of the transaction, a summary of any material business relationship with the independent opinion provider. This requirement would not extend to secondary transactions initiated by an investor.

Prohibited Activities

The proposal would also prohibit all private fund advisers, including RIAs and ERAs, from engaging in certain activities that the SEC believes raise material conflicts of interest or are contrary to protection of investors, including the following practices:

- Certain Fees and Expenses – Fund managers would be prohibited from charging the following fees and expenses to a private fund or portfolio investment:

  - Fees for Unperformed Services – Accelerated payments for monitoring, servicing, consulting, or other fees the adviser does not provide or reasonably expect to provide to a portfolio investment.
  - Examination & Investigation Costs – Fees or expenses associated with examination or investigation of the adviser or its related persons.

- Regulatory & Compliance Expenses – Fees or expenses related to the adviser or its related persons' registration as an investment adviser, or licensing of adviser personnel, and compliance with applicable regulations. This would not prohibit a fund from paying its own regulatory filing fees.
- Non-Pro Rata Fee and Expense Allocations – Would prohibit an adviser from charging or allocating fees and expenses related to a portfolio investment on a non-pro rata basis when multiple private funds and other clients have invested or proposed to invest in the same investment. This would also prohibit a fund from bearing dead deal expenses that other co-investors or potential co-investors do not share.

- Clawback Reductions – Managers would be prohibited from reducing the amount of any clawback by the amount of actual, potential, or hypothetical taxes applicable to the adviser, its related persons, or their respective owners.
- Limitations on Liability for Misconduct – Managers would be prohibited from seeking reimbursement, indemnification, exculpation, or limitation of the adviser's liability by the fund or investors for a breach of fiduciary duty, willful misfeasance, bad faith, negligence, or recklessness in providing services to the fund.
- Borrowing – Managers would be prohibited from borrowing money, securities, or other assets, or receiving extensions of credit from a private fund client. This practice would be prohibited even where disclosed (and potentially consented to by an advisory board or LPAC). Advisers, however, would not be precluded from lending money to private funds they manage for start-up costs or other expenses, so long as they do not charge excessive interest rates or engage in abusive practices.

Preferential Treatment

Noting the increased use of side letters and other agreements between fund managers and investors, the proposal would prohibit certain types of preferential terms that the SEC believes present significant conflicts of interest and are contrary to investor protection. For other side letter terms, the proposal would require that the adviser provide written disclosure to prospective and current investors regarding the terms provided to other investors, thereby increasing transparency and enabling investors to better understand potential conflicts and risks. Such disclosure would need to provide specific detail and not simply broad statements such as "some investors pay a lower fee." For prospective investors, such disclosure would be required prior to investment. For existing investors, such notice would be required at least annually if preferential treatment was provided since the date of the last notice. These requirements would apply to both RIAs and ERAs.

Advisers would be prohibited from granting an investor in a fund, or any substantially similar pool of assets (such as a parallel fund structure, master or feeder fund), the following preferential provisions:

- Preferential Liquidity – Permitting certain investors to redeem interests more frequently than other investors.
- Preferential Transparency – Providing information regarding portfolio holdings or exposures to certain, but not all, investors in a fund.

Books & Records

The proposal would require RIAs to maintain various books and records as needed to document and demonstrate compliance with the relevant provisions described herein. Such documents would be subject to similar record retention periods as other required documents.

Annual Compliance Review

Rule 206(4)-7, the Compliance Rule, requires all RIAs to conduct an annual review of their compliance policies and procedures. Historically, the rule did not require that such reviews be documented in writing. The rulemaking

would require that all registered investment advisers, not just private fund managers, document in writing such annual reviews.

SEC Proposed Rule – https://www.sec.gov/rules/proposed/2022/ia-5955.pdf

Cybersecurity Risk Management

In February 2022, the SEC proposed new rules that would require RIAs and registered investment companies to adopt and implement written cybersecurity policies and procedures reasonably designed to address cybersecurity risks. In addition, the SEC proposed to require advisers to report to the SEC significant cybersecurity incidents affecting the adviser or its clients and disclose cybersecurity risks and incidents to clients and investors. The proposed rule is similar in some respects to Rule 206(4)-7 of the Investment Advisers Act of 1940 (***Advisers Act***), the Compliance Rule, which requires firm to adopt and implement effective compliance programs. The Compliance Rule has been in effect for nearly 20 years and has redefined compliance practices for advisers. The SEC has conducted multiple cybersecurity exam initiatives and issued guidance over the past several years regarding information security and cybersecurity best practices. Given the increased incidences and implications of cybersecurity breaches in recent years, the rulemaking was expected and is likely to move forward. The proposed new rules complement other existing regulations, including Regulation S-P and Regulation S-ID, that further require firms to adopt and implement privacy policies and procedures to protect personal information of clients and investors. Following is a summary of the proposed new rules.

Cybersecurity Risk Management Program

Proposed Rule 206(4)-9 under the Advisers Act would require RIAs to adopt and implement risk-based cybersecurity policies and procedures containing certain mandatory elements but would permit and encourage RIAs to customize such policies and procedures to fit the nature and scope of their business. While such policies and procedures should specify those groups, positions, or individuals responsible for implementing, administering, and overseeing the effectiveness of the policies and procedures, the firm would have flexibility to determine such person(s) or group(s), which may include legal, compliance, information technology (***IT***), other operational staff, and/or third-party IT, cybersecurity, or risk management providers. The required elements of such cybersecurity risk management programs would include the following:

- Risk Assessment – Would require RIAs to periodically assess, update, and document the cybersecurity risks associated with their information systems and information, with reference to updates and guidance from other governmental and private sector resources. Risk Assessments should cover the following:
  - Risk Inventory – Categorize and prioritize cybersecurity risks based on the components of the firm's IT systems, information therein, and potential impact of a cybersecurity incident.
  - Service Provider Risks – Identify service providers that receive, maintain or process information on behalf of the firm, the information they have access to, and the cybersecurity risks associated with such parties, taking into consideration such parties' cybersecurity controls and practices.
- User Security & Access – Would require controls designed to minimize user-related risks and prevent unauthorized access to information and systems, incorporating:
  - Acceptable use policies
  - User identification and authentication
  - Password policies
  - Restricted/need to know access
  - Remote access controls
- Information Protection – Would require firms to monitor information systems, taking into consideration the nature and sensitivity of the information residing on such system, and implement reasonable measures to protect such information, e.g., through encryption, network segmentation, activity monitoring, service provider oversight, and other controls.

- Threat & Vulnerability Management – Would require firms to detect, mitigate and remediate cybersecurity threats and vulnerabilities with respect to information and systems, through ongoing monitoring and vulnerability assessments. Once a threat or vulnerability is identified, firms should take appropriate steps to mitigate and remediate such matter. RIAs would also be expected to conduct role-specific cybersecurity training.
- Incident Response Plans – Would require firms to establish incident response plans including effective measures to promptly detect, respond to, and remediate cybersecurity incidents. Such plans should designate specific individuals responsible for key actions and should contemplate steps to ensure continued operations, actions to protect sensitive information, effective information sharing and communications, reporting to the SEC and appropriate authorities, and robust documentation. Firms would be expected to periodically test such plans to assess their efficacy and determine any needed changes.
- Annual Review – Would require firms to review their cybersecurity policies and procedures at least annually to assess their design and effectiveness in addressing cybersecurity risks and whether any changes are needed. Advisers must prepare a written report documenting such annual review, including assessments, tests performed, cybersecurity incidents that occurred and any material changes to policies and procedures.
- Board Oversight – With respect to registered investment companies, the fund's board, including a majority of the independent directors, would be required to approve the firm's cybersecurity policies and procedures and annual cybersecurity review report.

Reporting of Significant Cybersecurity Incidents

The SEC further proposed a new regulatory reporting form, Form ADV-C, that RIAs would be required to file with the SEC promptly, i.e., no less than 48 hours, after a significant cybersecurity incident has occurred or been discovered. The form would require RIAs to provide general and specific information regarding the nature and scope of such incident and any disclosure or notification made to clients or investors. Firms would be required to promptly amend such form in the event new information is discovered, information previously reported becomes inaccurate, or after resolving a previously reported incident or closing an internal investigation. The proposal would define a "significant cybersecurity incident" as a single incident or group of related incidents that either 1) significantly disrupts or degrades the adviser's ability, or the ability of a private fund client, to maintain critical operations, or 2) leads to unauthorized access or use of adviser information that results in (a) substantial harm to the adviser or (b) substantial harm to a client or investor. Form ADV-C would be submitted through the IARD system, as with other Form ADV filings.

Disclosure of Cybersecurity Risks and Incidents

The proposal would further require that RIAs disclose cybersecurity risks and incidents to their clients and investors and other market participants. Such disclosures would be required in a new section of Form ADV Part 2A. Advisers would be expected to disclosure in plain English how they assess, prioritize, and address cybersecurity risks. Advisers would also be required to disclose any significant cybersecurity incidents that occurred within the last two fiscal years, utilizing the same definition as noted above for Form ADV-C. RIAs would be required to provide an amended Part 2A to clients promptly if the adviser adds disclosure of a cybersecurity incident.

Books & Records

Finally, the proposal would amend Rule 204-2, the Books and Records Rule, under the Advisers Act to require RIAs to maintain copies of their 1) cybersecurity risk assessment, 2) cybersecurity policies and procedures, 3) annual cybersecurity review report, 4) Form ADV-C, and 5) records of any cybersecurity incidents and response

thereto. Such documents would be subject to similar record retention periods as other required books and records.

Public Company Disclosures

In March 2022, the SEC further proposed rules and amendments to enhance and standardize disclosures for public companies regarding cybersecurity risk management, strategy, governance, and incident reporting. These proposals would require reporting of material cybersecurity incidents on Form 8-K as well as additional disclosures regarding firm cybersecurity risk policies and procedures. While not directly applicable to private fund managers, such disclosures would impact information utilized by hedge funds and other fund managers with respect to public company due diligence.

SEC Proposed Rules – https://www.sec.gov/rules/proposed/2022/33-11028.pdf and https://www.sec.gov/rules/proposed/2022/33-11038.pdf

Short Sale Disclosure

In February 2022, the SEC voted to propose Securities Exchange Act of 1934 (***Exchange Act***) Rule 13f-2 in an effort to provide greater transparency to investors and regulators by increasing the public availability of short sale related data thereby fulfilling a Congressional mandate added under the Dodd-Frank Wall Street Reform and Consumer Protection Act. The proposed rule would require institutional investment managers exercising investment discretion over short positions meeting specified thresholds to report on Proposed Form SHO information relating to end-of-the-month short positions and certain daily activity affecting such short positions. The SEC would then aggregate the resulting data by security, thus maintaining the confidentiality of the reporting managers, and publicly disseminate the data to all investors. This new data would supplement the short sale data that is currently publicly available from the Financial Industry Regulatory Authority and stock exchanges.

The confidential Proposed Form SHO would be filed via EDGAR within 14 calendar days after the end of each calendar month with regard to each equity security and all accounts over which the manager meets or exceeds either of the following thresholds:

- For any equity security of an issuer that is registered pursuant to Section 12 of the Exchange Act or for which the issuer is required to file reports pursuant to section 15(d) of the Exchange Act in which the manager meets or exceeds either (1) a gross short position in the equity security with a US dollar value of $10 million or more at the close of any settlement date during the calendar month, or (2) a monthly average gross short position as a percentage of shares outstanding in the equity security of 2.5 percent or more; or
- For any equity security of an issuer that is not a reporting company issuer as described above in which the manager meets or exceeds a gross short position in the equity security with a US dollar value of $500,000 or more at the close of any settlement date during the calendar month.

The information a manager would report includes:

- The name of the eligible security;
- End of month gross short position information; and,
- Daily trading activity that affects a manager's reported gross short position for each settlement date during the calendar month reporting period.

The SEC would publish, based on information reported in Proposed Form SHO:

- The issuer's name and other identifying information related to the issuer;
- The aggregated gross short position across all reporting managers in the reported security at the close of the last settlement date of the calendar month of the reporting period, as well as the corresponding dollar value of this reported gross short position;

- The percentage of the reported aggregate gross short position that is reported as being fully hedged, partially hedged, or not hedged; and
- For each reported settlement date during the calendar month reporting period, the "net" activity in the reported security, as aggregated across all reporting managers, within 14 business days of the calendar-month-end reporting deadline.

SEC Proposed Rule – https://www.sec.gov/rules/proposed/2022/34-94313.pdf

Modernization of Beneficial Ownership Reporting

For the first time in more than 50 years, in February 2022, the SEC proposed rule amendments to beneficial ownership reporting under Sections 13(d) and 13(g) of the Exchange Act. Currently, beneficial owners of more than 5% of outstanding shares of a public company must report their ownership to the SEC within 10 days by submitting either a Schedule 13D or 13G. These forms are publicly available which makes the regulatory deadlines for submission very important. The SEC is concerned that the current 10-day deadline contributes to information asymmetries that could harm investors. Furthermore, the SEC believes that, given the technological progress of the last five decades, less time is needed to compile the necessary data and prepare and transmit the Schedule 13D/G to the SEC.

The SEC is currently reviewing public comments. However, if passed in its current form, the amended rules would:

- Shorten the filing deadline for the initial Schedule 13D/G from ten to five days after the date on which a person acquires more than 5% of a covered class of equity;
- Revise the filing deadline for amendments to Schedule 13D to one business day after the date on which a material change occurs;
- Shorten the deadline for the initial Schedule 13G filing for Qualified Institutional Investors (***QIIs***) from 45 days after year-end to five business days after the end of the month in which the investor beneficially owns more than 5% of the covered class of securities;
- Require all Schedule 13G filers (passive investors), to file an amendment five business days after the month in which a material change occurred, rather than 45 days after the year in which any change occurred; and
- For Schedule 13G filers exceeding 10% beneficial ownership or in case of a 5% increase or decrease in beneficial ownership of a covered class of securities, require qualified institutional investors and passive investors to file an amendment within five days and one business day, respectively.

In addition, the proposed amendments would change the way investors working as a group report their beneficial ownership. Presently, regulations provide that two or more persons or entities beneficially owning shares of registered securities may be deemed to have formed a "group," which acts as a "person" for purposes of beneficial ownership reporting. Moreover, there is an implication that, to be subject to Section 13(d) reporting, an express agreement by two parties to act together must be in place for formation of a group. The proposed changes intend to remove this implication. The SEC designed the proposed amendments to prevent circumvention of Section 13(d), clarifying the specific situations that subject beneficial owners to Section 13(d) reporting. Lastly, the SEC proposes to extend the filing "cut-off" times for Schedules 13D and 13G from 5:30 p.m. to 10:00 p.m. ET.

SEC Proposed Rule – https://www.sec.gov/rules/proposed/2022/33-11030.pdf

Public Company Climate Risk Disclosures

In March 2022, the SEC proposed new disclosure requirements for public companies related to environmental, social, and governance (***ESG***) and climate related risks. While the proposed rulemaking does not directly apply to private funds or investment advisers, we are expecting additional rulemaking for such entities later in 2022

and the public company disclosures may signal some of the focus areas. In particular, public companies would be required to report certain climate-related information in SEC filings, including the following:

- Climate-Related Risks – Actual and likely impact to strategy, business model, and outlook over the short, medium or long-term
- Governance – Oversight and governance of climate related risks by the board and company management
- Risk Management Practices – Process for identifying, assessing and managing and climate-related risks
- Transition & Scenario Planning – Details regarding transition planning and assessing resiliency of business to climate-related risks
- Reporting Data & Metrics – Certain data and information, including:
    - Greenhouse gas emissions
    - Indirect emissions from upstream and downstream activities
    - Internal carbon price details
    - Impact of climate-related events on financials
    - Climate-related targets or goals
    - Use of carbon offsets or renewable energy certificates

SEC Proposed Rule – https://www.sec.gov/rules/proposed/2022/33-11042.pdf

Special Purpose Acquisition Companies (SPACs)

The SEC proposed new rulemaking and guidance with respect to SPACs which had garnered increased interest from private fund managers and other investment firms both as SPAC sponsors, potential investors, and/or potential sellers of a private company as a de-SPAC acquisition target. The proposed rules are intended to enhance investor protections in initial public offerings (***IPOs***) by SPACS and in subsequent business combination transactions between SPACs and private operating companies. Specifically, the new rules would address the following:

- Disclosures & Investor Protections – Would require enhanced disclosure and provide additional investor protections in IPOs by SPACs and in de-SPAC transactions, specifically related to:
    - SPAC Sponsors – Conflicts of interest and dilution
    - De-SPAC Transactions – Fairness of the transaction to SPAC investors
    - Private Operating Companies – Co-registration in SEC filings
    - Smaller Reporting Company – Redetermination of status prior to de-SPAC transaction
    - Blank Check Company – Amendment to definition to clarify liability
    - Underwriters – IPO underwriters generally deemed underwriters for de-SPAC
    - Shell Companies – Similar disclosure as required in IPO registration statements
    - Projections – Additional disclosure to assess basis of projections in conjunction with SPAC business combination transactions
- Investment Company Status – Would require certain conditions in order for a SPAC to be exempt from registration as an investment company, including:
    - Assets – Must maintain assets comprising only cash and cash equivalent securities
    - Business Operations – The surviving entity after a de-SPAC transaction must be primarily engaged in the business of the target company
    - Timeline – Must enter into de-SPAC transaction agreement with a target company within 18 months after IPO and complete the de-SPAC transaction within 24 months

SEC Proposed Rule – https://www.sec.gov/rules/proposed/2022/33-11048.pdf

Regulatory Updates and Enforcement

Shortening Securities Transaction Settlement (T+1)

In response to 2021 incident of increased market volatility related to the COVID-19 pandemic and unusual activity in certain "meme" stocks," in February 2022, the SEC produced rule amendments that would shorten the standard settlement cycle for securities transactions from two business days after trade date (T+2) to one business day after trade date (T+1). The amendments would further eliminate the separate T+4 settlement cycle for firm commitment offerings priced after 4:30pm. The rulemaking would require broker-dealers to complete the allocation, confirmation and affirmation process as soon as practicable but no later than end of day on trade date. Investment advisers would, in turn, be required to send allocation instructions and affirmations no later than end of the day on trade date and maintain records of such allocations and affirmations with a date and time stamp indicating when it was sent to the broker dealer.

SEC Proposed Rule – https://www.sec.gov/rules/proposed/2022/34-94196.pdf

Exam Developments

The SEC's Division of Examinations (***Exam Division***) Acting Director, Daniel Kahl, and Deputy Director, Kristin Snyder, both left the SEC in Q1 2022. Mr. Kahl was replaced in an acting capacity by Richard Best, the former Director of the SEC's New York Regional Office, and Ms. Snyder was replaced in an acting capacity by Joy Thompson, Associate Regional Director of the examination program in the Philadelphia Regional Office. Ms. Snyder also served as the Co-National Associate Director of the Investment Adviser/Investment Company (***IA/IC***) Examination Program and has been replaced in an acting capacity by Natasha Vij Greiner, who has spent time in the Exam Division as well as enforcement counsel and counsel within the SEC's Division of Trading and Markets. SEC examination staff continued to work and actively conduct examinations remotely through the first quarter of 2022. During Q1 2022, the Exam Division published its second private fund risk alert and 2022 exam priorities as summarized below.

Private Fund Risk Alert

Following an initial risk alert in June 2020, the Exam Division issued a second risk alert in January 2022 noting observations from private fund adviser examinations. The initial risk alert highlighted observations and concerns related to 1) conflicts of interest, 2) fees and expenses, and 3) material non-public information (***MNPI***) and codes of ethics. The current risk alert highlights investment advisers' fiduciary duty under the Advisers Act and the need for investment advisers at all times to serve in the best of its clients and not to subordinate client's interest to their own. The alert further noted prohibitions under Rule 206(4)-8 of the Advisers Act from making any untrue or misleading statements to investors or prospective investors in private funds. Finally, the risk alert highlighted the importance of adopting effective compliance policies and procedures and reviewing and evaluating their effectiveness in preventing violations of the Advisers Act. Specific deficiencies noted include the following:

- Conduct Inconsistent with Disclosures
    - Failure to Obtain Consent from LPAC – Fund limited partnership agreements, operating agreements, private placement memoranda, due diligence questionnaires, side letters or other disclosures frequently require fund managers to bring conflicts of interest to their LPAC for review and consent. However, examiners noted that managers often failed to bring conflicts to the LPAC, did not obtain consent until after the transaction occurred, or provided the LPAC with inadequate information regarding the conflict.
    - Management Fee Calculations – Examiners observed instances in which fund managers did not calculate management fees after the commitment period or investment period consistent with fund governing documents by failing to reduce fees for impairments, write-downs, write-offs, or dispositions.

  - Fund Extensions – Examiners noted that advisers sometimes extended funds' terms or failed to liquidate the fund without obtaining required approvals, resulting in inappropriate management fees being charged to investors.
  - Investment Deviations – Examiners observed fund managers that implemented investment strategies or utilized leverage in ways that differed materially from what was disclosed to investors.
  - Recycling Capital – Examiners noted that firms sometimes recycled realized investment proceeds in ways that were not consistent with disclosures, which may have resulted in excess management fees.
  - Key Person Provisions – Examiners observed advisers that did not adhere to the key person provisions in fund governing documents or did not promptly notify investors after the departure of principals.

- Disclosures Regarding Performance and Marketing
  - Misleading Track Record – Examiners noted instances where managers reported stale performance information, did not adequately disclose how the track record was constructed, did not accurately reflect fees and expenses, cherry-picked favorable investments or fund returns, did not adequately disclose the impact of leverage on fund performance or how benchmarks were used.
  - Inaccurate Performance Calculations – Examiners highlighted instances where funds used inaccurate data from incorrect time periods to calculate returns, mischaracterized return of capital as dividends, or presented projected returns rather than actual performance.
  - Prior Firm Track Record – Examiners observed fund managers that marketed performance from a prior firm where the information reported was incomplete, the same persons were not primarily responsible for achieving the performance, or where they did not have adequate supporting documentation.
  - Awards Touted – Examiners noted that managers sometimes highlighted awards received without fully and fairly disclosing material information about such awards, such as the fact that the adviser paid a fee in connection with the award or was paid a fee to promote the receipt of the reward.
  - SEC Oversight Claims – Examiners objected to advisers' claims that their investments were "supported" or "overseen" by the SEC or U.S. government.

- Due Diligence
  - Insufficient Due Diligence – Examiners observed advisers that did not perform reasonable investigation or conduct adequate due diligence prior to making an investment or engaging a key service provider, such as alternative data providers or placement agents.
  - Inadequate Policies and Procedures – Examiners further noted advisers that did not maintain adequate policies and procedures related to the due diligence of investments that were tailored to their business.

- Hedge Clauses
  - Waiver of Duty – Examiners objected to fund governing documents that included language purporting to waive or limit the firm's fiduciary duty, except for findings of gross negligence, willful misconduct, or fraud.

CORE analyzed the initial private fund risk alert closely and had dialogue with the SEC Private Fund Unit regarding questions and observations with respect to the issues highlighted. We expect to closely analyze each of the points in the most recent alert with a view toward the application to our private fund clients and their compliance practices, challenges, and solutions. Following are what we believe are several key lessons and considerations:

- Identifying and Analyzing Disclosures – Fund terms and activities are primarily governed by fund limited partnership or operating agreements. However, private funds routinely make disclosures in a variety of other documents, including private placement memoranda, due diligence questionnaires, marketing materials, side letters and other documents, to which they will be held by SEC examiners. Therefore, it is imperative that chief compliance officers (***CCOs***) and compliance teams review and compare language in each of these documents for consistency and to ensure that they develop appropriate procedures, monitoring and testing to confirm the firm is following each provision as disclosed. It is important to anticipate how investment guidelines, fee and offset provisions, and other terms will be implemented in practice during and after the investment period, throughout all stages of a fund's life and any extension periods. In short, SEC examiners expect firms to do what they say and say what they do.
- Conflict Resolution Process – Identification and mitigation of conflicts of interest is one of the greatest focus areas in SEC examinations, and the failure to effectively identify, disclose or resolve a conflict is routinely the cause of exam deficiencies and enforcement referrals. Therefore, it is exceedingly important for CCOs and compliance teams to be vigilant in monitoring for potential and actual conflicts with respect to all new, follow-on, and recycled investments, related party transactions, fees and expenses, fund extensions or restructurings, and other activities. The CCO should ensure that fulsome disclosure is made to, and consent received from, fund limited partners or the LPAC for all activities as required under fund governing documents. However, even if fund governing documents disclose potential conflicts and/or do not specifically require approval for certain transactions, SEC examiners generally will expect advisers to disclose relevant details regarding all conflicts that arise over the life of the fund with an opportunity for investors to raise questions or concerns.
- Performance Marketing – As management teams' prior experience and track record are critical factors for attracting and retaining investors, both potential limited partners and SEC examiners focus heavily on performance reporting. Institutional and other sophisticated investors often do not solely rely on a fund manager's performance presentation, but further request and analyze additional supporting information, including portfolio cash flows, valuations, trading records and other information to test such performance claims. Nevertheless, examiners expect fund managers to fully disclose all current and relevant facts and information to ensure that reported performance is not misleading. It is better to fully disclose all relevant information and ensure that all information provided is fair and balanced. Rather than omit negative returns or other adverse details, managers should instead focus on providing additional data or explanation to put the information provided into the proper context for sophisticated investors to fairly evaluate. CCOs and compliance teams play an important role in reviewing and approving performance marketing materials by playing the devil's advocate and providing the perspective of a potentially skeptical SEC examiner.
- Due Diligence – Investment research and due diligence are integral to fund managers' investment process, and investment teams may take for granted that they will execute that process adequately and may be resistant to adopt and implement formal policies, procedures or documentation related to such process. However, examiners typically give investment advisers far more credit for investment and other activities that are fully documented in compliance policies, procedures, and firm records. Therefore, CCOs and compliance teams should work collaboratively with their investment teams to ensure that robust documentation is maintained contemporaneous with investment decisions.
- Fiduciary Duty – Finally, an investment adviser's fiduciary duty is a central component of the investor protections provided by the Advisers Act. Accordingly, CCOs and compliance teams are encouraged to work closely with legal counsel to ensure that such duty is fully incorporated and reflected in fund governing documents, compliance policies, procedures, and disclosures.

SEC Risk Alert – https://www.sec.gov/files/private-fund-risk-alert-pt-2.pdf

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Fiscal Year 2022 Exam Priorities

In March 2022, the Exam Division published its examination priorities for fiscal year 2022 and noted that its level of examinations for FY21 returned to pre-Covid 19 levels and that it examined 16% of all RIAs compared to 15% for FY20. The number of RIAs has grown 20% over the past five years while assets under management by such RIAs has grown 70% over that same period. Of the more than 14,800 RIAs, approximately 35% (more than 5,000) manage private funds, with approximately $18 trillion in private fund assets. This represents an increase of nearly 70% over the past five years and has garnered significant attention from the SEC Chairman and Commissioners, with specific emphasis on the investment in private funds by state and local pension plans and increased exposure to private funds by retail investors and working families. Specific 2022 Exam priorities include the following focus areas:

Private Funds

As a result of the increased scrutiny of private funds, the Exam Division has listed private fund exams as the first focus area for 2022. Exam staff expect to review private fund manager's fiduciary duty, risks, conflicts, and disclosures with a specific focus on the following areas:

- Fees & Expenses – Calculation and allocation of fees and expenses, including the calculation of post-commitment period management fees and the impact of valuations on fees, particularly at private equity funds
- Preferential Treatment of Limited Partners – Specifically related to differences in liquidity, including imposing gates or suspensions on fund withdrawals
- Custody Rule Compliance – Compliance with the audit exception provisions, reporting and disclosure of fund auditors
- Related Party Transactions – Adequacy of disclosures and consent provisions for principal transactions (e.g., warehoused transactions), cross-transactions between funds/clients, and distressed sales
- Conflicts Regarding Liquidity – Adviser-led fund restructurings and stapled secondaries where new investors purchase the interest of existing investors
- Portfolio Management – Compliance with disclosed investment strategies and disclosure of investment risks
- Investment Allocations – Conflicts and disclosures related to investment allocation process
- SPAC Investments – Particularly where the fund manager is also the SPAC sponsor
- Risk Management Practices & Reporting – With a focus on systemic importance, such as outsized counterparty exposure or gross notional exposure relative to other private funds
- Insider Trading & Material Non-Public Information – Controls around the receipt and handling of MNPI

Environmental, Social, Governance

Consistent with increased SEC rulemaking and broader emphasis, the Exam Division has noted that it will continue to focus on ESG investing, both by private fund managers and all RIAs. As investors increasingly demand ESG investments and impose minimum standards in selecting managers, SEC exam staff are concerned that disclosures regarding portfolio management practices, as related to ESG, may be materially false or misleading. Examiners have noted that this risk is compounded by 1) the lack of standardization around ESG terminology, 2) the variety of approaches to ESG investing, and 3) the failure to effectively address legal and compliance issues with new business and products. Examiner reviews of ESG practices are expected to focus on the following:

- Investment Practices – Whether firms have implemented effective policies, procedures, and practices to ensure they are investing and monitoring investments consistently with ESG disclosures
- Voting Practices – Whether voting aligns with ESG-related disclosures and mandates and is consistent with proxy policies and procedures

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- Disclosures – Whether firms are overstating or misrepresenting ESG factors considered or incorporated in portfolio selection in advertising, marketing, and performance reporting

Information Security & Operational Resiliency

As a continued theme, the Exam Division has highlighted how critical it is for firms to be vigilant in protecting data to prevent unauthorized access, use, disclosure and destruction of sensitive information, and to ensure business continuity. Accordingly, examiners expect to evaluate whether private fund managers and other RIAs have taken appropriate measures around:

- Account Access – Whether firms have adequate safeguards to prevent account intrusion or unauthorized access
- Vendor Management – Whether firm have sufficient due diligence and other procedures to oversee vendors and service providers
- Malicious Attacks – Whether firms have strong controls to prevent, identify and protect against phishing and of malicious email activities
- Incident Response – Whether firms are prepared and can respond promptly to security incidents, including ransomware attacks
- Identity Theft – Whether firms are able to identify and detect red flags related to identity theft
- Remote Operations Risk – Whether firms effectively manage operational risk resulting from remote work environments
- Business Continuity/Disaster Recovery – How firms have improved BCP/DRP planning and whether such plans are adequate for sudden disruptions and incremental changes from climate risk

Emerging Technologies and Crypto-Assets

As RIAs increasingly utilize developing financial technologies, SEC exam staff will focus on the unique risks these activities create and whether compliance programs adequately address such risks. In addition, with respect to market participants engaged with crypto-assets, the Exam Division will review the following:

- Standards of Conduct – Whether firms have met standards of conduct and duties of care in their initial and ongoing understanding of the products
- Compliance Procedures – Whether firms routinely review, update and enhance compliance practices based on relevant risks, such as crypto-asset wallet safeguards, custody practices, valuation practices and AML reviews
- Disclosures – Whether firms have adequately disclosed risks inherent in such strategies and activities
- Operational Resiliency – Whether firms have appropriately addressed data integrity and business continuity plans specific to such activities

General Compliance Reviews

Finally, the Exam Division summarized how they review RIA compliance programs to assess whether policies and procedures are reasonably designed to prevent violations of the Advisers Act and breaches of an adviser's fiduciary duty. Exam staff noted that routine examinations generally focus on one or more of the following core areas: 1) marketing practices; 2) custody and safety of client assets; 3) valuation; 4) portfolio management; 5) brokerage and execution; 6) conflicts of interest and 7) disclosures. General compliance reviews are also expected to cover the following:

- Investment Advice – To ensure it is in best interest of clients
- Service Provider Oversight – To ensure it is adequate
- Compliance Resources – To ensure they are sufficient to perform compliance duties
- Alternative Data – To ensure adequate controls around the creation, receipt and use of potential MNPI
- High Risk Employees – To ensure heightened oversight for employees with disciplinary histories
- Supervision – To ensure adequate oversight of activities in other offices

- Fees & Expenses – To identify errors in fee calculations or failure to refund prepaid fees or pro-rate fees for new clients

SEC Exam Priorities – https://www.sec.gov/files/2022-exam-priorities.pdf

Enforcement Developments

The SEC Division of Enforcement (***Enforcement Division***) has continued and is expected to continue throughout 2022 a similarly aggressive pursuit of investigations and enforcement actions. The Commission announced its intention to seek admissions in enforcement actions involving egregious misconduct or significant harm and avoid "neither admit nor deny" settlements which were common under the prior Commission led by Chairman Jay Clayton. Stiffer corporate penalties, officer and director's bars, and a more restrictive approach to cooperation credit are a few recent trends consistent with the current enforcement environment.

SEC Enforcement Case Summaries

Audit & Custody Failures – Spruce Investment Advisors, LLC (March 30, 2022)

Spruce Investment Advisors, LLC (***Spruce*** or the ***Firm***) was charged with multiple violations of the Custody Rule under the Advisers Act due to failure to adopt and implement written policies and procedures with respect to compliance with the Custody Rule and allocation of fund expenses. Spruce has been a registered investment adviser with the SEC since 2003 and advises approximately 100 private equity funds (***AEI Funds***). The Firm formed Spruce Direct Investment Fund I (***SDIF***) and raised funds to acquire the managing member interests in AEI Funds, making SDIF a fund of funds. Spruce Private Investments Fund II (***SPIF***) was formed thereafter as a private fund which partially invests in SDIF, also making it a fund of funds. Spruce served as a managing member or general partner of each Fund at all relevant times and is deemed to have custody of Fund assets as the Firm has authority to make decisions for, or act on behalf of the Funds.

Under the Custody Rule, registered investment advisers with custody of clients' funds or securities must, among other requirements, ensure verification by surprise examination each year. Spruce attempted to comply with the Audited Financials Alternative (***AFA***) exception which requires the Funds to be audited as of year-end by a PCAOB-registered independent public accountant and the audited financial statements distributed to investors within 120 days of fiscal year-end. Advisers to fund of funds are allowed 180 days following fiscal year-end generally.

The audits were not completed on time due to Spruce being unable to provide pertinent records to the auditor. Because of this, Spruce failed to deliver the audits within 120 days of FYE 2014 forward for certain AEI Funds and for FYE 2015 forward for the other AEI Funds. They also failed to distribute audits to SDIF and SPIF investors within 180 days of FYE 2018 forward. Since Spruce failed to satisfy the AFA requirements, they were to comply with the Custody Rule, which they failed to do as well.

In late-2018, the Firm reallocated expenses previously borne by SDIF to AEI Funds. Spruce determined AEI Funds' operating agreements required SDIF to be reimbursed for all attributable expenses, then reallocated the expenses without sufficient supporting documentation. The auditors were informed after the implementation rather than consulted with beforehand, causing ongoing delays in audits as Spruce had to substantiate and correct multiple categories of expense allocations. SPIF, as an investor in SDIF, was also affected by this delay.

In 2016, a compliance consultant recommended that Spruce prepare more detailed policies and procedures for compliance with the Advisers Act. The Firm failed to adopt written policies and procedures regarding allocation of expenses to and between AEI Funds and SDIF, as well as with respect to the Custody Rule. Their policies merely referenced the rule rather than provided procedures to prevent such violations. The SEC charged Spruce with willfully violating Section 206(4) of the Advisers Act and Rules 206(4)-2 and 206(4)-7 thereunder. The Firm must notify past and current investors of the settlement terms of the SEC order and certify in narrative writing

with exhibits, compliance with the undertaking. They were also ordered to cease and desist from committing or causing future violations of Section 206(4) of the Advisers Act, censured, and pay a penalty of $75,000.

SEC Administrative Proceeding – https://www.sec.gov/enforce/ia-5987-s

Crypto Fraud Operation – John and JonAtina Barksdale (March 8, 2022)

The SEC charged siblings for allegedly defrauding thousands of investors out of $124 million through offerings of securities relating to a digital token known as "Ormeus Coin." The siblings offered Ormeus through crypto exchanges, and promoted the offering via YouTube, roadshows, press releases, and other promotional materials.

The defendants falsely stated that Ormeus Coin had a $250 million crypto mining operation and was producing $5.4 million to $8 million per month in mining revenues, although they abandoned their mining operations in 2019 after generating less than $3 million in revenue. The siblings setup a public website that displayed a wallet of an unrelated third party showing more than $190 million in assets, although the wallet was worth less than $500,000. The complaint also alleges that the siblings manipulated the price of Ormeus Coin and misused millions of dollars of investor funds for personal use.

The complaint was filed in the U.S. District Court for the Southern District of New York and charges the Barksdales with violating the federal securities laws and seeks injunctive relief, disgorgement plus interest, and civil penalties.

SEC Press Release – https://www.sec.gov/news/press-release/2022-34

Prepaid Management Fees & Affiliate Loan – Alumni Ventures Group, LLC (March 4, 2022)

The SEC issued an administrative order and cease and desist proceedings against Alumni Ventures Group, LLC (***AVG***), an exempt reporting adviser and venture capital fund manager, for making material misstatements and improper transactions. From January 2016 through February 2020, AVG included misstatements in marketing documents to investors, emails to prospective investors and on the firm's website. AVG misrepresented its management fees as being "2 and 20, an industry standard" during the ten years of the fund's term. Accordingly, investors expected to pay 2% management fees each year over the fund's 10-year term. In reality, investors were charged the entire management fee up front totaling 20% of an investor's initial fund investment (which represented ten years of 2% management fees) prior to investing any capital. The firm's CEO and founder specifically approved the use of this misleading representation by employees. The SEC case noted that the accelerated management fee amounted to an interest-free loan from the funds and noted that had the manager paid a reasonable rate of interest over the period, AVG would have paid approximately $4.7 million to the funds.

In addition, AVG made inter-fund loans and cash transfers, and also made loans to certain funds that were not properly documented, had no predetermined maturity date or interest rate and for which timing and repayment was solely at AVG's discretion. The loans were ultimately repaid without interest. The cross transactions were prohibited per the funds' operating agreements. AVG breached its fiduciary duty to the funds and its investors by failing to disclose these loans and transactions to its investors. The inter-fund transactions created an undisclosed conflict of interest. AVG violated Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 and the CEO cause the violations.

AVG was censured and ordered to cease and desist from committing or causing any violations and any future violations. AVG was ordered to adopt and implement policies and procedures requiring pre-approval by the CCO or General Counsel of AVG any written communication by an AVG employee regarding fee arrangements for any AVG fund. Further, AVG is required to create the CCO position and add an independent member to its board of directors. AVG was ordered to pay $700,000 and the CEO was ordered to pay $100,000

SEC Press Release – https://www.sec.gov/news/press-release/2022-34

Regulatory Updates and Enforcement

Misappropriation & Failure to Write-Down Assets – Vettivetpillai & Bourgeois (March 2, 2022)

The SEC announced settled fraud charges against London resident Sivendran Vettivetpillai, a managing partner of Abraaj Group (***Abraaj Group***), a now-defunct, Dubai-based private equity firm, and shareholder in and director of the board of Abraaj Group-related entities. On the same date, the SEC announced settled charges against Tennessee resident Mark Bourgeois, the Abraaj Group's former Head of Global Fundraising and Investor Relations, one of its managing partners, and the CEO of its New York office. The charges were for actions by Messrs. Vettivetpillai and Bourgeois in 2017 and 2018 that helped the Abraaj Group misappropriate client cash and mislead investors and potential investors about the firm's performance track record in the offer and sale of its newest fund, APEF VI. In July 2021, Vettivetpillai had pled guilty to federal criminal charges in connection with this conduct.

According to the SEC's order against him, Mr. Vettivetpillai, as a principal executive of the Abraaj Growth Markets Health Fund (the ***Fund***), 1) agreed to delay using cash from that fund and its investors so that Abraaj Group could use it for its own benefit and the benefit of its investment adviser subsidiary, Abraaj Investment Management Limited (***AIML***), an exempt reporting adviser filed with the SEC; 2) helped AIML conceal its misappropriation and desperate financial condition from Fund investors that were demanding information about the use and whereabouts of the Fund's cash; and 3) helped AIML mislead investors and prospective investors in APEF VI about the financial condition and misuse of client assets at Abraaj Group and AIML and about AIML's inflated performance track record.

AIML falsely told U.S.-based investors in the Fund that their money would be invested in the securities of healthcare-related portfolio companies in emerging markets, while in fact AIML misappropriated the money to cover cash shortfalls and remediate insolvency at AIML and its parent company. AIML transferred cash drawn down from Fund investors from the Fund's accounts to the accounts of AIML and its parent company to be commingled with those entities' cash and cash from other AIML-managed funds. AIML then used this commingled pool of cash as a central treasury to pay the expenses of those entities to keep them from collapsing.

The SEC's order against Vettivetpillai found that he was aware at least as early as late 2017 that significant write-downs to the valuation of certain portfolio companies included in AIML's track record were unavoidable, and that such write-downs would have adversely affected AIML's track record at the same time Abraaj Group was soliciting investments for APEF VI. According to the order, he advocated for AIML to delay the write-downs to avoid the negative impact the lower performance numbers would have on APEF VI fundraising. Similarly, Mr. Bourgeois, was aware of these advised write-downs on at least two separate occasions and recommended that AIML not apply the write-downs (or delay doing so) to avoid the negative impact on APEF VI fundraising. By fall 2017, following marketing efforts that included fundraising from U.S.-based investors, Abraaj Group had secured over $3 billion in investor commitments.

Vettivetpillai's actions included efforts in 2017 to assuage increasingly concerned Fund investors and members of the Fund's LPAC about the Fund's cash and financial statements. The Fund's largest investor, the U.S. Charitable Organization, led repeated demands by the LPAC and other Fund investors for proof that hundreds of millions of dollars in uninvested cash AIML reported on the Fund's balance sheet was in fact being held in the Fund's bank accounts. Vettivetpillai's misrepresentations in response to these inquiries included emails in December 2017 to a group of Fund investors and to the LPAC "in which he gave various innocuous explanations that AIML retained large cash balances for months because of delays caused by external factors." According to the order against Bourgeois, in February and March 2018, following publicized allegations of fraud and mismanagement against Abraaj Group, one of the largest U.S. investors asked Bourgeois that Abraaj Group release previously committed APEF VI investors from their capital commitments before such capital was called. Bourgeois urged that Arif Naqvi (Abraaj Group's founder, largest owner, and control person) acquiesce to these requests, and by early March Abraaj released the APEF VI investors from their commitments.

The SEC's orders found that Vettivetpillai and Bourgeois willfully aided and abetted and caused AIML's violations of the antifraud provisions of the Securities Act of 1933 and of the Advisers Act and Rule 206(4)-8 under the

Advisers Act. Vettivetpillai and Bourgeois agreed to a cease-and-desist order, to cooperate in the SEC's ongoing investigation and litigation relating to Abraaj Group, and to a collateral associational bar and investment company prohibition. Bourgeois also agreed to pay disgorgement of approximately $2 million.

SEC Releases – https://www.sec.gov/enforce/33-11036-s and https://www.sec.gov/enforce/33-11037-s

Valuation Fraud – James Velissaris (February 17, 2022)

The SEC charged the former Chief Investment Officer of a mutual fund and private fund manager with a fraudulent scheme that persisted for five years to overvalue over-the-counter derivative securities. The firm utilized a pricing service that purportedly provided independent pricing for such positions. However, Velissaris had the ability to set the terms and edit computer code utilized by the pricing service to effectively produce any valuation as desired. Velissaris allegedly knowingly inflated valuations by altering, cherry-picking and using incorrect inputs, selecting valuation models that he knew could not properly value the relevant positions, manipulating the code of a third-party pricing service. The case noted that Velissaris was aware that fund counterparties were valuing the same positions at massively different amounts, and that the mutual fund and private fund at times valued the same position differently. As a result of the inflated valuations, fund net asset values were overstated by over $1 billion, performance was materially exaggerated, and the firm collected more than $26 million in illicit profits. Velissaris provided forged documents to independent auditors to conceal the scheme and provided altered compliance manuals and private placement memoranda, as well as backdated valuation committee minutes for meetings that never occurred, to SEC staff as part of the investigation.

SEC Press Release – https://www.sec.gov/news/press-release/2022-29

Form CRS Delivery Failure Sweep (February 15, 2022)

The SEC announced that six investment adviser and six broker-dealer firms agreed to settle charges that they failed to file and deliver to their retail investors, by the required deadline, the customer relationship summary documents, the Form CRS. Some firms also failed to include all the requirements of Form CRS. Each firm was censured, ordered to cease and desist from violating the charged provisions and pay civil penalties ranging from $10,000 to $97,500. Most firms were fined $10,000 or $25,000.

This action added to previous Form CRS exam sweeps. With these 12 cases, the SEC has brought a total of 42 cases involving Form CRS failures.

SEC Press Release – https://www.sec.gov/news/press-release/2022-27

Hedge Fund Manager Insider Trading Scheme – Schottenstein, Sakal Capital, et al (January 6, 2022)

Recently, the SEC charged three individuals and two investment vehicles with trading in advance of market-moving announcements concerning DSW Inc., Rite Aid Corp., and Aphria Inc. According to the SEC complaint, David Schottenstein allegedly used MNPI for several different opportunities: the August 2017 DSW earnings announced, the December 2018 acquisition offer of Aphria, and the February 2018 announcement of the merger between Albertsons Companies and Rite Aid Corp to acquire more than $600,000. The SEC complaint claims that Schottenstein's cousin, a board member of DSW, a board member of the company attempting to acquire Aphria, and whose family-owned private business is involved in a Rite Aid transaction, repeatedly leaked the information to him.

Schottenstein used such MNPI himself as well as tip information to others via telephone, text messages and in-person meetings. He allegedly tipped two close friends, Kris Bortnovsky and Ryan Shapiro. Bortnovsky traded in both his account and accounts he controlled in investment management firm, Sakal Capital Management, and its hedge fund, Sakal U.S. Fund, amassing more than $4 million in illegal profits. Meanwhile, Shapiro illicitly gained $121,000. The case references multiple damming text conversations, including an exchange with Shapiro in which Schottenstein texts, “I have a good idea for u but I like explaining these things in person.” Shapiro later

messages, saying “Waiting for the tip,” and Schottenstein responds, “In person…I told u man….I had 2 tips….1 of them passed [weary face emoji]…But the other relevant.” In another text exchange from Schottenstein to Bortnovsky, he recounts “u never LOST due to my tips…EVER…not once.” All defendants are being charged with violating the antifraud and reporting provisions of the federal securities laws. The case is ongoing and the SEC seeks injunctive relief as well as civil penalties. Additionally, the three individuals face criminal charges by the U.S. Attorney’s Office for the District of Massachusetts.

SEC Press Release – https://www.sec.gov/news/press-release/2022-4

Other Regulatory Developments

Anti-Money Laundering & Sanctions Developments

Following Russia’s invasion of Ukraine in February 2022, the United States and other foreign governments have undertaken various measures to limit customary trade and financial relations with Russia and penalize Russian oligarchs for supporting President Vladimir Putin. Following is a brief overview of the Russian-related sanctions issued by the U.S. Department of the Treasury’s Office of Foreign Assets Control (***OFAC***) over the past several weeks and the obligations investment fund managers must comply with. Since February 22, 2022, hundreds of individuals and entities in Russia and around the world have been added to OFAC’s List of Specially Designated Nationals (the ***SDN List***) or otherwise designated as sanctioned by various governing bodies, including the Cayman Islands Monetary Authority (***CIMA***) and the United Kingdom’s Office of the Financial Sanctions Implementation (***OSFI***), whose consolidated list and lists of designated persons or entities are applicable to financial institutions domiciled or incorporated in the Cayman Islands.

All property and interests in property of SDN-designated individuals and entities that are in the United States or in the possession or control of U.S. persons, including U.S.-domiciled funds and Cayman funds controlled by U.S. persons, must be blocked and reported to OFAC. In addition, any entities that are owned, directly or indirectly, 50 percent or more by one or more blocked persons must also be blocked. This includes portfolio companies anywhere in the world controlled by or majority owned by U.S. persons. All transactions by U.S. persons or within the United States that involve any property or interests in property of designated or otherwise blocked persons are prohibited unless authorized by a general or specific license issued by OFAC, or otherwise exempted. These prohibitions include the making of any contribution or provision of funds, goods, or services by, to, or for the benefit of any blocked person and the receipt of any contribution or provision of funds, goods, or services from any such person.

Fund managers should ensure that they neither accept a subscription from or provide a redemption or distribution to anyone designated on the SDN List. They should be sure no payments are made to or accepted from any vendor, consultant, or other counterparty designated by OFAC. Even inadvertent violations of U.S. sanctions can lead to harsh penalties. If a fund manager or administrator discovers that a current fund investor or counterparty is included on the SDN list or otherwise sanctioned, or that an investor or counterparty is owned or controlled by an individual included on the SDN list, they should immediately halt any pending transactions to or from such investor or counterparty. Outside counsel and/or other sanctions and money laundering experts may need to be consulted and the determination made whether to notify an applicable fund’s custodian or bank where such assets are held. A report to the Treasury Department will likely need to be filed.

Restrictions on transactions involving sanctioned individuals and entities and a fund manager’s reporting obligations are substantially similar in the Cayman Islands for Cayman-domiciled funds. Assets relating to designated persons must be frozen and a report made to the Governor via the Financial Reporting Authority. It should be noted that the names included on each country’s respective sanctions list(s) do and will vary and it’s possible for an individual to be sanctioned within the Cayman Islands but not in the U.S. As noted above, Cayman funds controlled by U.S. persons must still comply with U.S. sanctions, even if a particular investor or counterparty is not specifically sanctioned under the Cayman regime.

Regulatory Updates and Enforcement

Please note, that new names and identifying information for relevant individuals are added to OFAC and other sanctions lists regularly and such lists are subject to change at any time. OFAC provides a free, online application to enable users to simultaneously search all of its sanctions lists: https://sanctionssearch.ofac.treas.gov/. Detailed information concerning OFAC Recent Actions can be found here: https://home.treasury.gov/policy-issues/financial-sanctions/recent-actions. Information regarding sanctions applicable to Cayman Island entities can be found here: https://www.cima.ky/un-and-eu-sanctions. The most conservative approach to avoid inadvertent sanctions violations is to conduct initial identification and ongoing monitoring of all investors and known beneficial owners and controllers, as well as portfolio companies.

Digital Asset Developments

The SEC Announced New Crypto Regulation Initiatives

Immediately following Q1, on April 4th, SEC Chairman Gary Gensler introduced numerous initiatives to extend investors safeguards in the crypto market. He stated the SEC plans to register and regulate crypto exchanges and will explore separating out asset custody to mitigate investor risks. Unlike traditional investment banks and platforms, crypto exchanges normally take custody of their customers' assets which can increase investors' vulnerability to a wide range of hacks. Last year, hackers and scammers stole $14 billion worth of crypto assets.

Additionally, Gensler announced the SEC would partner with the Commodity Futures Trading Commission to address platforms trading crypto-based security tokens and commodity tokens.

https://time.com/nextadvisor/investing/cryptocurrency/sec-new-crypto-regulation-gensler/

Digital Assets Top the List of SEC 2022 Examination Priorities

In its annual examination priorities, the Exam Division placed digital assets among its top focus areas. Generally, during examinations, the SEC will scrutinize custody arrangements as well as the offer, sale, recommendation, advice, and trading of crypto-assets. In particular, examinations will review whether market participants involved with crypto-assets: (1) have met their respective standards of conduct when recommending to or advising investors with a focus on duty of care and the initial and ongoing understanding of the products (e.g., blockchain); and (2) routinely review, update, and enhance their compliance practices (e.g., crypto-asset wallet reviews, custody practices, anti-money laundering reviews, and valuation procedures), risk disclosures, and operational resiliency practices (i.e., data integrity and business continuity plans).

https://www.sec.gov/files/2022-exam-priorities.pdf page 16

SEC Launches a Hiring Spree to Fight Cryptocurrency Fraud

The SEC is significantly expanding its fight against cryptocurrency fraud by hiring more than a dozen new employees to combat cyber-crime. The Cyber Unit, newly named the Crypto Asset & Cyber Unit, was first established within the SEC's Enforcement Division in 2017. Along with policing cryptocurrency exchanges and coin offerings, the SEC is aiming to monitor NFTs, decentralized finance platforms and stablecoins. The SEC is looking to fill positions of cyber-fraud analysts, trial and investigative attorneys and supervisors. "By nearly doubling the size of this key unit, the SEC will be better equipped to police wrongdoing in the crypto markets while continuing to identify disclosure and controls issues with respect to cybersecurity," Gensler said in a statement.

https://www.cnbc.com/2022/05/03/sec-adds-to-cryptocurrency-regulation-staff.html